

EXECUTIVE SUMMARY

Audit of the Security of CNMI Government Funds Deposited in Banks and Financial Institutions

Report No. AR-05-01, March 3, 2005

Summary

The Office of the Public Auditor (OPA) conducted an audit of government deposits held in banks and financial institutions as of April 30, 2002, and conducted a followup review of deposits as of April 30, 2004. The objective of the audit was to determine whether the Government Deposit Safety Act (Act), 1 CMC § 7721 *et seq.*, created to provide security for government deposits, was effectively implemented, and whether funds not covered by the Act should have comparable protection. OPA's audit included those funds held by the CNMI Treasury and those funds under the control of autonomous agencies and public corporations. In total, the Act, as of April 30, 2002, only applied to \$22.9 million in Treasury funds.¹ Government deposits not under the purview of the Act amounted to about \$81.5 million, comprised mainly of deposits of various autonomous agencies and public corporations.

Proper internal controls require, in the form of policies and procedures, the protection and safeguarding of government assets regardless of whether the deposits are under the control of the central government, autonomous agency, or public corporation. In particular, this applies to cash deposits - the most liquid form of all assets. On March 20, 1985, the CNMI addressed this concern with the passage of the Act. This Act initially required that all government deposits, both Treasury and CNMI Government agency/corporation, be collateralized 110% by the recipient, federally insured bank.

On December 28, 1994, the Act was amended to allow for the depositing of Treasury funds in non-federally insured banks. While the 1994 amendment gave the appearance of strengthening the security of Treasury funds, it also effectively excluded from the Act funds held by CNMI Government agencies/corporations.

On August 6, 2001, the Act was again amended reducing the collateralization requirement from the 1985 percentage of 110% down to 100%. Additionally, the amendment allowed the recipient bank to use as collateral "obligations and securities backed by the CNMI Government."

OPA's evaluation revealed a number of concerns, the urgency of which was so great that on April 3, 2002, OPA issued to the Governor, Senate President, Speaker of the House, and Secretary of Finance the results of its preliminary survey. OPA concluded that,

"Existing laws do not prohibit most CNMI government agencies from depositing their funds in non-FDIC banks," and although these banks have pledged security to the agencies there is no guarantee that the securities are adequate.

Shortly thereafter, a local bank was placed in receivership by the Superior Court. This action ultimately exposed that \$15.7 million in funds were inadequately collateralized.

¹ It is OPA's understanding that the funds of the Marianas Guam Office, Marianas Hawaii Office and the Office of the Resident Representative to Washington are deposited by the Secretary of Finance. As such, pursuant to § 7723 of the Act, those funds may be deemed to be in the Commonwealth Treasury. If those funds were to be deemed in the Commonwealth Treasury by virtue of § 7723 of the Act, as of April 30, 2002, the total Commonwealth Treasury funds on deposit would be \$23.2 million. Likewise, the funds of various CNMI Government agencies/corporations would then total \$81.2 million.



While the ultimate outcome of this event is unknown, the documented effect was to restrict government agencies from access to the majority of their funds for a period approaching three years.

The Legislative amendments to the Act in both 1994 and 2001 substantially weakened the security of government deposits. This is most notable in the exclusion of various agencies and public corporations from the provisions of the Act. OPA found in its audit that none of the major agencies or corporations had adequate regulations in place to insure the security of their deposits. Further, no regulations have ever been adopted for those CNMI Treasury funds covered under the Act.

The Commonwealth Banking Code (Code) governs all banks within the CNMI. The Code provides that regulations relating to the enforcement of the Code are the responsibility of the Department of Commerce. The Act stipulates that the development of regulations for government deposits rests with the Secretary of Finance. The lack of appropriate regulations by either agency results in a failure to define or implement needed monitoring mechanisms to insure compliance with the laws. Further, critical definitions are lacking, particularly in the meaning of “obligations and securities backed by the CNMI Government.” Additionally, there seems to be no formal agreement between the government and banks to clarify the responsibilities of the bank, or what constitutes a deposited balance.

OPA urges the Legislature to review the Act and all other laws covering government deposits with the view towards uniform coverage and compliance, not just for the Treasury funds, but **all** CNMI Government agencies/corporations.

Specifically, to address the issues of the CNMI Treasury funds, OPA recommends that the Secretary of Finance adopt regulations to interpret, execute and enforce the provisions of the Act.

OPA also recommends that all government agencies and public corporations currently excluded from the Act prepare regulations to address the issue of the security of public funds. Particular detail should be given to create an environment of transparency and avoidance of the perception of any conflict of interest.

Lastly, OPA recommends that the Department of Commerce implement a system to monitor all securities pledged by banks as collateral for all CNMI Government deposits, or seek legislative amendment to designate or transfer such responsibility to another capable government office or agency.

This audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States.



A copy of this report is available at the Office of the Public Auditor

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**Audit of the Security of CNMI Government Funds
Deposited in Banks and Financial Institutions**





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March 3, 2005

The Honorable Juan N. Babauta
Governor
Commonwealth of the Northern Mariana Islands
Caller Box 10007
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and

Honorable Joaquin G. Adriano
Senate President
14th Northern Mariana Commonwealth Legislature
P.O. Box 500129
Saipan, MP 96950

and

Honorable Benigno R. Fitial
Speaker
14th Northern Mariana Commonwealth Legislature
P.O. Box 500586
Saipan, MP 96950

Dear Governor Babauta, Senate President Adriano, and Speaker Fitial:

**Subject: Audit of the Security of CNMI¹ Government² Funds Deposited in
 Banks and Financial Institutions**

This report presents the Office of the Public Auditor's (OPA) audit of government deposits held in banks and institutions. Our objective was to determine whether the Government Deposit Safety Act (Act), 1 CMC § 7721 *et seq.*, created to provide security for government deposits, was

¹ Commonwealth of the Northern Mariana Islands

² The term CNMI Government as we use it refers to the three branches of government as well as the various public corporations and autonomous agencies.

effectively implemented, and whether funds not covered by the Act should have comparable protection. In accordance with statutory restrictions in the Auditing and Ethics Acts, names of individuals are not disclosed in this report.

BACKGROUND

In the CNMI, all banks are governed by the Commonwealth Banking Code (Banking Code), 4 CMC § 6101 *et seq.* The Banking Code places responsibility for development of related regulations with the Department of Commerce (DOC). Correspondingly, the Act, which requires banks to provide security for certain government deposits, places responsibility for the development of related regulations with the Department of Finance.

On March 20, 1985, the Act became law. The Commonwealth Legislature found that deposits of the CNMI Government are subject to “unwarranted risk without full collateralization of deposits. By requiring collateralization [*of 110%*], this act will bring the CNMI into conformity with U.S., state, county, and municipal deposit safety practices.” Subsequently, the Commonwealth Legislature amended the Act in 1994 and again in 2001.

On December 28, 1994, the Act was amended by Public Law (P.L.) 9-13, which removed the prohibition that funds may not be deposited “in a bank whose deposits of less than \$100,000 are not insured by an agency of the United States Government or by a U.S. Treasury listed surety agency.” This amendment also effectively excluded the funds of CNMI Government agencies and public corporations from the requirements of the Act, unless those funds were in the Commonwealth Treasury.³

On August 6, 2001, P. L. 12-61 amended the Act by reducing the security requirement from 110 percent to 100 percent. This amendment further allowed bank assets to be in the form of “obligations and securities backed by the CNMI Government.” Thus, banks were allowed to pledge as security for government deposits “obligations and securities backed by the CNMI Government” after August 6, 2001.

Public Concern Over the Safety of Government Deposits

OPA performed a preliminary survey of government deposits whereby it confirmed certain account balances. On April 3, 2002, OPA provided its survey results to the Governor, the Senate President, Speaker of the House, and the Department of Finance, and advised them that:

³ The Commonwealth Treasury is established in the Department of Finance by 1 CMC § 2561. Although there are several citations to the Commonwealth Treasury throughout the Code, it is unclear as to exactly what funds are in the Commonwealth Treasury. There is no definition or inclusive list of funds in the Code. There does not appear, however, to be an alternate place for funds to exist under the Secretary of Finance other than in the Commonwealth Treasury. The legislature in its revision of 1 CMC § 7723, Deposit Safety Requirements, through P.L. 9-13, added language, which OPA has construed to mean that any funds deposited by the Secretary of Finance in a bank are deemed to be in the Commonwealth Treasury. As ambiguity exists, OPA has attempted to set forth which funds it has included in its calculations throughout the report. In addition, as such ambiguity does exist, OPA would defer to the Attorney General and the courts for further clarification of what funds are in the Commonwealth Treasury or deemed to be in the Commonwealth Treasury under 1 CMC § 7723.

“Existing laws do not prohibit most CNMI government agencies from depositing their funds in non-FDIC⁴ member banks,” and although these banks have pledged security to the agencies, there is no guarantee that the securities are adequate.

Shortly thereafter, the Secretary of Commerce had reason to believe that a local bank was not financially sound. On April 30, 2002, the Secretary of Commerce exercised his power as the Director of Banking pursuant to 4 CMC § 6106(f), and requested that the court place a local bank under receivership to prevent a run on the bank by its depositors. The Superior Court placed the bank under receivership and appointed a temporary receiver that same day. A permanent receiver was later appointed on September 27, 2002. Both receivers were given the power to “withhold any and all deposits and put in abatement any creditor’s claims as necessary to maintain the liquidity of the Bank.” Consequently, the CNMI Government, including its various government agencies/corporations, was unable to withdraw about \$15.7 million in CNMI Government funds because there were no clear security agreements describing assets pledged by the bank for those deposits. The bank later reopened on May 27, 2003, and negotiations with government depositors resumed.

As of April 30, 2002, the CNMI Government had deposits of \$104.4 million in banks and financial institutions. (See **Appendix A**) These deposits included \$22.9 million in Commonwealth Treasury funds, and \$81.5 million in funds of various CNMI Government agencies/corporations.⁵ However, about \$17.3 million⁶ (16.5%) of the \$104.4 million was deposited in non-federally insured banks and financial institutions. Of the \$17.3 million, \$288,502 represented Commonwealth Treasury funds, and the remainder were funds of government agencies/corporations. As of April 30, 2004, the Commonwealth Treasury no longer had deposits in non-federally insured banks and financial institutions.

Deposits in Non-Federally Insured Banks and Institutions		
Agency	As of 4/30/02	As of 4/30/04
Marianas Public Land Authority (MPLA)	\$9,635,724	\$9,060,200
NMI Retirement Fund (NMIRF)	5,570,397	5,784,836
Commonwealth Development Authority (CDA)	1,251,563	1,306,446
Marianas Visitor Authority (MVA)	489,281	185,917
Commonwealth Treasury	288,502	0
Commonwealth Government Employees' Credit Union (CGECU)	25,638	242
Tinian Municipality	15,165	15,045
Total	\$17,276,270	\$16,352,686

⁴ Federal Deposit Insurance Corporation.

⁵ It is OPA’s understanding that the funds of the Marianas Guam Office, Marianas Hawaii Office and the Office of the Resident Representative to Washington are deposited by the Secretary of Finance. As such, pursuant to § 7723 of the Act, those funds may be deemed to be in the Commonwealth Treasury. If those funds were to be deemed in the Commonwealth Treasury by virtue of § 7723 of the Act, as of April 30, 2002, the total Commonwealth Treasury funds on deposit would be \$23.2 million. Likewise, the funds of various CNMI Government agencies/corporations would then total \$81.2 million.

⁶ Exclusive of deposits in Hongkong and Shanghai Bank, which pursuant to P.L. 8-3, is not required to obtain deposit insurance, as it has assets in excess of \$100 billion.

Objective, Scope and Methodology

The objective of this audit was to determine whether the Act was effectively implemented, and whether funds not covered by the Act should have protection comparable to those funds covered by the Act. OPA reviewed certain government funds on deposit with banks and financial institutions as of April 30, 2002, and made a follow-up review on April 30, 2004. Our audit was limited to government funds deposited in checking, savings, and time certificates of deposit.

OPA performed its audit at government agencies located on Saipan. In performing its audit, OPA: (1) interviewed appropriate government agency/corporation personnel; (2) reviewed government agency/corporation records and other documents to determine if government deposits are secure; (3) determined compliance with the Act; and (4) compared the Act with the enabling legislation of certain government agencies/corporations.

Our audit was made in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, OPA included such tests of records and other auditing procedures as were deemed necessary under the circumstances. This is OPA's initial audit of government deposits in banks and financial institutions.

RESULTS OF REVIEW

Amendments to the Act have lessened the coverage and security afforded to all CNMI Government deposits. The first amendment to the Act omitted various government agencies/corporations from being subject to the Act, thereby requiring only those funds in the Commonwealth Treasury to be subject to the Act. This resulted in \$81.5 million⁷ of various government agencies'/corporations' deposits to be exempt from the Act, and to be subject to varying security requirements. The second amendment allowed banks to use "obligations and securities backed by the CNMI Government" as collateral without clarifying what constitutes such obligations and securities. In addition to these major changes to the Act, the Department of Finance has not adopted regulations to interpret, execute, and enforce the Act. This has negatively impacted those government funds subject to the Act, because it is unclear how such funds should be secured and who should ensure the security of these funds. All these elements combined have contributed to the diminishing security of CNMI Government deposits.

Guidance Needed To Implement The Government Deposit Safety Act

The Act provides for 100 percent collateralization of deposits, and specifies that the collateral or security be in an acceptable form, namely: (1) United States Treasury bonds or "United States Government agency securities having readily ascertainable market value" fully backed by the United States Government; or (2) "obligations and securities backed by the CNMI Government."

⁷ Refer to footnote #5.

While the Act automatically subjects depository banks to the provisions of 1 CMC § 7723,⁸ it also provides, in 1 CMC § 7725, that the Secretary of Finance⁹ may issue regulations to interpret, execute, and enforce the Act.

In July 1985, the Department of Finance published Proposed Government Deposits Regulations in the Commonwealth Register.¹⁰ The proposed regulations included a mechanism for monitoring collateral pledged as well as how collateral is to be pledged for government deposits. Unfortunately, the Department of Finance never adopted the proposed regulations. As no regulations have been adopted, it is not clear:

- who should ensure that government deposits are fully collateralized, or
- how government deposits should be collateralized.

The following concerns demonstrate the need for regulations to clarify implementation of the Act:

- ***CNMI Has No Monitoring Mechanism to Assure Compliance With the Act.***

Officials at the DOC advised OPA that bank audits are not being conducted. With the resulting lack of oversight, banks may pledge the same securities simultaneously to multiple agencies without detection. For example, OPA found that a bank had pledged the same securities to three government agencies/corporations – CDA, MPLA, and the NMIRF. The bank pledged part of its portfolio of securities it held to CDA, but also pledged its entire portfolio to both MPLA and NMIRF. At the same time, it pledged loans backed by CDA in excess of \$6 million to both MPLA and NMIRF. In effect, the bank used the same securities as collateral for all three government agencies. OPA believes that monitoring compliance with the Act could have prevented this from occurring if monitoring included the tracing of all securities pledged by banks to their respective government deposits. Although the government funds noted in the example above are not covered by the Act thus nullifying the need for compliance, the same situation could have occurred had those funds been subject to the Act.

The Act provides that the Secretary of Finance may issue regulations to interpret, execute and enforce the purposes of the Act. Such regulations would help ensure compliance with the Act by providing oversight of government deposits. If the Act is amended, such oversight authority could be assigned to the Office of the Public Auditor, or other capable government agency.

⁸ 1 CMC § 7727 of the Act, which addresses Provisions of Depository Contracts, states that “[a]ny acceptance by a depository of government funds shall constitute an acceptance of the provisions of 1 CMC § 7723 and those provisions shall be deemed a part of and incorporated into the contract of deposit without necessity for specific mention thereof.”

⁹ 1 CMC § 7725 provides that “[t]he Director of Finance may issue regulations to interpret, execute and enforce the purposes of this chapter.” Executive Order 94-3, however, reorganized the Executive Branch, changing agency names and officials’ titles.

¹⁰ Commonwealth Register Vol. 7, No. 7 (1985), page 3831 *et seq.*

- ***“Obligations and securities backed by the CNMI Government” Are Not Defined.***

Public Law 12-61 amended the Act to allow banks to pledge “obligations and securities backed by the CNMI Government.” However, P.L. 12-61 did not define or cite examples of those obligations or securities. When the Act was signed into law on August 6, 2001, the former Governor pointed out that further clarification was needed. OPA believes that if obligations or securities are not specifically identified, it is unlikely that any monitoring will be effective.

- ***Deposit Slips Do Not Ensure That Banks Have Provided Adequate Collateral.***

Section 7727 of the Act states that “[a]ny acceptance by a depository of government funds shall constitute an acceptance of the provisions of 1 CMC § 7723 and those provisions shall be deemed a part of and incorporated into the contract of deposit without necessity for specific mention thereof.” Given the lack of banking oversight, bank deposit slips do not, by themselves, provide the CNMI Government the needed assurance that banks have provided it adequate collateral. While a bank acknowledged deposit slip may evidence the obligation of a bank to the government agency/corporation making the deposit, such standard banking practice does not, in itself, provide adequate assurance that a bank has provided adequate collateral.

Despite having a deposit slip evidencing a bank’s liability, CNMI Government agencies/corporations have been unable to ensure that banks furnish and pledge collateral as required by the Act. The Secretary of Finance failed to enforce the requirements of the Act and fully secure deposits in the Commonwealth Treasury which totaled over \$22.9 million.¹¹ While the Commonwealth Treasury had deposits of \$22.9 million in banks, only \$300,000 were secured in the form of FDIC insurance. The remaining \$22.6 million required 100 percent pledges pursuant to 1 CMC § 7723. However, the Commonwealth Treasury only received bank pledges of approximately \$17.6 million with no other document or means of security being provided.

OPA believes that a formal written deposit contract could help ensure compliance and help prevent the same bank asset from being either: (1) pledged to multiple depositors (as indicated on page 5); or (2) otherwise liquidated by the bank without the assignees’ consent. The contract should contain certain specific information, namely: (1) a list of the collateral pledged by the banks; (2) evidence that the contract has been properly acknowledged by all parties; and (3) evidence that official copies were provided to an oversight agency. In addition, OPA believes that regulations could clarify acceptable methods of furnishing and pledging collateral.

Amendments to the Government Deposit Safety Act Limited its Effectiveness

The Finding Section of P.L. 4-33, the original Act enacted in 1985, expressly stated that by requiring the collateralization of deposits, the law would bring the “CNMI into conformity with

¹¹ Refer to footnote #5.

U.S., state, county, and municipal deposit safety practices.” However, amendments to the Act have served to limit the Act’s effectiveness in securing CNMI Government funds. Public Law 9-13 enacted in 1994 excluded the funds of government agencies/corporations from the requirements of the Act unless these government agencies’/corporations’ funds are in the Commonwealth Treasury. As of April 30, 2002, the balances in banks and financial institutions of fifteen government agencies/corporations, which are no longer subject to the Act, totaled \$81.5 million.¹²

Legislation of Government Agencies/Corporations

OPA reviewed the law to determine whether government agencies/corporations are required to provide similar protection for their deposits. OPA compared the legislation of eight government agencies/corporations, accounting for deposits of over \$75 million or 72.2 percent of certain government deposits as of April 30, 2002,¹³ with three requirements of the Act. The following table depicts how these laws compared to the three requirements.

Comparison of Provisions in Enabling Laws of 8 Government Agencies/Corporations With Sections of the Government Deposit Safety Act								
	CDA	CGECU	CPA	CUC	MPLA	MVA	NMIRF	PSS
Is the bank required to pledge collateral backed by the CNMI Government or U.S. Government to secure the agency deposit?	No	Unclear	Limited	No	No	No	No	Limited
Is the bank required to furnish collateral, valued at 100% of the agency’s deposit, backed by the CNMI Government or U.S. Government to the agency?	No	Unclear	No	No	No	No	No	Limited
Does the agency’s legislation provide that banks are covered by an automatic contract between the agency and the bank evidencing compliance with the Act (1 CMC § 7721 et seq.)?	No	Unclear	No	No	No	No	No	Limited

More specifically, OPA found that:

- ***CDA’s Enabling Law Imposes Only a General Prudent Management Requirement Applicable to All Funds.***

4 CMC § 10403(a) provides that CDA “shall engage in prudent financial management of all its assets.” Other than specifics regarding the investment of reserves and other funds not needed for development activities or liquidity set forth in 4 CMC § 10403(d), and prudent investing set forth in 4 CMC § 10203(a)(12), there appear to be no guidelines for operating and liquidity funds other than the general prudent management requirement.

¹² Refer to footnote #5.

¹³ As of April 30, 2004, these eight government agencies/corporations had deposits of about \$67.3 million.

- CGECU’s Enabling Law References Three Sections of the Act in a Manner That is Unclear.***

4 CMC § 6929 states that CGECU “may, as it deems appropriate, make deposits of cash or other monetary instruments in banks which meet the requirements of 1 CMC § 7723, and in banks which meet the requirements of 1 CMC § 7723, 7727 and 7728.” Although it appears that it was intended for sections of the Act to be incorporated into CGECU’s legislation, the phrasing of the law coupled with the use of the word “may” make this section unclear.
- CPA’s Enabling Law Does Not Provide for Security for All Funds.***

2 CMC § 2175 states that the CPA board shall designate one or more depository banks. It further states “[a]ll funds of the authority shall be deposited in the depository bank or banks, except that funds required as security for or to pay bonds . . . may be deposited with a trustee bank as provided in the resolution authorizing the bonds. Funds on deposit in trustee banks shall be secured in the manner provided in the resolution authorizing the issuance of the bonds to which the funds relate.” There is no guidance in the law as to the criteria to be set in the resolutions. Further, there is no mention of security for other funds, such as operations, in the law.
- CUC’s Enabling Law Does Not Specify What is Acceptable Insurance or Collateral, or How Collateral is to be Handled.***

4 CMC § 8155 states that CUC “shall deposit all funds received by it in insured or fully collateralized accounts.” CUC’s legislation, however, does not set forth what type of insurance or collateral is required, nor does it state how the collateral is to be pledged, provided, maintained, or secured.
- MPLA’s Enabling Law Provides No Guidance Regarding the Security of Funds.***

Public Law 12-33 § 104(h) stated that “[a]ll moneys from the public lands . . . shall be paid into the Commonwealth Treasury and deposited into a special account established by 2 CMC § 4489.” As the funds were to be in the Commonwealth Treasury, such funds were subject to the Government Deposit Safety Act under 1 CMC § 7723. However, on November 13, 2001, P.L. 12-71 was signed into law transferring the funds from the Commonwealth Treasury to the Board of Directors of MPLA. As of the time of the transfer from the Commonwealth Treasury to the Board, the funds would no longer be subject to the Government Deposit Safety Act. Currently, the law does not give any guidance or impose any restrictions on MPLA’s funds.
- MVA’s Enabling Law is Unclear and Does Not Mention Security for its Deposits.***

4 CMC § 2125(b) states that “[a]ll moneys received by the MVA from whatever source shall be deposited in the Fund and eligible banks as defined in the Commonwealth Code.” The term “eligible banks,” however, is not defined anywhere in MVA’s legislation or elsewhere in the Commonwealth Code. Although the term is used one other time in the

Commonwealth Code, 2 CMC § 2174(b) of the CPA Act, it is not defined. OPA believes, therefore, that MVA may make deposits in any bank that is a “bank” as defined in the Banking Code at 4 CMC § 6103(b). OPA would defer interpretation of this law to MVA, the Attorney General and the courts.

- ***NMIRF’s Enabling Law Does Not Provide Security Requirements for All Deposits.***

The Board has full power to manage investments as it deems most appropriate to carry out the objectives of the fund. Although fund custodians are to be engaged by the Board to “assume responsibility for the physical possession of fund assets or evidences of assets,” it is unclear what funds in the Fund are to be under the control of such custodians. Except as to specific investment options and requirements discussed in the investment chapter (1 CMC § 8371 *et seq.*), it is unclear as to where funds are to be held, how they are to be secured, and whether or not they should be collateralized.

- ***PSS’s Funds Maintained by the Department of Finance are Subject to the Act, but PSS Legislation Does Not Provide Security for the Remainder of its Funds.***

1 CMC § 2281 established the Public School System Building Fund, which is to be maintained by the Department of Finance. OPA believes that as this fund is in the Department of Finance, it would be considered in the Commonwealth Treasury¹⁴ and would be subject to the Government Deposit Safety Act. PSS’s legislation does not contain deposit requirements for any of its funds.

Based on OPA’s comparative review, it is clear that the laws of these government agencies/corporations do not uniformly afford protection comparable to that of the Act. Further inquiry on our part showed that government agencies/corporations have no written policies or procedures addressing the handling of government funds. To illustrate, OPA interviewed officials of nine government agencies/corporations and inquired as to whether the entity had written policies and procedures regarding the handling of government funds. Of the nine, eight had no such policies, and one stated that it was in the process of formulating written policies and procedures.

The 1994 and 2001 amendments to the Act, P.L. 9-13 and 12-61, have had the effect of excluding government agencies/corporations from coverage, and allowing banks to use “obligations and securities backed by the CNMI Government” as collateral without defining or qualifying obligations and securities of the CNMI Government. This has resulted in a loss of uniformity over protection of government deposits, and has potentially put the \$17.3 million¹⁵ of CNMI Government funds deposited in non-federally insured banks and financial institutions at risk. To illustrate, while P.L. 4-33 stated that bank assets securing government deposits needed to be in the form of U.S. Treasury and U.S. Government Agency securities that have readily ascertainable market value, P.L. 12-61 allowed banks to use bank assets in the form of “obligations and

¹⁴ Refer to footnote #3.

¹⁵ Refer to footnote #6.

securities backed by the CNMI Government” as collateral for CNMI Government deposits. This had the effect of making the CNMI the insurer of its own deposits.

OTHER MATTERS FOR CONSIDERATION

The Banking Code was intended to “establish a comprehensive code for the regulation of the banking business within the Commonwealth,” and thereby help protect depositors and consumers. The Banking Code provides that the Secretary of Commerce¹⁶ shall serve as the Director of Banking, and grants the Director certain powers and responsibilities. The Banking Code provides that the Director “shall act in the interest of promoting and maintaining a sound banking system,” may issue and adopt regulations, and has the power to conduct annual or special audits of banks. OPA found that the Secretary of Commerce has not issued regulations to supplement the Banking Code, nor has the DOC conducted annual banking audits provided for in the Banking Code. DOC officials indicated that the last banking audit was conducted in 1994. When questioned as to why they had not conducted annual audits of banks, the officials explained that DOC lacks a sufficient number of personnel with banking expertise to do so.

On April 30, 2002, the CNMI Government had deposits in excess of \$1 million with a financial institution that is not a bank under the Banking Code. As of April 30, 2004, this amount decreased to just over \$500,000.

CONCLUSIONS AND RECOMMENDATIONS

The Act currently applies only to funds in the Commonwealth Treasury.¹⁷ Deposits of the various CNMI Government agencies/corporations adhere to their respective agency’s/corporation’s legislation that range from limited to no security requirements. As a result, as of April 30, 2004, \$15,850,300 in governmental deposits remained unavailable for immediate use due to court orders instituted upon the depositor institution and another \$500,000 remains on deposit with a non-banking institution.

OPA urges the legislature to review the Act and all other laws covering government deposits with a view toward uniform coverage and compliance not just for the Commonwealth Treasury but all government agencies and corporations. This will ensure that all CNMI Government deposits adhere to the same law(s), and are afforded the same security. Absent such uniformity, guidelines can be implemented in the interim to install certain safeguards, and provide consistency and accountability of government funds.

To improve the security of CNMI Government deposits, OPA recommends that:

1. The Secretary of Finance adopt regulations to “interpret, execute and enforce” the Government Deposit Safety Act, including defining and clarifying what items constitute

¹⁶ Executive Order 94-3 reorganized the Executive Branch and changed agency names and officials’ titles.

¹⁷ Refer to footnote #3.

“obligations and securities backed by the CNMI Government.”

2. The Commonwealth Development Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
3. The Commonwealth Government Employees’ Credit Union adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
4. The Commonwealth Ports Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
5. The Commonwealth Utilities Corporation adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
6. The Marianas Public Land Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
7. The Marianas Public Land Trust adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
8. The Marianas Visitors Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
9. The Northern Mariana Islands Retirement Fund adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
10. The Northern Marianas College adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
11. The Northern Marianas Housing Corporation adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
12. The Public School System adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
13. The Tinian Mayor’s Office adopt policies and procedures, and/or regulations to address the issue of the security of public funds.
14. The Department of Commerce implement a system to monitor all securities pledged by banks as collateral for all CNMI Government deposits, or seek legislative amendment to designate or transfer such responsibility to another capable government office or agency.

MPLT Response

In a letter dated February 11, 2005, the Executive Director of MPLT did not concur with recommendation 7. He stated that the policy of the MPLT Board of Directors is to maintain the Trust's checking account or any other depository account with an FDIC bank. In addition, the Trust's Constitutional function to invest the principal and income funds of MPLT is guided by the Statement of Investment Policies & Guidelines. Please see **Appendix B** for the complete response from MPLT.

OPA Comments

The scope of our audit only included readily available cash accounts (e.g., checking, savings, and time certificate of deposit) of CNMI Government agencies/corporations. As such, MPLT's investment portfolio was not a part of the audit. OPA still considers recommendation 7 open.

★ ★ ★

Our office has implemented an audit recommendation tracking system. All audit recommendations will be included in the tracking system as open until we have received evidence that the recommendations have been implemented. An *open* recommendation is one where no action or plan of action has been made by the client (department or agency). A *resolved* recommendation is one in which OPA is satisfied that the client cannot take immediate action, but has established a reasonable plan and time frame of action. A *closed* recommendation is one in which the client has taken sufficient action to meet the intent of the recommendation, or we have withdrawn it.

Please provide to us the status of your respective recommendation within 30 days, along with documentation showing the specific action taken. If corrective action takes longer than 30 days, please provide us additional information every 60 days until we notify you that the recommendation has been closed.

Sincerely,



Michael S. Sablan, CPA
Public Auditor

cc: Members of the Legislature
Secretary of Commerce
Secretary of Finance
Chairperson, Commonwealth Development Authority
Executive Director, Commonwealth Development Authority

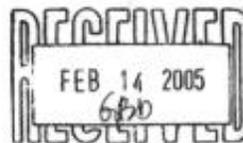
Chairperson, Commonwealth Government Employees' Credit Union
General Manager, Commonwealth Government Employees' Credit Union
Chairperson, Commonwealth Ports Authority
Executive Director, Commonwealth Ports Authority
Chairperson, Commonwealth Utilities Corporation
Executive Director, Commonwealth Utilities Corporation
Chairperson, Marianas Public Land Authority
Commissioner, Marianas Public Land Authority
Acting Chairperson, Marianas Public Land Trust
Executive Director, Marianas Public Land Trust
Chairperson, Marianas Visitors Authority
Managing Director, Marianas Visitors Authority
Chairperson, Northern Mariana Islands Retirement Fund
Administrator, Northern Mariana Islands Retirement Fund
Chairperson, Northern Marianas College
President, Northern Marianas College
Executive Director, Northern Marianas Housing Corporation
Chairperson, Board of Education
Commissioner, Public School System
Chairperson, Tinian Casino Gaming Control Commission
Executive Director, Tinian Casino Gaming Control Commission
Mayor of Tinian, Tinian Mayor's Office

GOVERNMENT DEPOSITS IN BANKS AND FINANCIAL INSTITUTIONS
AS OF APRIL 30, 2002

	Government Entity	Bank of Guam	Bank of Saipan	Bank of Hawaii	Bank Pacific	HongKong & Shanghai	Isla Financial	First Hawaiian Bank	Riggs Bank, NA	Total
1	Commonwealth Development Authority	12,529,735.59	1,251,562.64	1,519,703.17	1,102,800.62					\$16,403,802.02
2	Commonwealth Gov't Employees' Credit Union	473,395.23	25,638.40							\$499,033.72
3	Commonwealth Ports Authority	2,080,712.75								\$2,080,712.75
4	Commonwealth Utilities Corporation	20,156,584.35		69,878.43		1,232,347.07				\$21,458,809.85
5	Department of Finance - Treasury	22,413,758.12	288,502.00			100,000.00		152,451.49		\$22,964,711.61
6	Guam Liaison Office	15,866.48								\$15,866.48
7	Marianas Hawaii Office			155,874.65						\$155,874.65
8	Marianas Public Land Authority	5,518,608.88	8,135,724.32	3,074,369.34			1,500,000.00			\$18,228,702.52
9	Marianas Public Land Trust	112,124.20								\$112,124.20
10	Marianas Visitors Authority		489,280.99	835,313.51						\$1,324,594.50
11	Northern Mariana Islands Retirement Fund	6,019,042.03	5,570,396.79							\$11,589,438.82
12	Northern Marianas College	71,163.60		95,057.80						\$166,221.40
13	Northern Marianas Housing Corporation	481,979.87		1,141,352.79	1,842,773.70	1,355,167.89		357,107.84		\$5,178,432.09
14	Office of Resident Representative to Washington								106,291.32	\$106,291.32
15	Public School System	1,164,573.92		2,094,454.78						\$3,869,028.70
16	Tinian Municipality	299,934.81	15,165.19							\$315,099.80
TOTAL		\$71,337,479.91	\$15,776,270.42	\$9,586,004.47	\$2,945,574.32	\$2,687,504.96	\$1,500,000.00	\$509,619.33	\$106,291.32	\$104,448,744.43
% OF TOTAL		68.30%	15.10%	9.18%	2.82%	2.57%	1.44%	0.49%	0.10%	100.00%

GOVERNMENT DEPOSITS IN BANKS AND FINANCIAL INSTITUTIONS
AS OF APRIL 30, 2004

	Government Entity	Bank of Guam	Bank of Saipan	Bank of Hawaii	Bank Pacific	Isla Financial	Riggs Bank, NA	Total
1	Commonwealth Development Authority	16,050,400.58	1,306,446.14	950,305.22				\$18,307,151.94
2	Commonwealth Govt Employees' Credit Union	667,054.09	241.50					\$667,295.59
3	Commonwealth Ports Authority	3,596,068.15						\$3,596,068.15
4	Commonwealth Utilities Corporation	19,617,865.98		9,657.28				\$19,627,523.26
5	Department of Finance - Treasury	29,274,400.71						\$29,274,400.71
6	Guam Liaison Office	2,775.27						\$2,775.27
7	Marianas Hawaii Office			96,086.91				\$96,086.91
8	Marianas Public Land Authority	4,558,796.53	8,557,613.53	638,855.13		502,386.38		\$14,357,853.57
9	Marianas Public Land Trust	206,109.41						\$206,109.41
10	Marianas Visitors Authority		185,916.55	345,325.57				\$531,242.12
11	Northern Mariana Islands Retirement Fund	652,785.72	5,784,836.38	206,969.33				\$6,644,591.43
12	Northern Marianas College	86,054.22		3,717,907.44				\$3,803,961.66
13	Northern Marianas Housing Corporation	594,655.08		1,197,222.56	1,954,340.34			\$3,746,217.98
14	Office of Resident Representative to Washington						102,611.06	\$102,611.06
15	Public School System	993,117.59		2,610,697.74				\$3,603,815.33
16	Tinian Municipality	469,676.97	15,045.46					\$484,722.43
TOTAL		\$76,869,762.30	\$15,850,299.56	\$9,773,027.18	\$1,954,340.34	\$502,386.38	\$102,611.06	\$105,052,426.82
% OF TOTAL		73.17%	15.09%	9.30%	1.86%	0.48%	0.10%	100.00%



February 11, 2005

Mr. Michael S. Sablan, CPA
Public Auditor
Office of the Public Auditor
Commonwealth of the Northern Mariana Islands
P. O. Box 501399
Saipan, MP 96950

Re: Response to Recommendation #7 – Report on the Security of CNMI Government Funds Deposited in Banks and Financial Institutions

Dear Mr. Sablan:

In accordance with your draft report for the above named audit dated January 17, 2005, the recommendation #7 finds and recommends the following:

"The Marianas Public Land Trust adopts policies and procedures, and/or regulations to address the issue of the security of public funds."

There was no context or finding established from which this recommendation is being made. Since there were no specific findings relating to MPLT, it difficult to respond to the recommendation by way of concurrence or specific courses of action. Accordingly, we do neither.

I will state that it is the policy of the MPLT Board of Directors to maintain its checking account or any other depository account with an FDIC bank. In this manner, the operating funds are secure. Furthermore, our Constitutional function is to invest the principal and income funds of the Trust. We do so through well-established and generally accepted Investment Fiduciary Practices. As part of these Practices, we maintain an Investment Policy Statement, which guides our investment of public funds. A copy is enclosed for your review and consideration.

If you have any questions or other findings, please let us know.

Sincerely,

A handwritten signature in black ink, appearing to read "Bruce M. MacMillan".

Bruce M. MacMillan, CPA
Executive Director

Cc: MPLT Board of Trustees

Enclosure

Status of Recommendations

Audit of the Security of CNMI Government Funds Deposited in Banks and Financial Institutions

Recommendation 1 : The Secretary of Finance adopt regulations to “interpret, execute and enforce” the Government Deposit Safety Act, including defining/clarifying what items constitute “obligations and securities backed by the CNMI Government.”

Agency to Act : Department of Finance

Status : Open

Agency Response :

Recommendation 2 : The Commonwealth Development Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Commonwealth Development Authority

Status : Open

Agency Response :

Recommendation 3 : The Commonwealth Government Employees’ Credit Union adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Commonwealth Government Employees’ Credit Union

Status : Open

Agency Response :

Recommendation 4 : The Commonwealth Ports Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Commonwealth Ports Authority

Status : Open

Agency Response :

Recommendation 5 : The Commonwealth Utilities Corporation adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Commonwealth Utilities Corporation

Status : Open

Agency Response :

Recommendation 6 : The Marianas Public Land Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Marianas Public Land Authority

Status : Open

Agency Response :

Recommendation 7 : The Marianas Public Land Trust adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Marianas Public Land Trust

Status : Open

Agency Response : The Executive Director stated that the policy of the MPLT Board of Directors is to maintain the Trust's checking account or any other depository account with an FDIC bank. In addition, the Trust's Constitutional function to invest the principal and income funds of MPLT is guided by the Statement of Investment Policies & Guidelines.

Additional Information or Action Required : Provide OPA with a copy of MPLT's policies and procedures, and/or regulations addressing the issue of the security of public funds not covered under the Statement of Investment Policies & Guidelines.

Recommendation 8 : The Marianas Visitors Authority adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Marianas Visitors Authority

Status : Open

Agency Response :

Recommendation 9 : The Northern Mariana Islands Retirement Fund adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Northern Mariana Islands Retirement Fund

Status : Open

Agency Response :

Recommendation 10 : The Northern Marianas College adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Northern Marianas College

Status : Open

Agency Response :

Recommendation 11 : The Northern Marianas Housing Corporation adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Northern Marianas Housing Corporation

Status : Open

Agency Response :

Recommendation 12 : The Public School System adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Public School System

Status : Open

Agency Response :

Recommendation 13 : The Tinian Mayor's Office adopt policies and procedures, and/or regulations to address the issue of the security of public funds.

Agency to Act : Tinian Mayor's Office

Status : Open

Agency Response :

Recommendation 14 : The Department of Commerce implement a system to monitor all securities pledged by banks as collateral for all CNMI Government deposits, or seek legislative amendment to designate or transfer such responsibility to another capable government office or agency.

Agency to Act : Department of Commerce

Status : Open

Agency Response :
