

OPA REPORT
LT 96-06

Letter Audit Report

Saipan Municipal Council Improper Procurement of Air Conditioners

February 1994 - February 1996

(Letter Report No. LT-96-06)



Office of the Public Auditor
Commonwealth of the Northern Mariana Islands



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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October 10, 1996

Mr. Antonio Cabrera
Secretary, Department of Finance
Capitol Hill
Saipan, MP 96950

Dear Mr. Cabrera:

Subject: Final Letter Report on the Improper Procurement of Air Conditioners for the Saipan Municipal Council (Letter Report No. LT-96-06)

This report presents the results of our investigation into the circumstances surrounding the improper procurement of seven air conditioners costing \$19,018 by the former Director of Procurement and Supply on behalf of the Saipan Municipal Council. Our investigation showed that the former Director bypassed the processes of fund certification, competitive sealed bidding, and issuance of a purchase order (PO) required by the Planning and Budgeting Act, the CNMI Procurement Regulations, and the Procedures and Policies of the Department of Finance, respectively. As a result, the Council could not pay for the air conditioners due to lack of funding, there was no assurance that the Council obtained the best price and quality due to the absence of bidding, and terms and conditions for the procurement of the air conditioners were not clearly established because no PO was issued prior to procurement.

We recommended that the Secretary of Finance direct the current Director of Procurement and Supply 1) to create proper documentation on the procurement of the seven air conditioners and ensure that payments already made to the vendor are applied to the total cost of the air conditioners, and 2) to ensure that the air conditioners are tagged as government property. The Director of Procurement and Supply stated that the Division of Procurement and Supply is unable to record and tag the air conditioners because they do not belong to the CNMI Government. According to him, Procurement and Supply cannot take further action unless the balance of \$12,018 is paid in full and a receiving report is received. He also mentioned that the Saipan Municipal Council has the responsibility and obligation either to create the funds and pay for the subject air conditioners pursuant to CNMI Procurement Regulations, or to return the air conditioners to Chong's Corporation (**APPENDIX A**). Based on the Director's response, we are withdrawing recommendations 1 and 2. In lieu of those, we recommend that

the Secretary of Finance enforce the policy on confirming requisitions by requiring the appropriate parties responsible for procuring the air conditioners to pay for them forthwith or return them to the vendor.

Background

In March 1996, the Office of the Public Auditor received information that seven air conditioners costing \$19,018 were procured without fund certification, bidding procedures, and a purchase order. The seven air conditioners were acquired in February 1994 from Chong's Corporation by the former Director of Procurement and Supply on behalf of the Saipan Municipal Council. At the time the air conditioners were acquired, the former Director was also the Deputy Chairman of the Saipan Municipal Council.

Objective, Scope, and Methodology

The objective of our investigation was to ascertain whether the procurement of the seven air conditioners was made in compliance with the requirements of the Planning and Budgeting Act, CNMI's Procurement Regulations, and Procedures and Policies of the Department of Finance.

Between March and April 1996, the Office of the Public Auditor examined pertinent documents and interviewed employees and officers of the Saipan Municipal Council, Saipan Mayor's Office, Division of Procurement and Supply, and the vendor on matters pertaining to the procurement of the seven air conditioners.

Findings

No Funding

Pursuant to 1 CMC §7401, no Commonwealth official may make an obligation or contract for the expenditure of unappropriated Commonwealth funds unless provided by law or approved in advance by joint resolution of the Legislature. To ensure compliance with this provision, the Department of Finance (DOF) requires agencies to obtain certification of fund availability from DOF before they incur an obligation. When requisitioning goods or services, agencies are required to submit a purchase requisition to DOF for fund certification. If funds are available, the purchase requisition is certified and sent to Procurement and Supply for processing of a purchase order.

On or about February 28, 1994, the former Director of Procurement and Supply (who was also the former Deputy Chairman of the Saipan Municipal Council) procured on behalf of the Saipan Municipal Council seven air conditioners at a total cost of \$19,018 from Chong's Corporation. Our investigation showed that the former Director violated the above provision of the Planning and Budgeting Act by incurring an obligation on behalf of the Council although no funds had been appropriated for such purpose. The former Director acquired the air conditioners without an approved purchase requisition.

The former Director stated that there was a verbal agreement between the Council and the Saipan Mayor's Office that the Mayor's Office would assume the Council's obligation to Chong's. However, since the Mayor's Office did not follow reprogramming procedures, no transfer of funds from the Mayor's account to the Council's account was made. After making a few payments totaling \$6,000, the Mayor's Office could no longer provide funding for the payment of the Council's obligation to Chong's. The former Director stated that after the air conditioners were installed, the Council and the Mayor's Office did not receive sufficient funding from the Legislature to continue the payment to Chong's, and that from then on the former Director and the Council Chairman have been working to get the Legislature to provide funding to meet the Council's obligation to Chong's. The former Director told us that the transaction with Chong's was made in complete compliance with the rules and regulations of Procurement and Supply, and that the only reason there was a problem was because the Legislature and the Governor kept cutting the budgets of the Council and the Mayor's Office, which prevented them from paying the obligation as verbally agreed.

However, the failure in this instance was caused by the fact that the former Director initiated a procurement that was not funded. As a result, the Council was committed to an obligation it could not honor. Chong's has been pressuring the Council to settle this liability, which has remained outstanding for more than two years. As of February 20, 1996, a total of \$7,000 has been paid by the Mayor's Office and the Council to Chong's. To date, a balance of \$12,018 remains unpaid.

No Bidding

Section 3-101 of the CNMI Procurement Regulations provides that with the exception of seven types of procurement, all government procurement shall be awarded by competitive sealed bidding.¹ The Procurement Regulations defines *procurement* as buying, purchasing, renting, leasing, or acquiring construction, goods, or services, and defines *goods* as all property, including but not limited to equipment, materials, supplies, and other tangible personal property of any kind or nature, printing, insurance, lease of real and personal property, except the sale or disposal of public lands under the management of Marianas Public Land Corporation.

Our investigation showed that the former Director violated the CNMI's Procurement Regulations by not using competitive sealed bidding procedures in the procurement of the seven air conditioners. The former Director told us that bidding procedures were not required for this procurement because it was a rental and not a purchase. Based on the above definition of *procurement* and *goods*, however, competitive sealed bidding was required, regardless of whether the procurement of the air conditioners was a purchase or a rental. By not conducting bidding procedures, the CNMI government has no assurance that it received the best price and quality for this procurement. Based on our independent solicitation of quotations, selling prices

¹ The CNMI Procurement Regulations lists seven types of procurement not requiring competitive sealed bidding; these are small purchases, sole source procurement, emergency procurement, competitive sealed proposals, professional services, expedited purchasing, and architect-engineer services.

and installation costs quoted by other vendors for comparable types of air conditioners were lower than the prices of Chong's. For example, one vendor's quotation for installation of seven air conditioners was about \$8,000 lower than Chong's price of \$19,018.

Also, by not conducting bidding procedures, essential contractual terms and conditions were not put in writing,² and therefore were not clearly established. As a result, the former Director and Chong's Corporation have maintained opposing views on the type of procurement agreement they entered into. The former Director maintained that the transaction was a rental with an option to purchase, while the vendor insisted that the transaction was an outright purchase. Although the former Director stated that the transaction was a rental with an option to purchase, there was no lease agreement to support it being a rental. Furthermore, the price quotation and the first invoice issued by Chong's for the installation of the seven air conditioners indicated a purchase and not a rental.

No Purchase Order

The Manual of Procedures and Policies of the Department of Finance prohibits government agencies from making confirming requisitions. 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 Procurement and Supply for preparation of a PO. The Manual restricts confirming requisitions to emergency purchases not exceeding \$25 for each purchase, and requires that confirming requisitions not meeting the emergency criteria and cost ceiling be paid by individuals who made the purchases.

Our investigation showed that the former Director violated the above requirement by verbally instructing the vendor to install the air conditioners at the Council's office without approved purchase requisition and PO. Apparently, this was done in order to circumvent the requirement on fund certification. At the time the air conditioners were acquired, the former Director was aware that there were no funds available for this expenditure. Without available funding, a purchase requisition could not have been approved by the Department of Finance, and without a purchase requisition, a PO could not have been issued by Procurement and Supply.

Conclusion and Recommendations

Certification of fund availability, performance of bidding procedures, and issuance of POs are procedures designed to safeguard against unauthorized and uneconomical use of government funds. The director of Procurement and Supply is responsible for seeing to it that these procedures are complied with before authorizing a procurement. Our investigation showed, however, that the former Director of Procurement and Supply did not comply with these procedures in his procurement of seven air conditioners costing \$19,018 on behalf of the Saipan Municipal Council. The former Director procured the air conditioners during his term as the

² When competitive sealed bidding is performed, the detailed description of the item being procured, performance requirements, and other contractual terms and obligations are indicated in the invitation for bids.

Deputy Chairman of the Council. Knowing that there were no funds available for this procurement, the former Director bypassed the required processes of fund certification, bidding, and PO issuance, and verbally instructed Chong's Corporation to install the air conditioners at the Council's office. In so doing, the former Director violated the requirements of the Planning and Budgeting Act, the Procurement Regulations, and the Manual of Procedures and Policies of the Department of Finance.

By authorizing a procurement that was not funded, the former Director committed the Council to an obligation it could not honor. Consequently, the Council could not pay Chong's and had to arrange with the Saipan Mayor's Office to pay this obligation. For the past two years, however, the Mayor's Office paid only \$6,000 of the \$19,018 due to Chong's, and such payments were made without implementing reprogramming procedures. To date, Chong's continues to ask the Council to pay the balance, and the Council in turn continues to ask the Legislature to fund this obligation.

By not conducting bidding procedures, the CNMI may not have received the best price for this procurement. Based on our independent solicitation of quotations from other vendors, comparable types of air conditioners could have been acquired for about \$8,000 less than Chong's price of \$19,018. Also, by not conducting bidding procedures and issuing a PO, essential contractual terms and conditions were not put in writing, thereby causing a disagreement between the former Director and Chong's as to the type of procurement agreement they entered into. The former Director maintained that the transaction was a rental with option to purchase, while Chong's insisted that the transaction was an outright purchase. Based on documentary evidence, however, it was likely that the procurement was originally a purchase, but was later on made to appear as a rental with an option to purchase when the Council failed to get the Legislature to appropriate funds to pay the total cost of \$19,018 to Chong's.

Accordingly, we recommend that the Secretary direct the current Director of Procurement and Supply to:

- 1) Create proper documentation on the procurement of seven air conditioners and ensure that payments already made to Chong's are applied to the total cost of the air conditioners, and
- 2) Ensure that the seven air conditioners are tagged as government property.

Procurement and Supply Response

The Director of Procurement and Supply stated that the Division of Procurement and Supply is unable to record and tag the air conditioners because they do not belong to the CNMI Government. According to him, Procurement and Supply cannot take further action unless the balance of \$12,018 is paid in full and a receiving report is received. He also mentioned that the Saipan Municipal Council has the responsibility and obligation either to create the funds and pay for the subject air conditioners pursuant to CNMI Procurement Regulations, or to return

the air conditioners to Chong's Corporation (**APPENDIX A**).


Office of the Public Auditor Comment

Based on the Director's response, we are withdrawing recommendations 1 and 2. In lieu of those, we recommend that the Secretary of Finance enforce the policy on confirming requisitions by requiring the appropriate parties responsible for procuring the air conditioners to pay for them forthwith or return them to the vendor.

Pursuant to 1 CMC §7848, the Public Auditor has referred this matter to the Attorney General.

Our office has implemented an audit recommendation tracking system. All audit recommendations will be included in the tracking system as open or resolved 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 the auditors are satisfied that the client cannot take immediate action, but has established a reasonable plan and time frame for 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 recommendation implementation along with documentation showing the specific actions taken.

Sincerely,



Leo L. LaMotte
Public Auditor, CNMI

cc: Governor
Lt. Governor
10th CNMI Legislature (27 copies)
Special Assistant for Management and Budget
Attorney General
Director of Procurement and Supply
Chairman of Saipan Municipal Council
Public Information Officer
Press



Commonwealth of the Northern Mariana Islands

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August 23, 1996

Mr. Leo L. LaMotte
 Public Auditor, CNMI
 P.O. Box 1399
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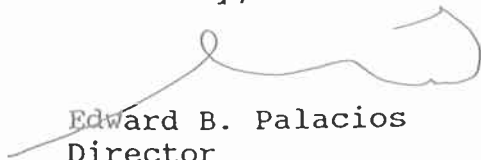
Dear Mr. LaMotte:

Subject: Draft Letter Report on the Improper Procurement of
 Air Conditioners for the Saipan Municipal Council

In an effort to clear the Division of Procurement and Supply from the subject Draft Letter Report dated July 05, 1996, we offer the following:

1. The Expenditure Authority, the Saipan Municipal Council, has the responsibility and obligation either to create the funds and pay for the subject air conditioners pursuant to CNMI Procurement Regulations or return them to Chong's Corporation.
2. The Division of Procurement and Supply is unable to record and tag the subject air conditioners because there is a balance due of \$12,018.00, as of February 20, 1996, therefore, they do not belong to the CNMI Government.
3. Also, we cannot record and tag them because there is no receiving report. Until the air conditioners are fully paid for and we receive a receiving report, we are not able to take further action.

Sincerely,


 Edward B. Palacios
 Director

cc: Secretary of Finance

Status of Recommendations

Recommendations	Status	Agency Response Additional Information or Action Required
1. The Secretary of Finance should enforce the policy on confirming requisitions by requiring the appropriate parties responsible for procuring the air conditioners to pay for them forthwith or return them to the vendor.	Open	The Office of the Public Auditor should be provided documentation showing the final disposition of this transaction.

