COMMONWEALTH DEVELOPMENT AUTHORITY

INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2006

Deloitte.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
Commonwealth Development Authority:

We have audited the financial statements of the Commonwealth Development Authority (CDA), as of and for the year ended September 30, 2006, and have issued our report thereon dated December 12, 2008. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CDA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CDA's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 8 through 23) as items 2006-1 through 2006-4.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable conditions described above to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated December 12, 2008.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CDA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 Questioned Costs as items 2006-5 and 2006-6.

This report is intended solely for the information and use of management, the Board of Directors, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLC

December 12, 2008

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors
Commonwealth Development Authority:

Compliance

We have audited the compliance of the Commonwealth Development Authority (CDA) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. CDA's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 8 through 23). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CDA's management. Our responsibility is to express an opinion on CDA's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about CDA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on CDA's compliance with those requirements.

As described in items 2006-7 through 2006-10 in the accompanying Schedule of Findings and Questioned Costs, CDA did not comply with requirements regarding cash management, program income and special test and provisions related to U.S. Department of Housing and Urban Development programs that are applicable to its major programs. Compliance with such requirements is necessary, in our opinion, for CDA to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, CDA complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2006.

Internal Control Over Compliance

The management of CDA is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered CDA's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect CDA's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2006-7 through 2006-10.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2006-8 and 2006-9 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of CDA as of and for the year ended September 30, 2006, and have issued our report thereon dated December 12, 2008. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of CDA. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended for the information of the management, the Board of Directors, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLC

December 12, 2008

COMMONWEALTH DEVELOPMENT AUTHORITY

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

Federal Grantor/ Program Title	Federal CFDA Number	Federal Cumulative Amount of Grant Award	Receivable (Deferred Revenue) from Grantor at October 1, 2005	Federal Funds Received in Fiscal Year 2006	Federal Funds Expended in Fiscal Year 2006	Receivable (Deferred Revenue) from Grantor at September 30, 2006
Direct Programs:						
U.S. Department of Housing and Urban Development /Section 8 Housing Choice Vouchers	14.871	$ 6,644,871	$ (952,909)	$ 2,551,233	$ 2,739,851	$ (764,291)
U.S. Department of Housing and Urban Development /Lower Income Housing Assistance Program_Section 8 Moderate Rehabilitation	14.856	464,544	-	464,544	464,544	-
	14.856	262,558	-	262,558	262,558	-
	14.856	234,112	-	234,112	234,112	-
	14.856	182,843	-	182,843	182,843	-
Subtotal CFDA #14.856		1,144,057	-	1,144,057	1,144,057	-
U.S. Department of Housing and Urban Development/Community Development Block Grants/Special Purpose Grants/Insular Areas						
Garapan Water Quality Restoration	14.225	1,000,000	-	34,673	34,673	-
Koblerville Sports Complex	14.225	200,000	-	25,495	25,495	-
Rota Pathway	14.225	350,000	-	166,244	166,244	-
Susupe Track and Field	14.225	250,000	-	9,905	9,905	-
Susupe Baseball Park Bleachers	14.225	165,000	-	157,442	157,442	-
Tinian Shelter	14.225	300,000	-	135,220	135,220	-
Living Transitional Model Homes	14.225	1,235,000	-	35,945	35,945	-
Administrative Fee	14.225	976,436	-	200,469	200,469	-
Subtotal CFDA #14.225		4,476,436	-	765,393	765,393	-
U.S. Department of Housing and Urban Development /Emergency Shelter Grants Program	14.231	285,785	14,798	74,062	67,503	8,239
U.S. Department of Housing and Urban Development /HOME Investment Partnerships Program	14.239	479,038	-	106,929	106,929	-
	14.239	164,922	-	164,922	119,276	(45,646)
	14.239	2,714,552	-	1,104,568	1,104,568	-
Subtotal CFDA #14.239		3,358,512	-	1,376,419	1,330,773	(45,646)
		$ 15,909,661	$ (938,111)	$ 5,911,164	$ 6,047,577	$ (801,698)

Reconciliation of expenditures to Statement of Revenues, Expenses and Changes in Net Assets:	
Federal award expenditures per above:	
U.S. Department of Housing and Urban Development /Section 8 Housing Choice Vouchers	$ 2,739,851
U.S. Department of Housing and Urban Development /Lower Income Housing Assistance Program_Section 8 Moderate Rehabilitation	1,144,057
	$ 3,883,908
Federal award expenditures per Statement of Revenues, Expenses and Changes in Net Assets:	
U.S. Department of Housing and Urban Development /Section 8 Housing Choice Vouchers:	
Section 8 rental	$ 2,471,599
Salaries and wages	114,425
Other	153,827
	2,739,851
U.S. Department of Housing and Urban Development /Lower Income Housing Assistance Program_Section 8 Moderate Rehabilitation:	
Salaries and wages	217,095
Employee benefits	101,292
Professional fees	98,187
Repairs and maintenance	512,660
Office rent	5,273
Other	209,550
	1,144,057
	$ 3,883,908

See accompanying notes to schedule of expenditures of federal awards.

(1) Scope of Review

The Commonwealth Development Authority (CDA) was created as an autonomous public agency of the Commonwealth of the Northern Mariana Islands (CNMI) pursuant to Public Law 4-49 as amended by Public Law 4-63 and 5-27. CDA's existence is to be perpetual and it shall have all the rights and privileges of a corporation. The purpose of CDA is to stimulate the economic development of the CNMI. The Northern Marianas Housing Corporation (NMHC), a component unit and subsidiary corporation of CDA, was established under Public Law 5-37 as amended by Public Law 5-67. The purpose of NMHC is to develop and administer low cost residential housing in the CNMI. All significant operations of CDA and NMHC are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as CDA's cognizant agency for the Single Audit.

(2) Summary of Significant Accounting Policies

a. Basis of Accounting

For purposes of this report, certain accounting procedures were followed, which help illustrate the authorizations and expenditures of the individual programs. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting. All authorizations represent the total allotment or grant award received. Disbursements made to subrecipients related to grant agreements are reported as expenditures. Disbursements made to subrecipients related to loan agreements are reported within applicable loan portfolios, and are subject to the Single Audit.

b. Subgrantees

Certain program funds are passed through CDA to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how the subgrantees outside of CDA's control utilized the funds.

c. Funds Received

U.S. Department of HUD - Community Development Block Grants/Special Purpose Grants/Insular Areas/HOME Investment Partnerships Program/Emergency Shelter Grants Program - NMHC received these funds in a direct capacity in fiscal year 2006 and administers the funds and is responsible for ensuring compliance with laws and regulations.

U.S. Department of HUD - Lower Income Housing Assistance Program_Section 8 Moderate Rehabilitation/Section 8 Housing Choice Vouchers - NMHC records federal rental assistance as Section 8 income. Program requirements do not entail the reporting of expenditures except for project No. TQ10-0016-004, Koblerville.

d. Indirect Cost Allocation

CDA does not receive an indirect cost allocation.

(3) Loan Funds

a. Development Banking Division

The Development Banking Division of CDA represents the revolving fund required under the *Agreement of the Special Representatives on Future United States Financial Assistance for the Northern Mariana Islands* into which repayments of principal and interest from revenue-producing projects funded under Section 702(c) of the Covenant shall be deposited. These funds will be used for financing additional revenue-producing capital development projects. During the year ended September 30, 2006, such funds amounting to $2,608,963 were transferred out as capital development grants to CNMI Office of the Governor for matching funds for grants from the U.S. Department of the Interior. As of September 30, 2006, $6,542,421 (net of the allowance for doubtful accounts of $61,913,510) of loans made out of this revolving fund were outstanding.

b. Development Corporation Division

The Development Corporation Division (DCD) of CDA represents the revolving fund established to account for funds received by the former Northern Mariana Islands Economic Development Loan Fund pursuant to Section 702(c) of the Covenant from February 15, 1975 through September 30, 1985. In addition to the aforementioned financial resources, DCD has been designated as the administrative agency for economic development loans transferred from the Trust Territory of the Pacific Islands government to the CNMI. DCD also served as an intermediary lender for part of the year, for the SBA Microloan Program and obtained loans from SBA and used the loan funds to issue short-term microloans to qualified newly established and growing small business concerns in the CNMI. As of September 30, 2006, $11,226,108 (net of the allowance for doubtful accounts of $21,705,993) of loans made out of this revolving fund were outstanding.

c. Northern Marianas Housing Corporation

The Northern Marianas Housing Corporation (formerly the Mariana Islands Housing Authority (MIHA)) received economic development loan funds from the former Northern Mariana Islands Economic Development Loan Fund pursuant to a Memorandum of Understanding transferring funds received under Section 702(c) of the Covenant to MIHA. These funds are used for a revolving fund for a special program of low interest housing loans for low-income families. As of September 30, 2006, $2,708,844 (net of the related allowance for doubtful accounts of $1,585,497 and out of total NMHC net loans receivable of $11,119,197) of loans made out of this revolving fund were outstanding.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Section I - Summary of Auditor's Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.

2. Reportable conditions in internal control over financial reporting were identified, which are considered to be material weaknesses.

3. Instances of noncompliance considered material to the financial statements were disclosed by the audit.

4. Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were identified, two of which are considered to be material weaknesses.

5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.

6. The audit disclosed findings required to be reported by OMB Circular A-133.

7. CDA's major programs were as follows:

Name of Federal Program or Cluster	CFDA Number
U.S. Department of Housing and Urban Development:	
Community Development Block Grants/Special Purpose Grants/Insular Areas	14.225
HOME Investment Partnerships Program	14.239
Lower Income Housing Assistance Program_Section 8Moderate Rehabilitation	14.856

8. A threshold of $300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.

9. CDA did not qualify as a low-risk audit as that term is defined in OMB Circular A-133.

Section II - Financial Statement Findings

Reference Number	Findings	Questioned Costs	Refer Page #
2006-1	DCD Loans Receivable	$ -	9 - 13
2006-2	NMHC Loans Receivable	$ -	14
2006-3	NMHC Land	$ -	15
2006-4	NMHC Loan Guarantee Agreements	$ -	16
2006-5	Local Noncompliance	$ -	17
2006-6	Local Noncompliance	$ -	18

Section III - Federal Award Findings and Questioned Costs

Reference Number	Findings	Questioned Costs	Refer Page #
2006-7	Cash Management	$ -	19 - 20
2006-8	Program Income	$ -	21
2006-9 - 10	Special Tests and Provisions	$ -	22 - 23

Section II - Financial Statement Findings

DCD Loans Receivable

Finding No. 2006-1

Criteria: An effective system of internal control includes procedures to ensure that loan payments are received on a timely basis. Further, all receivables should be assessed and monitored for collectability. Balances deemed not collectible should be adequately allowed for. Additionally, calculation of allowance for loan losses and other related receivables should be regularly reviewed for accuracy, completeness and reasonableness. Further, for restructured loans, the allowance should be determined in the same manner as prior to the restructuring until a sufficient time has passed that the borrower can meet the revised debt service requirements.

Condition: Our tests of DCD's loans receivable noted the following:

- An analysis of DCD's past due loans was performed to determine the propriety of the allowance for doubtful loans as of September 30, 2006. This analysis revealed that as of September 30, 2006, one hundred fifty-three loans (75% of the two hundred five total loans outstanding) were six months or more in arrears. At September 30, 2005, one hundred seventy-two loans (85% of the two hundred three total loans outstanding) were six months or more in arrears. Accrued interest on loans has increased from $13,140,752 at September 30, 2005 to $15,191,959 as of September 30, 2006. As such, the collateral for these loans is decreasing as a percentage of the total loan and interest portfolio.

- We were not provided the revised agreement for one loan (# CD 70248), the authorization that payments are to be applied to principal first instead of interest for one loan (# AD 20791), the current year correspondence or legal action taken for six delinquent loans (#s AD 20283, CD 31222, CD 33194, RE 70158, RE 70151 and CD 32892), a copy of Civil Action 05-0562D to determine the status of three loans (#s AD 70026, AD 70027 and CD 70029) and loan files for two loans (#s RE 70166 and RE 40294). Further, we noted that approximately $45,500 in interest income recognized for one loan (# AD 20283) relates to prior years.

- For restructured loans, CDA's loan system will age outstanding balances based on revised due dates. Further, we noted seven loans, which are matured, or twelve months in arrears but were classified as less than six months in arrears as they were restructured and the due dates were revised. As a result, the calculation of the related allowance was based on incorrect rates.

Cause: The cause of the above condition is the increase in past due loans.

Effect: The effect of the above condition is an increased possibility of loan losses due to non-payment by borrowers.

Recommendation: We recommend that follow-up procedures on past due loans be adhered to. We recommend that evaluations be performed on these loans and a corrective plan be developed and documented. Future results may be compared against this plan and actions taken by management as deemed necessary. Legal action should be considered for those loans, which are considered unlikely to be serviceable by the borrower. In addition, we recommend that all loan files, related memos and correspondences be maintained and interest income be recognized in the proper period. We further recommend CDA review the aging of restructured loans.

Finding No. 2006-1, Continued

Prior Year Status: Past due loans was reported as a finding in the Single Audits of CDA for fiscal years 1994 through 2005.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Oscar C. Camacho, CDA Acting Chief Executive Officer

Corrective Action: This response is a departure from previous cut and paste repeatedly general responses on the findings on the loans receivables. In past responses, there was the understanding that the loan department was to embark on certain actions addressing the findings which included aggressive loan collections, loan workout arrangements, revisions and amendments to the rules and regulations to allow for certain strategies to address delinquencies. As of October 2006, CDA had adopted a Strategic Mission Plan which became the working document on which to address the identified deficiencies. The Board had adopted a debt relief program and of which only recently has passed legal muster, thus allowing for a realistic approach on working with clients. The program has the following features: interest rates are to be reduced to as low as two percent (2%); terms are to be extended out to an additional thirty (30) years for purposes of amortization only with mandated three (3) years callable (balloon payment) provisions where warranted and justified; and the accrued interests will be deferred and set aside and will not be capitalized. The current principal balance will remain as is where the two percent (2%) will be applied.

The following responses are directed to correct or address the individual and specific account audit findings:

- Loan # CD 70248: The most recent revision was done on September 29, 2006.
- Loan # AD 20791: The Acting Executive Director instructed the Financial Administrator of the Accounting Department to allocate the rental payments received to the principal first instead of interest. The rationale behind this determination stems from the "stipulation Re: Settlement Between CDA and DLNR/Order" dated August 15, 1997. The stipulation acknowledges the assignment to CDA of the property Management Agreement between the Saipan Farmers Market (SFM) and the Department of Lands and Natural Resources (DLNR). The stipulation allows CDA to lease the building out to enable SFM to retire its debt as quickly as possible and until such time that the debt is fully paid. Once paid, the property reverts back to DLNR. Furthermore, the Board of Directors of CDA in its meeting on August 7, 2005, sanctioned DCD's recommendations on the application of proceeds on the sale of assets as noted which in essence is very similar to the SFM condition. Given the conditions of this loan and the circumstances surrounding its resolution, the Acting Executive Director determined that such application is in the best interest of CDA since SFM is no longer in existence and cannot service the loan and as such, there could not be a loan to a none entity. CDA manages the property via a rental arrangement with Car Quest and thus, has determined that the principal portion of the loan should be sought out first.

Finding No. 2006-1, Continued

Auditee Response and Corrective Action Plan, Continued:

Corrective Action, Continued:

- Loan # 20283: A Supreme Court judgment order was obtained on January 24, 2003. Legal Counsel is sorting out via the court order the lot delineation. A 2,000 square meter lot has been identified. A copy of the court order was provided. In regards to the interest income of $45,500 recognized, which relates to prior years, the best response we can provide is that this loan was accruing a five percent (5%) interest rate prior to it being reclassified as a judgment loan and was adjusted to the required court ordered nine percent (9%) interest rate.

- Loan # 31222: A Deed in Lieu of Foreclosure (DILOF) Agreement was entered into on December 14, 2006. Along with the DILOF agreement, CDA wrote-off all other outstanding balances. A total of $522,000 constituted "valid and sufficient consideration for the conveyance of the mortgaged property to CDA". With this agreement, CDA became the owner of approximately over 9,000 square meters of improved real estate in the Chalan Kiya area. The property has recently been rented out on a monthly arrangement on a 15-year lease.

- Loan # 33194: There has not been any formal response from the client to our communication as to CDA's offer for a loan workout arrangement via the debt relief program.

- Loan # 70158: An oral request to consolidate the loans has been communicated to the Loan Manager. This matter has been brought up to the Board and instruction was to obtain a written and formal request from the borrower. To date there has not been any submission from the borrower.

- Loan # 70151: There have been ongoing discussions with the client to avail of the debt relief program.

No legal actions have commenced on any of the last three loans above albeit are warranted. All borrowers are given monthly statements of their respective loan accounts along with monthly payment coupons showing arrearages and what amounts are needed to bring the loans current. Follow-ups are scheduled to move forward with the objectives of the debt relief program.

- Loan #s 70026, 70027 and 70029: A copy of the CDA/DCD Legal Counsel Reports on Calvo's Development, Inc. is enclosed. The filed complaint is available. To satisfy the auditor's concern, this page of the litigation report should suffice to disclose the status of the litigation.

- The files for loan #s 70166 and 40294 are and were available. I apologize that I was not made aware that files were not provided to the auditors. On loan # 70166, the debt relief program is being worked on. With loan # 40294, the loan has been reduced to judgment; however, the client has appealed to the Supreme Court.

Finding No. 2006-1, Continued

Auditee Response and Corrective Action Plan, Continued:

Corrective Action, Continued:

The auditor's analysis on the number of DCD past due loans shows an improvement over previous years. At September 30, 2006, 75% of total outstanding loans were six months or more in arrears while the previous year's rate was at 85%. However, between 2004 and 2005, the rate was at 61%. The change in accrued interest increases between the years 2006, 2005 and 2004 showed relatively the same rate at 16%. The objective of the debt relief program is to arrest this increase to an acceptable rate of 5 to 7% while aggressively collecting on the delinquent accounts. However, our primary objective is to reduce the delinquency thru this debt relief program while protecting CDA's interests in the collaterals posted to secure these accounts. CDA recognizes that the collateral values relative to the size of the loan accounts have been diminished or reduced due to mounting accrued interests and will not improve if objectives mentioned above are not met.

The concern on recently restructured loans versus related allowances incorrectly allocated, the debt relief program anticipates the following plan:

- A new bank or classification will be created and dedicated only to accounts under the debt relief program. Under this bank, the arrested accrued interests will be identified and will be presented to the Board to be written-off. A Rights to Possession Agreement as prelude to either a DILOF or actual judicial foreclosure proceeding will be a requisite to this debt relief. This agreement entitles CDA to take possession and control of the RE collaterals and business operations while foreclosure proceedings or a DILOF are pursued.

- Should borrowers adhere to the program, then there will be no need to foreclose and the loan will continue to be serviced until conditions improve. At such time that principal portions are substantially reduced and the loan becomes manageable and serviceable at higher interest rates, then CDA may negotiate to increase interest rates come the third year when the loan is due in its entirety in the form of a balloon payment. Should conditions remain, the same terms may be extended for another three years with the same amortization schedules.

- All CDA borrowers, except those reduced to judgment orders, are given this opportunity but not all will qualify since individual conditions and requirements are different. The goal of this plan is to increase cash collections by enticing delinquent borrowers to realize that there is still hope in escaping foreclosures and losing their prized collaterals.

Item # 2 Allowance For Loan Losses (DBD Receivable From NMHC)

Communication from the Financial Administrator is enclosed requesting for guidance as to language of Public Law (PL) 11-57 with respect to the accrual of interests on the remaining balance after the authorized and agreed write-off. Assessment as to the question at hand has to consider the Mariana Islands Authority - Commonwealth Development Authority Agreement and the PL 11-57 together to be able to respond appropriately. A review of the Agreement and the language of PL 11-57 reveal that interest of 1% above the Bank of America Reference Rate as announced publicly from time to time shall be interest rate assessed on the outstanding loan amount.

Finding No. 2006-1, Continued

Auditee Response and Corrective Action Plan, Continued:

Corrective Action, Continued:

Item # 2 Allowance For Loan Losses (DBD Receivable From NMHC), Continued

According to records, the reference rate has never been adjusted to reflect any changes as called forth in the agreement and as such, the interest rate has remained at the 7.5% since 1989. Because we cannot tell whether there was any action to maintain the rate at 7.5% and since there is no record of any objection, this response to the auditor shall be the controlling determination until such time that the matter is addressed appropriately. Interest shall continue to accrue at the 7.5% rate on the outstanding balance of $3,364,412 and of which has been reduced to $1,027,211. The treatment on interest allowance is to be reversed as stated in the Financial Administrator's Memorandum to the Acting CEO.

Proposed Completion Date: Fiscal year 2007

NMHC Loans Receivable

Finding No. 2006-2

Criteria: An effective system of internal control includes procedures to ensure that loan payments are received on a timely basis. Further, all receivables should be assessed and monitored for collectability. Balances deemed not collectible should be adequately allowed for. Additionally, calculation of allowance for loan losses and other related receivables should be regularly reviewed for accuracy, completeness and reasonableness.

Condition: Our tests of NMHC's loans receivable noted the following:

- An analysis of allowance for delinquent loans noted a significant increase of delinquent loans over ninety days. The delinquency report as of September 30, 2006 includes at least eighty-one borrowers who are seriously in default for more than two years (more than seven hundred thirty days). NMHC's position is that the loans are collateralized by real properties, which they can resell in the event of foreclosure. However, considering current economic conditions, NMHC should consider whether the fair market values of these properties are sufficient to cover the outstanding loan balances.

- NMHC has existing loan agreements and related loan purchase agreements with certain financial institutions. As of September 30, 2006, loan guarantees relating to these agreements amounted to approximately $17,600,000 of which approximately $1,300,000 is more than one hundred twenty days overdue. Further, $853,350 of defaulted loans guaranteed was demanded from NMHC at September 30, 2006. An audit adjustment was proposed to record a reserve of $853,350.

Cause: The cause of the above condition is the increase in past due loans.

Effect: The effect of the above condition is an increased possibility of loan losses due to non-payment by borrowers.

Recommendation: We recommend NMHC continue performing a detailed review of the adequacy of its reserve for seriously defaulted loans. We further recommend NMHC review guaranteed loans with these financial institutions and assess the need to provide additional reserve for defaulted loans.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Joshua T. Sasamoto, NMHC Corporate Director

Corrective Action: NMHC will perform a detailed review of the adequacy of its reserve for seriously defaulted loans and guaranteed loans with these financial institutions and assess the need to provide additional reserves for defaulted loans which is based on the appraisal value of the property.

Proposed Completion Date: Fiscal year 2007

NMHC Land

Finding No. 2006-3

Criteria: Long-lived assets should be reported at the lower of carrying amount or fair value. A review of the valuations of real properties should be periodically performed by management and adjustments should be made to reflect real estate at the lower of the carrying amount or fair market value.

Condition: As of September 30, 2006, NMHC has recorded land consisting of several lots with recorded values of $10,409,602. These properties were appraised during fiscal year 2003. There were no appraisals obtained since then except for two lots with recorded values of $256,000 as of September 30, 2006. Based on an independent appraisal obtained in November 2007 for the two lots, the appraised values amounted to $172,000 which is an $84,000 decline in the recorded value. A review of the valuation of the remaining lots amounting to $10,153,682 was not performed by management.

Cause: The cause of the above condition is the lack of established policies and procedures of periodic review of recorded values of real properties and the high cost of obtaining appraisal services.

Effect: The effect of the above condition is the potential misstatement of the land account.

Recommendation: We recommend NMHC ensure that long-lived assets are reported at the lower of carrying amount or fair value. Additionally, we recommend NMHC establish policies and procedures to periodically evaluate recorded and fair value of long-lived assets.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Jesse S. Palacios, NMHC Manager, Mortgage Credit Division

Corrective Action: NMHC will take corrective measures to ensure that long-lived assets are reported at the lower of carrying amount or fair values. To determine the fair market value of these assets, NMHC will publish an RFP for the performance of an appraisal of each individual long-lived asset. The entities submitting the proposals must be licensed by the CNMI Board of Professional Licensing. The winning entity will then be contracted to perform the appraisals to determine each asset's fair market value. This process will be repeated every other year so that the most current fair market value is readily available.

Proposed Completion Date: From RFP announcement in the newspapers to selection of winning entity to the completion of appraisal reports, NMHC proposes a completion date of February 27, 2009.

NMHC Loan Guarantee Agreements

Finding No. 2006-4

Criteria: An effective system of internal control includes procedures to ensure that contingent liabilities are assessed and reviewed for probable losses.

Condition: NMHC has existing loan guarantee agreements and related loan purchase agreements with certain financial institutions. As of September 30, 2006, NMHC's loan guarantees relating to these agreements amounted to $13,528,979. Of the total guaranteed amount, NMHC has received demand notices to pay for past due loans amounting to $853,350. NMHC has recorded a reserve for loan guaranty for the $853,350. However, NMHC has not performed an analysis of whether an additional reserve should be established for remaining defaulted loans of $2,925,376.

Cause: The cause of the above condition is the lack of established policies and procedures in assessing and reviewing the adequacy of the reserve for guaranteed loans and the lack of relevant and sufficient information from financial institutions to estimate probable losses.

Effect: The effect of the above condition is the possible misstatement of the reserve for loan guaranty and related accounts.

Recommendation: We recommend NMHC ensure that the reserve for guaranteed loans is assessed and reviewed for adequacy. Further, we recommend NMHC establish policies and procedures in assessing the adequacy of the reserve for guaranteed loans, both past due and current. Additionally, we recommend NMHC continue to obtain sufficient information from those financial institutions about the status of defaulted loans and determine which of the defaulted loans will likely result in being paid or settled by NMHC.

Auditee Response and Corrective Action Plan:

Name of Contact Persons: Roger A. Dris, NMHC Chief Accountant and Jesse S. Palacios, NMHC Manager, Mortgage Credit Division

Corrective Action: NMHC will ensure that reserve for guaranteed loans is assessed and reviewed for adequacy. NMHC will establish policies and procedures to obtain an appraisal once every two years. The Accounting and Loan Divisions of NMHC will coordinate to obtain an appraisal once every two years.

NMHC will review the existing agreements with banking institutions to determine if the reserve requirements are adequate. In addition, the MCD and FD will work closely to assess and review potential loan losses by taking into account changes in local economic and business conditions as well as future developments. MCD will also continue to monitor the delinquency reports provided by the banks so that we can contact those borrowers who are on the list, especially, those who are on the 60-day and above delinquency categories in order to prevent banks from debiting our guarantee accounts or to discourage the banks from calling on the loans.

Proposed Completion Date: Beginning of FY 2009

Local Noncompliance

Finding No. 2006-5

Criteria: Grants and contributions provided to grantees should be properly monitored to ensure funds are used in accordance with established agreements and for authorized purposes.

Condition: On July 26, 2006, CDA contributed $4,000,000 from DCD's local funds to the CNMI Government pursuant to Public Law (P.L.) 15-1. P.L. 15-1 authorized the Governor reprogramming authority prior to the enactment of a comprehensive appropriations act for fiscal year 2006 and for other purposes. The letter that accompanied the transmittal of funds indicated that the $4,000,000 could not be used for operating purposes. We were unable to determine whether CDA was monitoring the use of these funds.

Cause: The cause of the above condition is the fiscal crisis and deficit spending of the CNMI Government.

Effect: The effect of the above condition is that the CNMI Government is potentially using the funds for unauthorized purposes.

Recommendation: We recommend CDA determine whether the funds have been used for authorized purposes.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Oscar C. Camacho, CDA Acting Chief Executive Officer

Corrective Action: CDA will review the use of the local funds disbursed.

Proposed Completion Date: Fiscal year 2008

Local Noncompliance

Finding No. 2006-6

Criteria: Public Law (P.L.) 12-27 and the loan agreement with the Marianas Public Land Trust (MPLT) specifically restrict the use of the $10,000,000 loan and any interest earned for future housing loans.

Condition: Interest earned from housing loans funded by the $10,000,000 loan from MPLT was included in NMHC's operations budget and expended for operations.

Cause: The cause of the above condition is the lack of control to ensure interest earned from housing loans funded by the $10,000,000 loan from MPLT are strictly used for future housing loans.

Effect: The effect of the above condition is noncompliance with P.L. 12-27 and the loan agreement with MPLT.

Recommendation: We recommend NMHC ensure strict compliance with Public Law 12-27 and the loan agreement with MPLT.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Joshua T. Sasamoto, NMHC Corporate Director

Corrective Action: NMHC will ensure strict compliance with Public Law 12-27 and the loan agreement with MPLT. NMHC and its legal counsel are in the process of resolving the issues with MPLT's legal counsel.

Proposed Completion Date: Fiscal year 2007

Section III - Federal Award Findings and Questioned Costs

U.S. Department of Housing and Urban Development
Cash Management - HOME Investment Partnerships Program
CFDA #14.239, Federal Award # M (01 to 05)-ST-69-0001
Federal Award Period October 1, 2001 - 2005 to September 30, 2006 - 2010

Finding No. 2006-7

Criteria: The terms stipulated in the Cash Management Improvement Act Agreement (CMIAA) between the CNMI and the U.S. Department of the Treasury should be followed by the CNMI and its component units. Additionally, the CMIAA states that the grantee shall be liable for interest on federal funds from the date federal funds are credited to the grantee's account until those funds are paid out for program purposes. Further, CFR Title 24 Part 92.502 (C) (2) states that HOME funds drawn from the United States Treasury account must be expended for eligible costs within fifteen (15) days. Any interest earned within the 15 day period may be retained by the participating jurisdiction as HOME funds. Any funds that are drawn down and not expended for eligible costs within 15 days of the disbursement must be returned to HUD for deposit in the participating jurisdiction's United States Treasury account of the HOME Investment Trust Fund. Interest earned after 15 days belongs to the United States and must be remitted promptly, but at least quarterly, to HUD, except that a local participating jurisdiction may retain interest amounts up to $100 per year for administrative expenses.

Condition: For seventeen of one hundred nine disbursements tested, NMHC made payments from fifteen to fifty-four days after they received the drawdown reimbursement as follows:

Check #	Amount	Clearing Date	Receipt Date	Days Elapsed
19685	$ 6,016	11/30/05	11/10/05	20
19686	$ 3,008	11/30/05	11/10/05	20
19687	$ 4,775	01/03/06	11/10/08	54
20002	$ 4,725	01/11/06	12/13/05	29
20003	$ 3,150	01/11/06	12/13/05	29
20027	$ 3,500	01/11/06	12/20/05	22
20042	$ 6,750	01/17/06	12/22/05	26
20498	$ 2,420	03/03/06	02/16/06	15
20514	$ 3,371	03/27/06	02/21/06	34
20519	$ 13,689	03/27/06	02/21/06	34
20521	$ 7,738	03/27/06	02/21/06	34
20637	$ 15,340	04/06/06	03/07/06	30
20952	$ 2,500	04/24/06	04/07/06	17
21540	$ 2,427	07/10/06	06/19/06	21
22005	$ 9,566	09/06/06	08/18/06	19
22006	$ 7,634	09/06/06	08/18/06	19
22007	$ 4,666	09/06/06	08/18/06	19

Cause: The cause of the above condition is a lack of procedures in place to ensure cash advanced from grantor agency is disbursed within a timely manner.

Finding No. 2006-7, Continued

Effect: The effect of the above condition is noncompliance with applicable cash management requirements. However, no questioned costs resulted from the condition, as the estimated interest liability to the U.S. Department of Housing and Urban Development is less than $10,000.

Recommendation: We recommend NMHC establish procedures to ensure that cash advances are disbursed within a timely manner.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Joshua T. Sasamoto, NMHC Corporate Director

Corrective Action: We recommend that Deloitte & Touche calculate the beginning date based on the pick-up date by the vendor to clearing date to satisfy the fifteen-day clearing time. NMHC will consider the fifteen-day clearing when the vendors receive their checks and deposit them to their accounts. NMHC gives the checks to the vendors timely, but has no control over when they deposit the checks.

Proposed Completion Date: Fiscal year 2007

Auditor Response:

NMHC shall be liable for interest on federal funds from the date the federal funds are credited to NMHC's bank account until those funds are paid out and are deducted from that bank account for program purposes. The interest from the time elapsed between the date the funds are received in the bank account and the date those funds are removed from the bank account, after considering the clearance pattern of fifteen days, represents the basis for calculating the interest liability due to the grantor agency.

U.S. Department of Housing and Urban Development
Program Income - HOME Investment Partnerships Program
CFDA #14.239, Federal Award # M (01 to 05)-ST-69-0001
Federal Award Period October 1, 2001 - 2005 to September 30, 2006 - 2010

Finding No. 2006-8

Criteria: Revenues should be recognized in the period earned. Unearned revenues should be deferred and presented as deferred revenues in the financial statements. Further, HOME program income should be recognized in the general ledger for repayments of principal and interest on loans made with HOME funds.

Condition: NMHC records HOME loan disbursements as contributed capital which NMHC presents as revenues in its financial statements. Further, repayments of principal and interest on loans made using HOME funds are not recorded as program income in the general ledger. This condition was corrected through a proposed audit adjustment.

Cause: The cause of the above condition is management's oversight of the proper accounting of HOME loan disbursements and program income generated from HOME funds.

Effect: The effect of the above condition is the misstatement of revenues and related liabilities.

Recommendation: We recommend that NMHC ensure that HOME loan disbursements and repayments from participants are properly recorded in the general ledger. Further, NMHC should ensure that program income is recognized in the general ledger for repayments of principal and interest on loans made using HOME funds.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Roger A. Dris, NMHC Chief Accountant

Corrective Action: NMHC will ensure that HOME loan disbursements and repayments from participants are properly recorded in the general ledger. NMHC will ensure that program income is recognized in the general ledger for repayment of principal and interest on loans made using HOME funds. NMHC agreed with the grantor agency in recording program income by drawing down first the program income before entitlement funds.

Proposed Completion Date: Fiscal year 2009

U.S. Department of Housing and Urban Development
Special Tests and Provisions - HOME Investment Partnerships Program
CFDA #14.239, Federal Award # M (01 to 05)-ST-69-0001
Federal Award Period October 1, 2001 - 2005 to September 30, 2006 - 2010

Finding No. 2006-9

Criteria: HOME loans extended to eligible participants should be properly monitored and accounted for.

Condition: Beginning in fiscal year 2006, NMHC has recorded, in its general ledger, loans receivable for HOME loans under a deferment agreement. Prior to fiscal year 2006, NMHC had not recorded loans receivables in its general ledger for loans extended to borrowers under a deferment agreement. At September 30, 2006, NMHC is in the process of determining the cumulative amount of loans under deferment agreement prior to fiscal year 2006.

Cause: The cause of the above condition is NMHC's understanding that loans under deferment agreements should not be recorded in the general ledger since repayments from these deferred loans are not expected.

Effect: The effect of the above condition is the possibility that loans under deferment agreements are not properly accounted for and presented in the financial reports.

Recommendation: We recommend NMHC determine with the grantor agency whether NMHC should be recording deferred HOME loan receivable and monitoring HOME loans under a deferment agreement.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Roger A. Dris, NMHC Chief Accountant

Correction Action: NMHC has confirmed with the grantor agency that all deferred loans should be recorded. NMHC is working with the NMHC legal counsel on revising HOME loans under a deferment agreement. NMHC is implementing and recording deferred HOME loan receivable.

Proposed Completion Date: Fiscal year 2009

U.S. Department of Housing and Urban Development
Special Tests and Provisions - HOME Investment Partnerships Program
CFDA #14.239, Federal Award # M (01 to 05)-ST-69-0001
Federal Award Period October 1, 2001 - 2005 to September 30, 2006 - 2010

Finding No. 2006-10

Criteria: Under NMHC's policies and procedures for Homeowner Rehabilitation, HOME loan applicants that have been determined eligible for financial assistance and have proven lack of financial resources for repayment of their direct loan may have their monthly loan payments deferred for a payment of up to fifteen years. Further, borrowers with a deferment agreement shall be required to be annually re-certified as eligible to continue receiving a deferment during any potential deferment period.

Condition: NMHC did not perform the required annual re-certification for borrowers with deferment agreements.

Cause: The cause of the above condition is oversight by NMHC management in ensuring compliance with established policies and procedures for Homeowner Rehabilitation.

Effect: The effect of the above condition is noncompliance with established policies and procedures on Homeowner Rehabilitation.

Recommendation: We recommend NMHC management ensure that the annual recertifications of borrowers with deferment agreements be strictly adhered to.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Roger A. Dris, NMHC Chief Accountant

Correction Action: NMHC has confirmed with the grantor agency that all deferred loans should be recorded. NMHC is working with the NMHC legal counsel on revising HOME loans under a deferment agreement. NMHC is implementing and recording deferred HOME loan receivable.

Proposed Completion Date: Fiscal year 2009

Unresolved Prior Year Comments
Year Ended September 30, 2006

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2006:

Questioned costs as previously reported	$ 13,406
Questioned costs of fiscal year 2006 Single Audit	-
Unresolved questioned costs at September 30, 2006	$ 13,406

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 8 through 23).

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Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended September 30, 2005:

Financial Statement Findings

Finding No. 2005-1 - Not corrected. See corrective action plan to Finding No. 2006-1.

Federal Award Findings and Questioned Costs

Finding No. 2005-2 - Corrective action was taken.