



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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November 16, 1999

Ms. Lucy DLG. Nielsen
Secretary, Department of Finance
P.O. Box 5234 CHRB
Saipan, MP 96950

Dear Ms. Nielsen:

Subject: Final Letter Report on the Follow-up Audit of the Tinian Mayor's Contract for the Lease of the KBC Building (Report LT-99-10)

This report presents the results of our follow-up audit of the KBC Building Lease Contract. The objective of our audit was to determine the final amount due from the CNMI Government for the lease of the KBC Building.

Our audit showed that as of March 5, 1998, the final amount due from the CNMI Government for the lease of the KBC Building was \$5,518.57. It also showed that the Department of Finance (DOF) made payment in the amount of \$10,000 to James Fleming for periods not covered by the original lease contract.

We recommended that the Secretary of DOF (1) order the processing of a \$5,518.57 payment in final settlement of its liability for the lease of the KBC Building. This amount excludes the lease payments improperly made in November and December 1994. Subsequently, we learned from the DOF Legal Counsel that James Fleming has agreed to pay the remaining \$10,000 directly to the Commonwealth Development Authority (CDA) as credit against his mortgage loan. In addition, we recommended that the Secretary of DOF (2) ensure that the \$5,518.57 is either deposited in an escrow account or withheld until such time as the proper recipient has been mutually determined by all the parties involved.

In her response dated March 9, 1999, the DOF Secretary agreed with the two recommendations. She stated that the amount of \$5,518.57 was placed into an escrow account, and was later paid to CDA pursuant to a Memorandum of Understanding (MOU) executed in September 1998 by all the parties involved.

Based on the responses we received from the DOF Secretary, we consider Recommendations 1 and 2 closed.

BACKGROUND

On April 8, 1998, the Office of the Public Auditor (OPA) issued a letter audit report on the results of its audit and investigation of the KBC Building lease contract. The objectives of the audit were to determine (1) whether the contract for the lease of the KBC Building (including the lot and all other permanent and existing improvements on it which together are hereinafter referred to as the "Property") was procured in accordance with the CNMI Procurement Regulations (CNMI-PR), and (2) the steps the CNMI government should take to ensure that payments for



The Kammer Beach Club (KBC) Building in Tinian.

the lease of the Property will be made to the right parties. This audit showed that the former Director of Procurement and Supply (P&S) violated the CNMI-PR by approving a 2-year lease contract amounting to \$240,000 without either competitive bidding or, at the least, a sole source justification. It also showed that the former Director failed to assess the legal capacity and authority of the vendor to enter into a lease agreement for the Property prior to its approval. OPA recommended that the Secretary of DOF (1) determine whether adverse action should be imposed against the Director of P&S for violating provisions of the CNMI-PR, and (2) deposit the \$10,000 monthly rental to an escrow account until such time as; (a) a written justification for the lease contract has been received and thoroughly evaluated, (b) a court or the parties concerned reach a decision as to who is really entitled to the Property, and (c) the conflict over who is the proper recipient of the rental payments has been resolved.

In her letter to OPA, the Secretary of DOF responded that adverse action does not apply to gubernatorial appointees. As a penalty, however, a copy of the OPA final letter audit report was filed in the former Director's permanent personnel record at the Office of Personnel Management. While we believe that this action was appropriate, we do not agree with the Secretary's statement that adverse action does not apply to gubernatorial appointees. CNMI-PR Section 6-211(1) provides that any employee who violates the provisions of the CNMI-PR is subject to adverse action. Government employee is defined to include any person whether appointed, elected, excepted service or civil service.

With regard to the second recommendation, the Secretary informed us that funds amounting to \$65,000 have been placed in an escrow account to defray the expenses under the Lease contract. On November 26, 1997, a check in the amount of \$45,506.87 was issued to CDA by agreement of the parties involved.

On March 3, 1998, the DOF Legal Counsel informed OPA that the Tinian Mayor's office and DOF-Tinian had vacated the Property. In relation to this, she requested OPA to determine the final amount due from the CNMI Government for the remaining term of the lease.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of our audit was to determine the final amount due from the CNMI Government for the lease of the KBC Building. We performed our audit in March 1998 mainly at the DOF office in Saipan. As part of our audit, we evaluated the system of internal controls related to lease contract payments to the extent we considered necessary to accomplish the audit objective.

Our audit was made, where applicable, in accordance with Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures as were necessary under the circumstances.

RESULTS OF REVIEW

Our review of the governing lease contracts and payment records showed that as of March 5, 1998 the final amount due from the CNMI Government for the lease of the Property was \$5,518.57. As shown in the table below, this amount represents the total obligation commencing from the term of the original lease contract to the date when the Property was completely vacated, less the total amount paid by the CNMI Government for the lease of the Property as of March 5, 1998.

	No. of Mos.	Sub-total (at \$5,000/mo.)	Total
Total Obligation for the Lease of the Property			
First Floor (Jan. 1, 1995 to Jan. 31, 1998)	37	\$185,000.00	
Second Floor (Jan. 1, 1996 to Oct. 31, 1997)	22	110,000.00	\$295,000.00
Less: Payments Made (APPENDIX A)			
To James Fleming		\$205,000.00	
To Commonwealth Development Authority		84,481.43	(289,481.43)
Net Amount Payable			\$5,518.57

Obligation for the Lease of the Property

The Property was first leased in January 1995 to the CNMI Government when the Mayor of Tinian executed an initial nine-month lease agreement for the first floor of the Property for DOF-Tinian. On July 1, 1996, the Mayor of Tinian executed a contract change order to include the second floor of the Property, which increased the monthly lease payment to \$10,000. Our review of the payment records showed that lease payments for the second floor of the Property were made retroactive to January 1996, suggesting that the second floor was already occupied by DOF-Tinian at that time.

On January 27, 1997, James Fleming and the Mayor of Tinian renewed the lease contract up to September 30, 1997, notwithstanding the fact that the unrestricted rights of James Fleming in the Property were set to expire a month later¹. Sometime in October 1997, the Tinian Mayor's office vacated the second floor of the Property and moved to a new building. Our review of the lease contract for the Tinian Mayor's new office showed that the lease went into effect on November 1, 1997, although approved only in December 1997.

In January 1998, DOF-Tinian vacated the first floor of the Property. On February 1, 1998, the lease agreement for the separate office of DOF-Tinian went into effect, and on February 2, 1998, a utility service connection was made by the Commonwealth Utilities Corporation (CUC) at this new leased office.

Payments Made by the Department of Finance

The initial nine-month lease contract was approved on January 25, 1995, with the lease term to begin on January 1, 1995 and end on September 30, 1995. However, our review of the payment records showed that lease payments totaling \$10,000.00 were also made for the months of November and December 1994, which were clearly not covered in the approved lease contract. In addition, we noted from CUC records that there was no significant water and electrical activity for those months. Accordingly, this was deducted from the computation of the net amount due.

In November 1996, DOF began to release half of the monthly lease payment (\$5,000.00) to CDA, pursuant to the Assignment agreement made by James Fleming with CDA in March 1995². Despite the expiration of his unrestricted rights as stated in the February 1992 Ground Lease agreement, James Fleming still continued to receive the monthly lease payment up to the time when the CNMI Government suspended payment on this lease in June 1997 (See **APPENDIX A**).

With the concurrence of all parties involved, DOF issued a \$45,506.87 check to CDA on November 26, 1997. According to the Acting Secretary of DOF, this amount was taken from an escrow account of \$65,000.00, supposedly established in response to a previous OPA recommendation. Based on our review of records and interviews, however, we have determined that there was not such an account established relating to the lease of the Property. The amount of \$45,506.87 released to CDA was taken from the Mayor's account (Account No. 1063) and DOF-Tinian's account (Account No. 1111). Moreover, we also noted that the check issued to CDA on January 14, 1998 for \$8,974.56 was taken from the General Fund (Account No. 1010) and not from an escrow account.

¹ Under the February 1992 Ground Lease agreement with a certain lessee (hereinafter referred to as the "lessee"), it was provided that James Fleming shall have unrestricted use of the Property only until February 26, 1997, after which all his rights to the Property, including the right to the rent and other profits earned from the Property, would go to the lessee or the lessee's assignee.

² This agreement assigned the then-\$5,000.00 monthly lease payment to CDA to cover amortization of the loan made by CDA to James Fleming in June 1986.

Conclusion and Recommendations

Based on the foregoing information, we have determined that as of March 5, 1998, the final amount due from the CNMI Government for the lease of the Property was \$5,518.57. This amount excludes the \$10,000 lease payments improperly made in November and December 1994 that will be paid directly by James Fleming to CDA.

Accordingly, we recommended that the Secretary of DOF (1) order the processing of a \$5,518.57 payment in final settlement of the liability for the lease of the KBC Building, and (2) ensure that such amount is either deposited to an escrow account or withheld until such time as the proper recipient has been mutually determined by all the parties involved.

DOF Response

In her response dated March 9, 1999, the DOF Secretary agreed with the two recommendations. According to her, the amount of \$5,518.57 was placed into an escrow account, and was later paid to CDA pursuant to an MOU executed in September 1998 by all the parties involved. The MOU provided that all the remaining funds relating to the lease of the Property will be applied as credit against the loan by CDA to James Fleming which is secured by the mortgage of the Property.

Subsequently, we learned from the DOF Legal Counsel that James Fleming agreed to pay the remaining \$10,000 directly to CDA as credit against the mortgage loan.

OPA Comments

Based on the response we received from the Secretary, we consider Recommendations 1 and 2 closed.

Sincerely,



Leo L. LaMotte
Public Auditor

cc: Governor
Lt. Governor
Eleventh CNMI Legislature (27 copies)
Acting Attorney General
Legal Counsel, Department of Finance
Director, Division of Procurement and Supply
Special Assistant for Management and Budget
Public Information Officer
Press

**SCHEDULE OF PAYMENTS MADE FOR THE KBC BUILDING
AS OF MARCH 5, 1998**

Payment to James Fleming				Payment to CDA			
Date	Check #	Nature	Amount	Date	Check #	Nature	Amount
1/25/95	8222	November 94	5,000.00				
1/25/95	8223	December 94	5,000.00				
1/31/95	8246	January 95	5,000.00				
3/01/95	8304	February 95	5,000.00				
4/04/95	8446	March 95	5,000.00				
6/27/95	396185	April 95	5,000.00				
6/27/95	396185	May 95	5,000.00				
6/27/95	396185	June 95	5,000.00				
7/13/95	398045	July 95	5,000.00				
10/05/95	405007	August 95	5,000.00				
10/05/95	405007	September 95	5,000.00				
11/22/95	407867	October 95	5,000.00				
11/22/95	407867	November 95	5,000.00				
12/14/95	409160	December 95	5,000.00				
1/23/96	411377	January 96	5,000.00				
3/19/96	414989	February 96	5,000.00				
3/20/96	414989	March 96	5,000.00				
6/18/96	436526	April 96	5,000.00				
6/18/96	436526	May 96	5,000.00				
6/18/96	436526	June 96	5,000.00				

APPENDIX A
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Payment to James Fleming				Payment to CDA			
Date	Check #	Nature	Amount	Date	Check #	Nature	Amount
7/03/96	445685	Jan. 96 -Suppl.	5,000.00				
7/03/96	445685	Feb.-Mar 96	10,000.00				
7/05/96	445776	April-June 96	15,000.00				
7/09/96	445940	July 96	10,000.00				
8/13/96	452693	August 96	10,000.00				
9/30/96	460711	September 96	10,000.00				
11/05/96	460711	October 96	10,000.00				
11/13/96	461342	November 96	5,000.00	11/13/96	461344	November 96	5,000.00
12/03/96	462376	December 96	5,000.00	12/03/96	462980	December 96	5,000.00
1/08/97	465457	January 97	5,000.00	1/08/97	465502	January 97	5,000.00
1/21/97	466373	February 97	5,000.00				
1/29/97	467017	March 97	5,000.00	3/07/97	469932	March 97	5,000.00
4/11/97	473106	April 97	5,000.00	4/03/97	472159	April 97	5,000.00
5/07/97	475394	May 97	5,000.00	5/21/97	483295	May 97	5,000.00
				11/26/97	509386	Lump. Pay	45,506.87
				1/14/98	509572	Lump. Pay	8,974.56
Total			205,000.00	Total			84,481.43

**FOLLOW-UP LETTER REPORT
 AUDIT OF THE TINIAN MAYOR'S CONTRACT
 FOR THE LEASE OF THE KBC BUILDING**

STATUS OF RECOMMENDATIONS

Recommendations	Agency	Status	Action Required
1. Order the processing of a \$5,518.57 payment in final settlement of the liability for the lease of the KBC Building.	DOF	Closed	Provide OPA with a copy of the check issued and transmittal letter, if any, related to the final settlement of this liability.
2. Ensure that such amount is either deposited to an escrow account or withheld until such time as the proper recipient has been mutually determined by all the parties involved.	DOF	Closed	<i>DOF Response</i> The DOF Legal Counsel submitted to OPA a copy of a Memorandum of Understanding made by the parties involved which provided that all the remaining funds relating to the lease of the Property will be applied as credit against the loan to CDA.