

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, 2015

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

Ms. Marianne Concepcion-Teregeyo
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, 2015, and the related notes to the financial statements, which collectively comprise DPL's basic financial statements, and have issued our report thereon dated October 3, 2016.

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 opinion 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 2015-001 through 2015-004 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 2015-001 through 2015-004.

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 responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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

October 3, 2016

DEPARTMENT OF PUBLIC LANDS

Schedule of Findings and Responses
Year Ended September 30, 2015

Local Noncompliance and General Ledger System

Finding No. 2015-001

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. Public Law 15-02 required the establishment of the DPL Operations Fund which shall be maintained by the CNMI Department of Finance (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.

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

- Revenues received by DPL are not deposited in the DPL Operations Fund;
- 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 DOF's general ledger;
- Journal vouchers posted to DOF's general ledger by DOF personnel are not approved by DPL management;
- The aged receivable subsidiary ledger included invalid receivables of \$185,961 as of September 30, 2015 (permit nos. C9501S, C9003S, CR9501S, T09001S, T07014S, TR0714S and TR9007S);
- Receivables, accounts payable, accruals and unearned revenues are not reconciled in DOF's general ledger; and
- DOF recorded an invalid miscellaneous adjustment expense of \$198,503. An audit adjustment was proposed to correct the invalid amount.

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

Cause: The causes of the above condition are the lack of compliance with Public Law 15-02, 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 compliance with Public Law 15-02 and lack of reliable and relevant financial information and the inability to timely detect errors and inaccuracies.

DEPARTMENT OF PUBLIC LANDS

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-001, Continued

Recommendation: We recommend DPL comply with Public Law 15-02 and 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, reconcile account balances maintained in the DOF general ledger and reconcile the aged receivable subsidiary ledger and exclude invalid receivables.

Prior Year Status: The lack of compliance with Public Law 15-02 and 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 2014.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Marianne Concepcion-Teregeyo, Secretary

Corrective Action: DPL's predecessor, the Marianas Public Lands Authority (MPLA) was an autonomous agency responsible for maintaining its own system of financial accounting independent of the Department of Finance (DOF). In February 2006, MPLA was abolished and its functions were transferred to the Executive Branch under DPL. DOF is charged with the finance and accounting of all Executive Branch departments and DPL is restricted from manipulating DOF's accounting system. DPL's efforts to address these issues include its letter of April 22, 2016 requesting DOF to bring both DOF and DPL into a single accounting system to facilitate compliance with Public Law (PL) 15-02 and accounting standards.

We discussed the letter with the Secretary of Finance (SOF) on July 26, 2016. The SOF explained that DOF has increased its capacity in using features of the JD Edwards accounting system with respect to generating customized periodic reports for DPL both hard copy and electronically for ease of export to spreadsheets. With this new capacity, the SOF committed to providing the reports DPL needs to facilitate timely reconciliation of accounts upon DPL's request.

With respect to establishing the "DPL Operations Fund" account, we have arranged with our financial institution to modify DPL's existing bank accounts for DOF to be a co-holder with certain rights while DPL maintains expenditure authority in compliance with PL 15-02.

Proposed Completion Date: DPL's effort in establishing in-house capacity to maintain a general ledger is near completion and management intends to start by October 2016. We anticipate the "DPL Operations Fund" account(s) to be in place by October 2016.

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Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Revenue/Receipts

Finding No. 2015-002

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 forty-four 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 five receipts related to contracts and permits requiring such documents.

<u>Lessee No.</u>	<u>Receipt No</u>
L9712S	15-0401
L9002S	2015-0738
L9404S	2015-0854
L0708S	2015-1127
T12032T	PLT2627

2. Financial statements for one lessee were provided, but were not audited by certified public accountants as required by the lease (# L9601S).

3. A signed permit extension was not provided for the lease period tested:

<u>Lessee #</u>	<u>Cash Receipt Date</u>	<u>Period</u>
T0212S	04/06/15	April 2015
T0008S	02/20/15	January 2015 - February 2016

4. Guaranteed annual rental (GAR) is based on the higher of eight percent (8%) of the property's appraised fair value or the agreed rental per the lease agreement. For one lease (# L9404S), annual rental rates were not based on current appraisals. An appraisal did not occur until 2016.

5. For one lease (# L09001S), the former annual rental rate (\$11,500) billed did not reflect the updated annual rental rate as required per the lease's rental schedule.

Recommendation: We recommend that management update lease contracts and permits and enforce lease provisions.

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 2014.

DEPARTMENT OF PUBLIC LANDS

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Finding No. 2015-002, Continued

Auditee Response and Corrective Action Plan:

Name of Contact Person: Marianne Concepcion-Teregeyo, Secretary

Corrective Action: DPL adopted regulations governing leases and permits in February 2016. The regulations differentiate leases that require financial statements audited by a Certified Public Accountant versus those that do not for future leases. It also standardizes lease contracts, rents, addresses events of default, as well as establishes a pecking order for the application of payments. DPL will establish monitoring procedures for compliance.

Proposed Completion Date: DPL intends on formalizing monitoring procedures by December 2016.

DEPARTMENT OF PUBLIC LANDS

Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Receivables

Finding No. 2015-003

Criteria: Receivables should be recorded when revenues are earned and should be timely assessed for collectability. DPL policy requires a 100% allowance for receivable balances that are ninety days past due.

Condition: Tests of receivables noted the following:

- Audit adjustments were proposed to increase the allowance for lease receivables by \$392,640 as of September 30, 2015 in accordance with DPL policy.
- Of forty-nine receivables tested, confirmation requests were not prepared by DPL due to lack of current mailing addresses and/or contact information for twenty-one lessees (contract #s L8904S, L9001S, L9504S, L9611S, L9706S, SL9201S, L8656R, L9004R, L9018R, L07001T, LD9708T, LR9708T, L9607S, L9901S, LR8660S, C9701S, C9704S, CB8610S, L9708T, T9613S and A8708R).
- A confirmation request was not prepared for L9104S as DPL is still in the process of determining the correct outstanding receivable for this lessee.
- A confirmation reply for L9107S indicated a zero receivable balance at 09/30/15 compared to DPL's balance of \$49,231. The DPL balance represented invalid amounts and this condition was corrected through a proposed audit adjustment.
- Three confirmation letters (L8650S, L0903T and CR9501S) were returned due to unknown address or the recipient moved.
- One lease receivable (L9003R) had a negative balance of \$42,802 due to unposted billings of \$86,956.
- Quarterly lease payments (L0905S) of \$1,170 are not based on the latest appraisal report of \$2,940.

Cause: The cause of the above condition is the lack of monitoring the allowance for doubtful accounts and not updating lessees' information and lease agreements.

Effect: The effect of the above condition is the misstatement of lease receivables.

Recommendation: We recommend that DPL monitor the allowance for doubtful accounts, update lessees' contact information and update lease agreements.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Marianne Concepcion-Teregeyo, Secretary

Corrective Action: DPL is in the process of establishing a system of monitoring and collecting receivables and a policy for allowance for doubtful accounts.

Proposed Completion Date: DPL intends on completing the corrective action by December 2016.

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Schedule of Findings and Responses, Continued
Year Ended September 30, 2015

Local Noncompliance

Finding No. 2015-004

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).

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

Cause: The cause of the above condition is the lack of agreement with MPLT.

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

Recommendation: We recommend that DPL obtain a legal determination on the merits of transfers to MPLT.

Prior Year Status: The lack of agreement with MPLT was reported as a finding in the audits of DPL for fiscal years 2010 through 2014.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Marianne Concepcion-Teregeyo, Secretary

Corrective Action: There is no constitutional or statutory requirement for DPL to obtain concurrence with MPLT on the amounts to be remitted. PL 15-02 mandates DPL to remit surplus amounts annually net of expenses for operations and programs. DPL has complied with this by submitting its budget to the legislature - the authority over department expenditures - and operating within that budget. Amounts realized in excess of approved expenditures and audited is the basis for amounts to be remitted to MPLT.

Proposed Completion Date:

Auditor Response: DPL's policy of reserving the ensuing years budget should be reviewed for constitutional or statutory compliance.

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Unresolved Prior Year Comments
Year Ended September 30, 2015

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