

DEPARTMENT OF PUBLIC LANDS  
(A GOVERNMENTAL FUND OF THE COMMONWEALTH  
OF THE NORTHERN MARIANA ISLANDS)

INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2014

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Mr. Pedro A. Tenorio  
Secretary  
Department of Public Lands:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Department of Public Lands (DPL) as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise DPL's basic financial statements, and have issued our report thereon dated June 16, 2015.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered DPL's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of DPL's internal control. Accordingly, we do not express an opinion on the effectiveness of DPL's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses (pages 3 through 8), we identified certain deficiencies in internal control that we consider to be material weaknesses.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2014-001 through 2014-003 to be material weaknesses.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether DPL's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2014-001 through 2014-003.

## **DPL's Responses to Findings**

DPL's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. DPL's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Deloitte & Touche LLC*

June 16, 2015

DEPARTMENT OF PUBLIC LANDS

Schedule of Findings and Responses  
Year Ended September 30, 2014

Revenue/Receipts

Finding No. 2014-001

Criteria: Management is responsible to enforce its policies for leasing public lands. Long-term lease contracts and temporary permits require that the lessee, not later than forty-five (45) or thirty (30) days after the end of each calendar year of the lease or permit, submit audited financial statements and a schedule of gross receipts indicating sources and deductions. Some leases and permits require that the financial statements be audited by certified public accountants. Additional requirements include the lessee to perform an appraisal of the fair market value of the unimproved land after each succeeding five or ten-year term to determine the new annual base rental.

Condition: Tests of thirty-one cash receipts for long-term lease contracts and temporary permits noted the following:

1. Audited financial statements and a schedule of gross receipts were not provided for nine receipts related to contracts and permits requiring such documents.

<u>Lessee No.</u>	<u>Receipt No.</u>
L9104S	14-0822
L9601S	2014-0038
L9107S	14-1015
L9712S	14-0352
T1002S	2014-0087
T0603S	14-0598
L9003R	Lease Rental-03481
L8901S	14-1006
T06019S	04-0677

2. Four receipts related to expired or terminated permits and leases.

<u>Lessee No.</u>	<u>Receipt No.</u>	<u>Contract Detail</u>
T1002S	2014-0087	Expired permit
L8627S	Wire transfer	Expired lease
L8641S	None	Terminated lease
L7001T	None	Terminated lease

3. One receipt for interest was improperly recorded to rental receivables (receipt no. 14-0780 for lessee no. L1001S).

Cause: The cause of the above condition is the lack of monitoring procedures to determine which contracts and/or permits require financial statements or audited financial statements and a schedule of gross receipts, and the lack of valid and authorized permits on file.

Effect: The effect of the above condition is the potential underpayment of lease revenues and collections on invalid permits and leases.

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Schedule of Findings and Responses  
Year Ended September 30, 2014

Finding No. 2014-001, Continued

Recommendation: We recommend that management endeavor to update the lease contracts and permits and propose a standard threshold which would differentiate those lessees to be audited by certified public accountants from those by regular accountants, or by none at all.

Prior Year Status: The lack of monitoring procedures in place to determine which contracts and/or permits require financial statements or audited financial statements and a schedule of gross receipts, and the lack of valid and authorized permits on file was reported as a finding in the audits of DPL for fiscal years 2010 through 2013.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Evelyn J. Sablan, Finance Manager

**Corrective Action:** Differentiating leases - DPL is in the process of finalizing draft regulations on leases for promulgation. The draft regulations propose to differentiate the leases that require CPA audited financial statements by requiring all lessees with business gross receipts of more than \$500,000 per year to submit audited financial statements annually.

Expired leases - All DPL leases contain a "holdover" provision for lessees to continue occupying the leased property beyond the term of the lease. The holdover period is intended to allow time for a renewal or an extension to be negotiated and processed. Lessees are charged a premium on lease payments during holdover periods.

DPL will formalize regulations to differentiate leases that require audited financial statements from those that do not. DPL will clarify the intent of holdover provisions in its lease and permit agreements.

**Proposed Completion Date:** DPL intends on completing the corrective actions by December 2015.

## DEPARTMENT OF PUBLIC LANDS

### Schedule of Findings and Responses, Continued Year Ended September 30, 2014

#### General Ledger System

##### Finding No. 2014-002

Criteria: An effective system of internal control over financial reporting includes maintenance of a separate general ledger system that will record transactions and timely generate reliable and relevant financial information.

Condition: DPL has not maintained a separate general ledger system since fiscal year 2007. Specifically:

- Pursuant to Public Law 15-02, effective October 1, 2007, disbursement of DPL expenses, including land compensation claims, was centralized at the CNMI Department of Finance (DOF). DPL reimburses DOF for expenses paid on behalf of DPL;
- A general ledger for DPL transactions is maintained by DOF but it is not reconciled or monitored by DOF or DPL;
- Cash transactions, received and disbursed at DPL, are summarized in cash receipt and cash disbursement journals, which are not recorded in the DOF general ledger;
- Journal vouchers posted to the DOF general ledger by DOF personnel are not approved by DPL management or evidenced as being reviewed by DOF management;
- The aged receivable subsidiary ledger included invalid receivables of \$186,261 as of September 30, 2014 (Permit nos. C9501S, C9003S, CR9501S, T09001S, T07014S, TR0714S and TR9007S); and
- Receivables, accounts payable, accruals and unearned revenues are not reconciled in the DOF general ledger.

Adjustments to record DPL transactions within the DOF general ledger were recorded by DPL, through proposed audit adjustments.

Cause: The cause of the above condition is the lack of monitoring and timely reconciliation of transactions with DOF, the failure to implement available system controls over the financial reporting process and the lack of established monitoring control procedures to determine the accuracy and completeness of disbursements processed at DOF.

Effect: The effect of the above condition is the lack of reliable and relevant financial information and the inability to timely detect errors and inaccuracies.

Recommendation: We recommend DPL monitor and reconcile transactions with DOF in a timely manner, establish monitoring control procedures over disbursements, perform periodic reconciliations with DOF to verify the accuracy and completeness of disbursements processed and reconcile account balances maintained in the DOF general ledger.

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Schedule of Findings and Responses, Continued  
Year Ended September 30, 2014

Finding No. 2014-002, Continued

Prior Year Status: The lack of reliable and relevant financial information and the inability to timely detect errors and inaccuracies was reported as a finding in the audits of DPL for fiscal years 2010 through 2013.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Evelyn J. Sablan, Finance Manager

**Corrective Action:** DPL plans on maintaining a general ledger internally to better monitor all financial transactions and allow for proper and periodic reconciliation of account balances with the DOF general ledger. DPL will continue to discuss with DOF the need to establish a process for periodically reconciling throughout the year.

**Proposed Completion Date:** DPL has made efforts in the past to establish the reconciliation process with DOF and intends on completing this by January 2016.

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Schedule of Findings and Responses, Continued  
Year Ended September 30, 2014

Local Noncompliance

Finding No. 2014-003

Criteria: The CNMI Constitution requires that all revenues received by DPL in excess of the amount necessary to meet reasonable expenses of administration and management, land surveying, homestead development, and any other expenses reasonably necessary for the accomplishment of its functions, must be transferred to the Marianas Public Land Trust (MPLT).

Public Law 15-02 required the establishment of the DPL Operations Fund which shall be maintained by DOF and required, 1) all revenues received by DPL be deposited in the DPL Operations Fund, and 2) all operational expenses of DPL be paid from the DPL Operations Fund.

Conditions: DPL has not obtained concurrence from MPLT regarding its method for determining amounts owed.

Revenues received by DPL are not deposited in the DPL Operations Fund. Additionally, not all operational expenses of DPL are paid from the DPL Operations Fund. Specifically, during the year ended September 30, 2014, DPL paid \$6,324 directly to the Northern Mariana Islands Retirement Fund. The payments may have duplicated payments by DOF and DPL has recorded the payments as fully reserved receivables.

Cause: The cause of the above condition is the lack of agreement with MPLT and the lack of compliance with Public Law 15-02.

Effect: The effect of the above condition is potential noncompliance with DPL's constitutional mandate to transfer net revenues received to MPLT and with Public Law 15-02.

Recommendation: We recommend that DPL obtain a legal determination on the merits of transfers to MPLT and comply with Public Law 15-02.

Prior Year Status: The lack of agreement with MPLT and compliance with Public Law 15-02 was reported as a finding in the audits of DPL for fiscal years 2010 through 2013.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Evelyn J. Sablan, Finance Manager

**Corrective Action:** DPL has discussed this matter with its legal counsel and sees no basis for this finding as there is no constitutional or statutory requirement for DPL to obtain concurrence with MPLT on the amounts to be remitted. Public Law 15-02 mandates DPL remit surplus amounts after DPL has netted out its expenses for operations and programs. DPL has adhered to this by relying on audited financial statements as the basis for amounts to be remitted to MPLT.

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Schedule of Findings and Responses, Continued  
Year Ended September 30, 2014

Finding No. 2014-003, Continued

Auditee Response and Corrective Action Plan, Continued:

**Corrective Action, Continued:**

Operations Account - DPL cannot open an account on behalf of DOF; therefore, DOF must arrange for the operations account to be opened at a local bank with DPL as the expenditure authority in accordance with Public Law 15-02. The law also requires the account to be separate and apart from the CNMI's general fund bank account(s) and other funds of the CNMI Government. DPL notes that if there is even a slight possibility of public land funds being commingled with the CNMI's general fund accounts, the Secretary of DPL may be in violation of the "strict standards of fiduciary care" he is held to by Public Law 15-02.

DPL will seek legal determination on the merits of transfers to MPLT. DPL will discuss with DOF the possibility of opening a bank account. However, DPL may also seek to amend Public Law 15-02 if the account cannot be structured to ensure public land funds are not commingled with CNMI's funds.

**Proposed Completion Date:**

Legal determination - September 2015.  
Operations account - December 2015.

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Unresolved Prior Year Comments  
Year Ended September 30, 2014

The status of unresolved prior year findings is discussed in the Schedule of Findings and Responses section of this report (pages 3 through 8).