



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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November 20, 1998

The Honorable Pedro P. Tenorio
Governor of the Commonwealth of the
Northern Mariana Islands
P.O. Box 10007, Capitol Hill
Saipan, MP 96950

Dear Governor Tenorio:

Subject: Final Letter Report on the Follow-up Audit of the Improper Procurement of Air Conditioners for the Saipan Municipal Council (Report No. Lt-98-13)

This report presents the results of our "Follow-up Audit of the Improper Procurement of Air Conditioners for the Saipan Municipal Council." As in the previous audit, this follow-up audit does not challenge the necessity of acquiring air conditioners for the use of the Saipan Municipal Council (Council). What the previous audit pointed out was the improper way in which those air conditioners were acquired, and what this follow-up audit points out is the unlawful use of public funds to pay for those air conditioners. The concerns raised during the previous audit (e.g., absence of funding, absence of bidding, and not issuing a purchase order prior to the procurement of air conditioners) were not addressed by the past Administration. On the contrary, this follow-up audit has shown that former Administration officials ignored the audit findings and condoned the action of involved officials by not holding them accountable for the improper procurement of air conditioners. The intervention of the former Executive Assistant to the Governor, former Special Assistant for Management and Budget, and former Acting Secretary of Finance allowed the Council to use its FY 1997 appropriation to complete the payment for the air conditioners. The Administration officials ignored prior decisions by the Legislature, Attorney General's Office, Office of the Public Auditor, and Procurement and Supply Office to disapprove the Council's request to make the payment. As a result, an additional \$12,018 in public funds were spent on the improperly procured air conditioners in violation of the FY 1997 Appropriation Act.

BACKGROUND

On October 10, 1996, the Office of the Public Auditor (OPA) issued an audit report (**Letter Report No. LT-96-06**) showing the results of OPA's investigation into the circumstances surrounding the improper procurement of air conditioners costing \$19,018 by a former Director of Procurement and Supply on behalf of the Council in February 1994. The procurement of air

conditioners was improper because no appropriation was made for such purpose, which violated the Planning and Budgeting Act; no bidding was requested, which violated the CNMI Procurement Regulations; and no purchase order was issued prior to the procurement, which violated the Procedures and Policies of the Department of Finance.

The former Director had a conflict of interest when he facilitated the improper procurement of air conditioners for the Council as he was concurrently serving as the Deputy Chairman of the Council at the time. The former Director acquired the air conditioners although he knew there was no money appropriated for that purpose, which subsequently resulted in the Council failing to pay the required amount. The Council struggled to find means to pay the vendor the full amount of \$19,018. After three installment payments totaling \$7,000, a balance of \$12,018 remained outstanding for about three-and-a-half years (1994-1997). The balance remained unpaid despite the Council's repeated requests to the Legislature to provide funding for the payment of this liability.

In fiscal year 1997, after the Legislature did not appropriate the amount of \$12,018 as requested by the Council, the Council sought the assistance of the Governor's Office. The \$12,018 was then paid from the Governor's Discretionary Fund in circumvention of the legislative intent not to provide funding for the improperly procured air conditioners. This action likewise disregarded the instruction of the Attorney General's Office (AGO) to withhold the processing of payment while AGO considered the possibility of negotiating a reduced price with the vendor based on lower price quotations obtained by OPA from other vendors selling similar units. The questionable manner in which the \$12,018 was paid is the subject matter of this follow-up audit.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine the facts surrounding the \$12,018 payment made by the Saipan Municipal Council to liquidate the unpaid balance on the improperly procured air conditioners, and to look into possible violations of laws or regulations.

FINDINGS

No Appropriation to Pay the Council's Debt

As discussed in our previous audit report titled "Improper Procurement of Air Conditioners for the Saipan Municipal Council," the law prohibits any Commonwealth official from making an obligation or contract for the expenditure of unappropriated Commonwealth funds unless provided by law or approved in advance by a joint resolution of the Legislature (1 CMC §7401). Controls have been instituted to ensure compliance with this law. One such control requires that before agencies incur obligations, the Department of Finance (DOF) should first certify that funds are available for the purposes indicated in the agencies' requests.

Pursuant to established procedures for processing procurement, the requisitioning agency first submits a Purchase Requisition (PR) to DOF for certification of fund availability. After DOF certifies fund availability for the PR, the PR is forwarded to the Procurement and Supply Office.

The Procurement and Supply Office then conducts competitive sealed bidding and awards a Purchase Order (PO) to the vendor who wins the bid. In accordance with the CNMI Procurement Regulations, all government procurement shall be awarded by competitive sealed bidding, except those procurement types listed in the Procurement Regulations as not requiring

competitive sealed bidding, namely: small purchases, sole source procurement, emergency procurement, competitive sealed proposals, professional services, expedited purchasing, and architect-engineer services.



The procurement of air conditioners was required to be processed in the manner described in the preceding paragraph (i.e., issuance of a PO after competitive sealed bidding based on an approved PR). Our prior investigation showed, however, that the procurement was not processed in such manner. The former Director of Procurement and Supply deliberately bypassed the processes of fund certification, competitive sealed bidding, and issuance of a PO because the Council's purchase requisition could not be approved due to the absence of funding.



To facilitate the acquisition of air conditioners for the Council, the former Director of Procurement and Supply negotiated directly with a vendor to supply and install them. The vendor accommodated the former Director's verbal request to deliver without a PO and installed the air conditioners in February 1994. However, the Council could not pay the vendor the full \$19,018 cost of the air conditioners because DOF would not process the payment due to the absence of appropriated funds and the improper procurement method. After repeated demands, the vendor was paid \$7,000 in three installments. Of this amount, \$6,000 was paid directly from the Saipan Mayor's budget for "Rental" in November 1994, and \$1,000 was paid from the Council's budget



Some of the air conditioners installed at the Saipan Municipal Council

for “Rental-Office Equipment” in February 1996. Although the \$7,000 constituted a capital expenditure and should have been recorded as office equipment (pursuant to generally accepted accounting principles), it was improperly recorded as a rental expense. This was done in order to circumvent the appropriation acts, which provided zero-funding to the Council’s “Office Equipment” account. Under the Planning and Budgeting Act, no funds may be reprogrammed into accounts that have been zero-funded by the Legislature. After paying a total of \$7,000, a balance of \$12,018 remained outstanding from February 1996 to June 1997.

Referral of Case to AGO

When we released our audit report in October 1996, the balance of \$12,018 was still outstanding. The report did not conclude whether the balance of \$12,018 should be paid or not, or whether the \$7,000 already paid to the vendor should be recovered. There was also a need to determine whether the officials who made the confirming requisitions¹ could be compelled to pay the vendor and whether the vendor should be paid a lesser amount. Because no bids were solicited, the Council did not have the option to procure less expensive air conditioners being sold by other vendors. Based on our independent solicitation of price quotations, another vendor was selling a different brand of air conditioner with comparable capacity, but priced at about \$8,000 less than the total price for the units obtained by the former Director of Procurement and Supply. The legal ramifications of procuring the air conditioners without appropriated funds and without bidding had to be resolved before those decisions could be made.

In October 1996, OPA referred the matter to the Attorney General’s Office for resolution of the above legal issues and for possible legal action against individuals involved in the improper procurement of air conditioners.

Council’s Debt Paid Despite Disapprovals by Legislature, AGO, OPA, and Procurement and Supply Office

In June 1997, eight months after the release of OPA’s report on the improper procurement of air conditioners, the \$12,018 balance was paid. The payment was made by DOF despite disapprovals by the Legislature, AGO, OPA, and Procurement and Supply Office to process the payment.

The payment was processed by DOF in an irregular manner. Instead of recording the payment in the Council’s (buyer) account, the payment was recorded in the Governor’s Discretionary Fund. Then, in August 1997, the recorded \$12,018 payment was transferred (through a journal entry by DOF) from the Governor’s Discretionary Fund account to the Council’s account.

It appeared that the payment was made via the Governor’s Discretionary Fund because the Council was not allowed to pay for the unfunded procurement of air conditioners by the Legislature, AGO, OPA, and Procurement and Supply Office. Since there is a notion that the

¹ A *confirming requisition* occurs when a commitment to procure is made before a Purchase Requisition is prepared and submitted to the Department of Finance for certification of fund availability and to the Procurement and Supply Office for preparation of a Purchase Order. The Manual of Procedures and Policies of the Department of Finance requires that confirming requisitions be paid by the individual who made the purchase.

Discretionary Fund is available for all types of expenditures, the request to pay the \$12,018 out of the Governor's Discretionary Fund was allowed to be processed by DOF. The subsequent transfer by journal entry created the same result in the DOF records as if payment had been made by the Council and not from the Governor's Discretionary Fund.

When it requested payment of the \$12,018 balance in March 1997, the Council submitted a Purchase Requisition (PR) to DOF for fund certification and to Procurement and Supply for Purchase Order (PO) preparation. DOF approved the PR while Procurement and Supply refused to approve it on the ground that the audit findings had not been resolved. Additionally, AGO was looking into the case and had given instructions not to process the payment. The Council persisted by asking OPA to give its stamp of approval to the Council's request to pay the balance. However, in the absence of an appropriation authorizing payment of the \$12,018, OPA denied the Council's request and affirmed that the audit findings should be resolved first.

In pursuing the issuance of a PO for the \$12,018, the Council submitted a justification letter to Procurement and Supply stating that the Legislature intended to authorize this payment. The Council reasoned that although the FY 1997 appropriation did not show funding for the payment of this obligation, it was the Legislature's intent to authorize the payment because the total amount appropriated to the Council was greater than the total amount requested.

We disagree with the Council's assertion that the Legislature intended to authorize the payment of \$12,018. First, the \$12,018 was not specifically included in the appropriation; secondly, the total amount appropriated was *less* than the total amount requested. The Council's budget submission to the House Ways and Means Committee showed that the Council requested a total of \$117,000 for expenditures under the category All Others and a total of \$38,500 for payment of Prior Year Obligations (the \$12,018 was one of the items comprising the \$38,500). The budget submission clearly designated the \$117,000 for FY1997 expenses and the \$38,500 for prior year liabilities. The appropriation granted to the Council, however, was less than the budget submission, disproving the Council's assertion that the Legislature appropriated an amount greater than the amount requested by the Council. The appropriation included the \$117,000 for All Others, but did not include the \$38,500 for Prior Year Obligations. In addition, the account "Office Equipment" under All Others was zero-funded, which meant that the Council could not use any portion of the \$117,000 to pay for the air conditioners by reprogramming funds to "Office Equipment." As further confirmation of the Legislature's intent not to fund the payment of \$12,018, the former Chairperson of the House Ways and Means Committee told the Council during the FY 1998 budget hearing held in May 1997 that there were no funds in either the FY 1996 or FY 1997 budgets to pay for the air conditioners that the Council had procured in violation of law.

Council's Debt Paid through Intervention of Former Administration Officials

After the Council failed to get the approval of the Legislature, AGO, OPA, and Procurement and Supply to pay the \$12,018, the Council sought the assistance of the Governor. In its June 10, 1997 letter to the former Governor, the Council said that it was seeking the Governor's assistance because it had "... exhausted (its) time in trying to satisfy the Procurement and Supply Office and

OPA in trying to resolve (the) problem.” While the letter mentioned that the Council informed the House Ways and Means Committee during the FY 1997 budget hearings about the needed funding to pay the Council’s prior year obligations, the letter omitted the fact that no funding for prior year obligations (and specifically for the \$12,018 debt) was included in the FY 1997 appropriation. Failure to mention this fact and to disclose the comments of the former Chairperson of the House Ways and Means Committee that there were no funds either in the FY 1996 or FY 1997 appropriations to pay for the \$12,018 appeared to be an attempt by the Council to thwart the legislative intent not to provide funding for the improperly procured air conditioners.

In response to the Council’s request to the Governor on June 10, 1997, the former Special Assistant for Management and Budget issued on the same day a memorandum requesting the former Executive Assistant to the Governor to process the payment of \$12,018. The Governor’s Executive Assistant then instructed DOF to pay the amount out of the Governor’s Discretionary Fund. On June 11, 1997, DOF processed a check for \$12,018 by charging the account “Office Equipment” under the Governor’s Discretionary Fund.

In our opinion, the payment was coursed through the Governor’s Discretionary Fund because the Council was unable to obtain a PO from Procurement and Supply for the \$12,018 unpaid balance (without a PO authorizing the payment, DOF could not charge the payment to the Council’s FY 1997 budget). Later on, after the payment had been processed by DOF using funds from the Governor’s Discretionary Fund, the Council requested DOF to transfer the payment of \$12,018 from the account “Office Equipment” in the Governor’s Discretionary Fund to the Council’s “Office Furniture & Fixtures” account. Prior to this, funds had been reprogrammed by the Council from “Rental-Others” to “Office Furniture & Fixtures” to cover the \$12,018 payment. As mentioned earlier, although “Office Equipment” is the proper account classification for air conditioners, the Council could not reprogram funds into it because it was zero-funded.

Air Conditioners not Tagged

On June 19, 1998, we performed an inspection of the air conditioners installed at the Saipan Municipal Council. Based on the result of that inspection, we found that the air conditioners did not have CNMI tag numbers. The air conditioners should have been tagged by the Procurement and Supply Office a year ago after the \$12,018 was paid to the vendor. As a result of our inspection, the Council wrote to Procurement and Supply on June 19, 1998 requesting the latter to tag the air conditioners and other office equipment at the Council.

On July 9, 1998, the Executive Director of the Council informed us that Procurement and Supply had tagged the air conditioners. A copy of the inventory listing showing the tag numbers and descriptions of the air conditioners was provided to us by the Council.

Conclusion

Without authority, the Council used its FY 1997 appropriation to pay the balance of \$12,018 owed for the air conditioners purchased in 1994. The payment circumvented the Legislature’s intent

not to provide funding for the air conditioners, and disregarded the AGO's instruction to hold the payment while the case was being evaluated for the possibility of negotiating a lower price with the vendor. With the complicity of the Governor's Office, OMB, and DOF, the Council was able to make the final payment of \$12,018 on the improperly procured air conditioners despite disapprovals by the Legislature, AGO, OPA, and the Procurement and Supply Office.

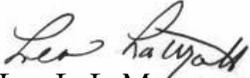
The decision of former Administration officials to allow the payment of \$12,018 and, consequently, to not hold the officials who purchased the air conditioners accountable, demonstrates the Government's leniency toward government officials or employees who incur obligations and expenditures without appropriations. Others may view the dollar effect of the Council's improper procurement of air conditioners as immaterial. However, based on past audits of various government operations and activities, use of public funds for purposes with no appropriations was the major cause of the deficit in the General Fund. This condition cannot be corrected without the firm resolve of government officials to uphold appropriation laws and to hold accountable - *without exception* - any public official or employee who violates them.

Inasmuch as the air conditioners have been fully paid by the Council and tagged by the Procurement and Supply Office, no recommendation is deemed necessary. Lastly, with serious reservations as to the way this case was handled by the past Administration, we conclude our audit of the "Improper Procurement of Air Conditioners for the Saipan Municipal Council."

OPA Comments

On July 29, 1998, draft copies of this report were provided to the Chairman of the Saipan Municipal Council, Secretary of Department of Finance, and Director of Procurement and Supply to give them an opportunity to present comments or explanations concerning the findings discussed in the report. OPA did not receive a response from any of these agencies.

Sincerely,


Leo L. LaMotte
Public Auditor, CNMI

cc: Lt. Governor
Eleventh CNMI Legislature (27 copies)
Chairman of the Saipan Municipal Council
Secretary of Finance
Director of Procurement and Supply
Attorney General
Special Assistant for Management and Budget
Public Information Officer
Press