



U.S. Department of the Interior
Office of Inspector General

AUDIT REPORT

**MANAGEMENT OF PUBLIC LAND,
COMMONWEALTH OF THE
NORTHERN MARIANA ISLANDS**

**REPORT NO. 96-I-596
MARCH 1996**



United States Department of the Interior

OFFICE OF THE INSPECTOR GENERAL
Washington, D.C. 20240

MAR 20 1996

MEMORANDUM

TO: The Secretary

FROM: Wilma A. Lewis
Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information -
"Management of Public Land, Commonwealth of the
Northern Mariana Islands" (No. 96-I-596)

Attached for your information is a copy of the subject final audit report.

We concluded that the Marianas Public Land Corporation, now the Division of Public Lands, Department of Lands and Natural Resources, did not effectively develop management policies, procedures, and controls related to public land. As a result, the Commonwealth lost \$118.4 million on completed exchanges of public land, could lose \$70.1 million on pending exchanges, and lost revenues of \$25.1 million on exchanged public land that was leased to a developer by landowners. In addition, lease revenues of \$565,000 were lost, and the Government may lose additional lease revenues of \$469.2 million over the unexpired period of the leases; homestead recipients improperly received \$7 million from the unauthorized sale or lease of the lots; and homestead lots were awarded to applicants who were ineligible or who did not have the greatest need.

We made seven recommendations to the Governor to correct the deficiencies noted. However, since the Governor did not provide a response to the draft report, the recommendations are unresolved.

If you have any questions concerning this matter, please contact me or Ms. Judy Harrison, Assistant Inspector General for Audits, at (202) 208-5745.

Attachment



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20240

The Honorable Froilan C. Tenorio
Governor of the Commonwealth of the
Northern Mariana Islands
Office of the Governor
Saipan, MP 96950

MAR 20 1996

Dear Governor Tenorio:

Subject: Final Audit Report on Management of Public Land. Commonwealth of
the Northern Mariana Islands (No. 96-I-596)

This final report presents the results of our audit of the Commonwealth of the Northern Mariana Islands management of public land. The objective of our audit was to determine whether the Commonwealth was effective in: (1) developing management policies, procedures, and controls related to the purchase, lease, use, and disposal of public land; (2) controlling and utilizing U.S. Government land transferred to the Commonwealth; and (3) preventing encroachment on or adverse possession of public land. We also evaluated the Commonwealth's efforts to identify, survey, and register public land and to record and maintain a current inventory of all government real property.

Based on our review, we found that the Marianas Public Land Corporation, now the Division of Public Lands, Department of Lands and Natural Resources, did not effectively develop management policies, procedures, and controls related to public land. Specifically, the Corporation did not: (1) exchange public land for private land of comparable value; (2) use current land valuations in land exchanges; (3) utilize public land in an efficient manner; (4) receive rental income based on fair market value in return for leasing public land; (5) assess all rental amounts payable under the lease agreements; and (6) adequately pursue the collection of all lease amounts payable. In addition, the Corporation: (1) permitted homestead recipients to improperly transfer their interest in homestead lots and/or commercial structures to be built on these lots; and (2) awarded homestead lots to applicants who were ineligible or who did not have the greatest need.

These conditions occurred because the Corporation did not have written policies and procedures to ensure that: (1) land exchanges were for comparable values based on current land appraisals and served a public purpose; (2) lease agreements based minimum rentals on the appraised fair market value; (3) required financial documents were provided and lessee rental calculations were accurate; (4) lease rental payments were collected or default provisions of the lease agreements were pursued in a timely manner; (5) deeded homestead lots were inspected periodically

and were used in accordance with laws, regulations, and deed restrictions; and (6) homestead permits were awarded to applicants who were eligible or who had the greatest need in accordance with regulations.

As a result, the Commonwealth lost \$118.4 million on completed exchanges of public land; could lose \$70.1 million on pending exchanges; and lost revenues of \$25.1 million on exchanged public land that was leased to a developer by landowners. In addition, lease revenues of \$565,000 were lost, and the Government may lose additional lease revenues of \$469.2 million over the unexpired period of the leases; homestead recipients improperly received \$7 million from the unauthorized sale or lease of the lots; and homestead lots were awarded to applicants who were ineligible or who did not have the greatest need.

To correct the conditions noted, we recommended that the Governor ensure that the Secretary, Department of Lands and Natural Resources, develops and implements written policies and procedures which require that: (1) land exchanges be of comparable value based on current appraisals and that land exchanges be made only when they serve a public purpose; and (2) all pending land exchanges be suspended until implementation. We also recommended that the Governor ensure that the Secretary develops and implements policies and procedures which require that: (1) lease agreements base minimum rentals on the appraised fair market value; (2) financial documents required in lease agreements be provided and lessee rental calculations be accurate; and (3) lease rental payments be collected or default provisions of the lease agreements be pursued in a timely manner.

We further recommended that the Governor ensure that the Secretary, Department of Lands and Natural Resources, takes the following actions: (1) develops and implements policies and procedures which require that deeded homestead lots be inspected periodically and be used in accordance with laws, regulations, and deed restrictions and that homestead permits be awarded to applicants who, in accordance with the regulations, are eligible and who have the greatest need; (2) reviews all previously issued homestead deeds and permits and performs on-site inspections to ensure that deeded homestead lots are being used properly; (3) initiates action to reacquire those homestead lots which the recipients improperly used or subleased, which the recipients sold in violation of the 10-year Constitutional requirement, and which were issued to ineligible applicants; and (4) requests an Attorney General's opinion on seeking the recovery of illegal and/or improper monetary gains resulting from the sale and/or lease of village homestead lots and initiates action to recover such funds if appropriate.

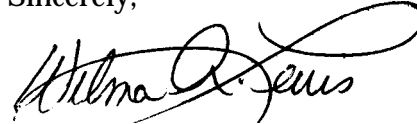
On November 13, 1995, we transmitted a draft of this report to you, as Governor of the Commonwealth of the Northern Mariana Islands, requesting your comments by December 15, 1995. At the request of your Legal Counsel, the response date was extended to December 22, 1995. However, no further requests for extensions were received, and a response to the draft report has not been provided. Accordingly, this

final report is being issued without the benefit of your response, and all of the recommendations are deemed unresolved (see Appendix 4).

The Inspector General Act, Public Law 95-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

In view of the above, please provide a response to this report, as required by Public Law 97-357, by May 31, 1996. The response should provide the information requested in Appendix 4 and be sent to the attention of Mr. Peter J. Scharwark, U.S. Department of the Interior, Office of Inspector General, North Pacific Region, 238 Archbishop F.C. Flores Street, Suite 807, Pacific News Building, Agana, Guam 96910.

Sincerely,

A handwritten signature in black ink, appearing to read "Wilma A. Lewis", with a large, stylized flourish at the end.

Wilma A. Lewis
Inspector General

cc: Secretary, Department of Lands and Natural Resources

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INTRODUCTION

BACKGROUND

The Marianas Public Land Corporation was established on January 9, 1978, by Article XI of the Constitution of the Commonwealth of the Northern Mariana Islands. The Corporation was designated to receive and was given responsibility for managing and disposing of public land from the former Trust Territory of the Pacific Islands Government on behalf of the Commonwealth through: (1) Secretarial Orders 2969 and 2989 and (2) Article VIII of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union With the United States of America (U.S. Public Law 94-241). The Corporation's primary functions included: (1) managing public land in accordance with a comprehensive land use plan; (2) coordinating land exchanges for public purposes; (3) controlling the use of public land through leases and permits; and (4) developing and administering homestead programs.

The Corporation was governed by a five-member Board of Directors, appointed by the Governor with the advice and consent of the Senate.¹ The Corporation completed its Public Land Use Plan during December 1989. Based on the Land Use Plan, the total acreage of public land available and usable by island was as follows:

	<u>Saipan</u>	<u>Rota</u>	<u>Tinian</u>	<u>Total</u>
	(In Acres)			
Total Public Land	<u>17,380</u>	<u>18,500</u>	<u>23,060</u>	<u>58,940</u>
Less:				
Leased/Committed	6,948	7,225	21,298	35,471
Too Steep/Not Usable	<u>1,780</u>	<u>2,495</u>	<u>9 2 3</u>	<u>5,198</u>
Available/Usable	<u>8,652</u>	<u>8,780</u>	<u>839</u>	<u>18,271</u>

¹ On August 24, 1994, Commonwealth Executive Order 94-3 dissolved the Corporation and transferred its functions to the newly established Department of Lands and Natural Resources, Division of Public Lands.

As of January 23, 1995, the Corporation's latest update to the 1989 Public Land Use Plan for Saipan was through December 31, 1992, and it indicated that the acreage of available/usable public land on Saipan had decreased to 4,380 acres.²

Because of incomplete and inaccurate records, we were unable to verify the accuracy of the land transaction records maintained by the Corporation and its successor, the Division of Public Lands. However, based on our compilation of available Corporation files, we found that a total of 5,072 village and agricultural homesteads had been awarded and agreements on 790 land exchange transactions had been completed since 1978. From October 1, 1989, through June 30, 1994, the Corporation awarded 2,563 homesteads and completed agreements on 317 land exchange transactions. As of June 30, 1994, the Corporation had 4,197 homestead applications on file, 250 pending land exchange transactions, and 157 active leases and permits. Audited financial statements for fiscal years 1991 and 1992 indicated that lease and permit income totaled about \$4.1 million and \$4.4 million, respectively.

OBJECTIVE AND SCOPE

The objective of our audit was to determine whether the Commonwealth was effective in: (1) developing management policies, procedures, and controls related to the purchase, lease, use, and disposal of public land; (2) controlling and utilizing U.S. Government land transferred to the Commonwealth; and (3) preventing encroachment on, or adverse possession of, public land. We also evaluated the Commonwealth's efforts to: (1) identify, survey, and register public land; and (2) record and maintain a current inventory of all government real property.

This audit was conducted at the offices of the Corporation/Division of Public Lands. In addition, we met with Commonwealth officials from: (1) the Departments of Lands and Natural Resources, Finance, and Public Health and Environmental Services; (2) the Offices of the Attorney General, Coastal Resources Management, and Recorder; (3) the Land Commission; and (4) the Legislature. We also met with officials of the U.S. Department of Agriculture and the U.S. Geological Survey. To accomplish our objective, we reviewed, for the period October 1, 1989, to September 30, 1994, and other periods as appropriate, selected applications, deeds, leases, permits, contracts, and appraisals. We also reviewed, for the same period, applicable laws, regulations, and operating procedures related to administering land exchanges, public land leases, homesteads, and transfers to other governmental departments and agencies. However, our audit scope was limited because the Commonwealth's land transaction records were incomplete and inaccurate.

²This amount excludes land that was pending execution of a deed or lease as of December 31, 1992.

The audit was conducted, as applicable, in accordance with the “Government Auditing Standards,” issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our audit, we evaluated the Corporation’s internal controls over: (1) selecting and appraising public and private land used in land exchanges; (2) establishing, assessing, and collecting rent on leased and permitted public land; and (3) awarding and monitoring homesteads. We found major weaknesses in all of these areas. Further, we found that the Corporation was identifying, surveying, and registering public land only on an as-needed basis (for example, land exchanges, public land leases, homestead subdivisions, and transfers to other governmental agencies/departments) and did not maintain a current inventory of all government real property. The internal control weaknesses are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

During the past 5 years, neither the General Accounting Office nor the Office of Inspector General has audited the Commonwealth’s land management practices. However, the Commonwealth Public Auditor issued two reports that evaluated Commonwealth land management practices. The first report, entitled “Marianas Public Land Corporation, Commonwealth of the Northern Mariana Islands, Review of Hotel Lease Payments, Lease Years 1988 and 1989,” issued on June 17, 1991, concluded that the Corporation did not collect rentals totaling at least \$249,000. The report stated that this occurred because: (1) lessees misinterpreted provisions of the lease agreements and did not make required lease payments; and (2) the Corporation had not monitored collections, billed past due amounts, and established procedures to ensure that lease payments were made in accordance with the lease agreements.

The second report, entitled “Marianas Public Land Corporation, Commonwealth of the Northern Mariana Islands, Review of Rental Payments From Quarry and Nonquarry Operations, Lease Years 1988 and 1989,” issued on August 3, 1993, concluded that the Corporation did not collect rentals totaling at least \$244,000. The report stated that this occurred because: (1) the lessees had not correctly computed or made required lease payments; and (2) the Corporation had not verified the lessees’ computations or pursued the collection of lease payments.

In addition, an independent public accounting firm issued an audit report on the Corporation for each of fiscal years 1989, 1990, 1991, and 1992. The reports stated that the Corporation had internal control weaknesses that included the following: (1) lease and permit revenues were not recorded or were recorded incorrectly; (2)

permit files did not have documentation indicating that the related premises were vacated upon expiration of the permits; (3) lease receivables were not aged and a reserve for doubtful accounts was not established; (4) lessees were not required to provide financial statements, extraction reports of materials removed from quarries on leased land, and/or applicable documents in support of their lease payments to the Corporation; (5) lease and permit revenues were not deposited timely or intact to the bank; and (6) action was not taken to collect past-due permit revenues.

FINDINGS AND RECOMMENDATIONS

A. LAND EXCHANGES

The Marianas Public Land Corporation did not effectively develop policies, procedures, and controls related to land exchanges. Specifically, the Corporation did not exchange public land for private land of comparable value, use current land valuations in land exchanges, and utilize public land in an efficient manner. The Commonwealth Code (Title 2, Division 4, Chapter 1, Section 4144) states that no public land is to be exchanged for private land unless the exchange is accomplished for a “public purpose” and the land to be exchanged is of comparable value based on an independent appraisal made at approximately the same time for all land to be exchanged. However, the Corporation did not have written policies and procedures to ensure that land exchanges were for comparable values based on current land appraisals and served a public purpose. As summarized in Appendix 2, the Corporation lost public land valued at \$118.4 million on completed exchanges, and if pending exchanges are completed, the Government could lose additional public land valued at \$70.1 million. Further, the Corporation lost revenues of \$25.1 million on exchanged public land that was leased to a developer by private landowners.

From October 1, 1989, through June 30, 1994, according to Corporation records, the Corporation completed agreements on 317 land exchange transactions. By means of these agreements, the Corporation gave up 3.1 million square meters of public land and received 1.1 million square meters of private land. Corporation records indicated at the time the Corporation was dissolved that 250 land exchange transactions were pending. These pending exchanges were transferred to the Department of Lands and Natural Resources, Division of Public Lands. According to the Division Director, the exchanges would not be completed until our audit was completed.

We reviewed five completed exchange agreements (Appendix 2) and found that the Corporation exchanged public land for private land of lesser value in all five cases, undervalued the public land it gave up in all five cases, and overvalued the private land it received in four of the five cases. Corporation officials could not provide adequate justification for these actions. For example, for two of the five agreements, the Corporation used inappropriate appraisal values and, as a result, lost public land valued at \$1,301,388 as follows:

³ A policies and procedures manual was finalized in June 1994. The Director of Public Lands said, however, that the manual was “outdated” and had not been implemented because the Corporation was dissolved on August 24, 1994.

- On July 12, 1991, the Corporation exchanged 5,804 square meters of public land for 758 square meters of private land. Both parcels of land had been valued by the Corporation at a total of \$148,000. However, the Corporation had applied 1990 appraisals, which did not reflect fair market values. Based on a 1991 appraisal value of \$696,480 for the public land and the purchase price of \$23,000 for the private land, we determined that the Corporation lost public land valued at \$673,480.

- On May 11, 1994, the Corporation exchanged 2,843 square meters of public land for 1,006 square meters of private land valued by the Corporation at \$197,816 and \$150,900, respectively. This exchange was not based on comparable value. In addition, the Corporation applied a 1990 appraisal value to the public land rather than an available 1992 appraisal value. Further, the Board had arbitrarily applied an unsupported value to the private land rather than a 1992 appraisal value. Based on the 1992 appraisals, we determined that the values of the public and private land at the time of the exchange were \$716,436 and \$88,528, respectively. Therefore, the Corporation lost public land valued at \$627,908.

Further, for the three other exchanges we reviewed, the Corporation not only exchanged land of unequal value and used inappropriate appraisal values but also exchanged public land that private companies had indicated they wanted to develop commercially. Therefore, the Corporation lost public land valued at \$16,925,916 from exchanges that were not based on comparable value and lost \$25,085,390 in lease revenues when private owners leased former public land, obtained through exchanges, to a developer as follows:

- On April 11, 1990, the Corporation exchanged 8,000 square meters of public land for 1,205 square meters of private land valued by the Corporation at \$200,000 and \$168,700, respectively. However, while the 1990 appraisal value of the private land was reasonable, the Corporation had arbitrarily applied an unsupported value to the public land rather than the 1990 appraised value. Based on the 1990 appraised values, we determined that the values of the public and private land at the time of the exchange were \$556,640 and \$168,700, respectively. Therefore, the Corporation lost public land valued at \$387,940. Further, the Corporation lost lease revenues of \$2,000,000 when the acquired land was leased to a private company for use as part of a proposed resort project. In addition, the public purpose of the exchange appears to be questionable.

- On May 27 and 28, 1993, the Corporation made two exchanges. First, 17,246 square meters of public land were exchanged for 10,000 square meters of private land valued by the Corporation at \$1,199,977 and \$840,000, respectively. Second, 66,062 square meters of public land were exchanged for 54,652 square meters of private land valued by the Corporation at \$4,596,594 and \$4,590,768, respectively. However, for both exchanges, the Corporation had applied a 1990 appraisal value to the public land and arbitrarily applied an unsupported value to the

private land rather than using available 1992 appraisal values. Based on the 1992 appraisal values, we determined that the values of the public and private land at the time of the exchange were \$4,345,992 and \$700,000, respectively, for the first exchange and \$16,647,624 and \$3,755,640, respectively, for the second exchange. Therefore, the Corporation lost public land valued at \$16,537,976 on the exchanges and lost lease revenues of \$23,085,390 because the recipients of the now-former public land leased part of it to a private company for use as part of a proposed resort project. In addition, we believe that the public purpose of the exchanges is questionable.

Based on our findings from the five cases in which the Corporation lost \$18,227,304, we expanded our review to completed and pending exchanges of similar public and private properties in which the Corporation had used outdated appraisals for valuing the properties (Appendix 2). We determined that the Corporation lost \$100,210,237 on completed exchanges and that, if pending exchanges are executed, the Government could lose additional public land valued at \$70,063,566. For example:

- The Corporation valued 904,873 square meters of public land at \$47,411,184 (\$29,541,942 on completed exchanges and \$17,869,232 on pending exchanges) using 1990 appraisal values. However, using the applicable 1992 appraisal values, we determined that the value of the public land was \$213,397,347 (\$127,110,658 on completed exchanges and \$86,286,689 on pending exchanges). As a result of undervaluing the public land, the Corporation lost public land valued at \$97,568,706 on completed exchanges, and another \$68,417,457 could be lost from pending exchanges.

- The Corporation valued 184,375 square meters of private land at \$17,930,334 (\$13,948,284 on completed exchanges and \$3,982,050 on pending exchanges) using unsupported values. However, using the applicable 1992 appraisal values, we determined that the value of the private land was \$13,642,694 (\$11,306,753 on completed exchanges and \$2,335,941 on pending exchanges). As a result of overvaluing private land, the Corporation lost public land valued at \$2,641,531 on completed exchanges, and another \$1,646,109 could be lost from pending exchanges.

Subsequent Actions

During our audit, we discussed the land exchange issues cited above with Commonwealth officials. To address these issues, the Governor issued a directive on January 19, 1995, that requires his written approval on any land exchange agreements entered into by the Department of Lands and Natural Resources.

Recommendations

We recommend that the Governor of the Commonwealth of the Northern Mariana Islands ensure that the Secretary, Department of Lands and Natural Resources:

1. Develops and implements written policies and procedures which require that land exchanges are of comparable value based on current appraisals and that land exchanges are made only when they serve a public purpose.

2. Suspends all pending land exchange agreements until Recommendation 1 has been implemented.

Commonwealth of the Northern Mariana Islands Response and Office of Inspector General Reply

The Governor of the Commonwealth of the Northern Mariana Islands did not respond to the draft report; therefore, both recommendations are unresolved (see Appendix 4).

B. LEASE MANAGEMENT

The Marianas Public Land Corporation did not receive rental income based on fair market value in return for leasing public land; assess all rental amounts due under the lease agreements; or adequately pursue the collection of all lease amounts receivable. The Public Land Use Plan states that public land leases will be based on fair market value. Lease provisions specify when payments are to be made, the conditions of default, and subsequent actions to be taken by the Corporation. Lease provisions also require the lessee to provide certain financial documents. However, the Corporation did not have written policies and procedures to ensure that: (1) lease agreements based minimum rentals on the appraised fair market value; (2) required financial documents were provided and lessee rental calculations were accurate; and (3) lease rental payments were collected or default provisions of the lease agreements were pursued in a timely manner. As a result, the Corporation lost \$564,715 and may lose another \$1,789,611 for fiscal years 1987 through 1994. Also, the Government could lose an additional \$467,434,436 over the unexpired period of the 12 leases we reviewed.

The Corporation's latest audited financial statements indicate that lease income for fiscal years 1991 and 1992 was \$4.1 million and \$4.4 million, respectively. As of June 30, 1994, Corporation records indicated that there were 101 commercial leases, 41 permits for 1 to 5 years, and 15 quarry permits for the use of public land. When the Corporation was dissolved on August 24, 1994, responsibility for these leases and permits was transferred to the Department of Lands and Natural Resources, Division of Public Lands. In addition, the Division executed four new leases from August 1994 through January 1995. For our review, we selected nine commercial development leases that were executed by the Corporation before its dissolution and three commercial development leases that were executed by the Division after the dissolution (Appendix 3). Minimum rental payments and public benefit contributions on the 12 leases we reviewed totaled \$67,254,772 over the terms of the leases. In addition, each lease included a gross receipts rental provision that required the lessee to pay additional rental when the lessee's annual gross receipts attributable to lease site operations multiplied by a preset rate exceeded the annual minimum lease payment.

Market Value

Our review of the 12 leases disclosed that neither the Corporation nor the Division of Public Lands based the minimum lease payment amount on fair market value or maintained records documenting the basis of rental computations. According to the

⁴These contributions were additional payments required by the Legislature from developers as a condition of approving two of the leases.

Director, and as indicated in the lease provisions, minimum annual rental payments were to be based on 8 percent of the appraised fair market value. However, we found that the Corporation did not have written policies and procedures to ensure that lease agreements based minimum rentals on appraised fair market values. Therefore, we determined that for the 12 leases reviewed, the Corporation lost rental income totaling \$564,715 on 2 leases and the Government could lose rental income totaling another \$465,785,468 over the remaining terms of 6 leases (see Appendix 3).

For example, the Corporation executed a 25-year lease on November 9, 1993, with minimum rental payments of \$152,035 to be paid over the life of the lease. However, the Corporation did not have an appraisal or other documentation to support the property value used or the determination of the minimum lease payments. In addition, on November 16, 1993, only 7 days after obtaining the lease, the lessee subleased the property to a third party for total rental payments of \$720,000 over a 25-year sublease. Based on the value of the sublease, the Corporation lost at least \$28,249 for the 11 months ending September 30, 1994, and the Government could lose another \$539,716 over the balance of the 25-year lease.

In another example, the Division executed a 25-year lease on November 29, 1994, with minimum rental payments of \$18,739,442 to be paid over the life of the lease. However, the Division was unable to support either the source of the property value used or the basis used to support the calculation of the minimum lease payments. Using 8 percent of a 1992 appraisal of adjacent public land (which the Corporation had used for other valuations), we determined that the fair market value of the minimum rental payments should have been \$262,200,000 over the term of the lease. As a result, the Government could lose \$243,460,558 over the 25-year term of this lease.

Assessment

Based on our review of the 12 leases, we determined that the Corporation did not assess all rental amounts due for 5 of the 9 lease agreements subject to assessment. Lease provisions required payment of a gross receipts rental and of interest on past-due rental payments. In addition, to assist the Commonwealth in determining potential gross receipts rentals that may be due, lease provisions required that lessees submit: (1) annual certified financial statements, including schedules indicating sources of and deductions from the lessee's gross receipts; (2) Commonwealth business gross revenue quarterly tax returns; and (3) computations of quarterly gross receipts rentals. However, the Corporation did not have written policies and procedures to ensure that required financial documents were provided and that lessee rental calculations were accurate. Therefore, we determined that of the nine leases that were subject to assessment, the Corporation had not assessed five lessees for \$788,097 in delinquent lease payments and interest. Also, if current procedures

are not changed, we believe that the Government could lose another \$1,648,968 in lease revenues over the balance of the lease terms (Appendix 3).

For example, as of May 15, 1994, the Corporation had collected \$41,546 in gross receipts rentals from a lease that was executed on May 28, 1987. However, the Corporation had not obtained financial documents necessary to confirm the accuracy of the gross receipts rental payments. Without the required financial documents, the Corporation's Compliance Accountant was limited to verifying the accuracy of the lessee's calculation of quarterly gross receipts rentals. In addition, neither the Compliance Accountant nor the Corporation's Land Enforcement Officer had made any on-site inspections to familiarize themselves with the lessee's operations. Based on our review, we determined that the lessee was incorrectly deducting off-premises sales from gross receipts revenues which were attributable to the lease-site operations. As a result, the lessee underpaid gross receipts rentals by \$123,932 and had accrued interest on the underpayment totaling \$38,502. In addition, the Corporation had not assessed the lessee for the delinquent lease payments and accrued interest. If payment and assessment practices remain unchanged, we believe that the Government could lose another \$637,218 in lease revenue over the balance of the lease term.

Collection

The Corporation did not initiate effective collection actions on the 6 leases (of the 12 reviewed) that had delinquent receivables. Lease provisions specify when lease payments are to be made, when a default occurs, and what actions are available to the Corporation if the lessee defaults. However, the Corporation did not have policies and procedures to ensure that lease rental payments were collected or default provisions of the lease agreements were pursued in a timely manner. As a result, we determined that the Government may lose lease revenues of \$1 million if the six lessees are unable to pay the amounts past due (Appendix 3).

For example, on August 17, 1992, the Corporation issued a 5-year lease to a company that had previously leased the same property for over 5 years using two temporary permits. When the Corporation issued the lease, the lessee owed delinquent permit fees and accrued interest totaling \$243,753. As of June 30, 1994, the lessee's rental payments on the new lease had been delinquent since April 1993. In addition, the Corporation had sent only one request for payment (in June 1993) and had not made any attempt to collect the delinquent permit rentals. We determined that as of June 30, 1994, the lessee owed rentals and accrued interest totaling \$43,700 on the current lease and \$303,418 on the temporary permits. Further, the Government may lose the \$347,118 if the lessee is unable to pay the past-due amounts.

Subsequent Actions

During our audit, we discussed the lease issues noted above with Commonwealth officials. To address these issues, the Governor issued a directive on January 19, 1995, that requires his written approval on any lease agreements entered into by the Department of Lands and Natural Resources.

Recommendation

We recommend that the Governor of the Commonwealth of the Northern Mariana Islands ensure that the Secretary, Department of Lands and Natural Resources, develops and implements policies and procedures which require that lease agreements base minimum rentals on the appraised fair market value; financial documents required in lease agreements are provided and lessee rental calculations are accurate; and lease rental payments are collected or default provisions of the lease agreements are pursued in a timely manner.

Commonwealth of the Northern Mariana Islands Response and Office of Inspector General Reply

The Governor of the Commonwealth of the Northern Mariana Islands did not respond to the draft report; therefore, the recommendation is unresolved (see Appendix 4).

C. HOMESTEAD ADMINISTRATION

The Marianas Public Land Corporation permitted homestead recipients to improperly transfer their interest in homestead lots and/or commercial structures to be built on the lots and awarded homestead lots to applicants who were ineligible or who did not have the greatest need. These conditions occurred because the Corporation did not have written policies and procedures to ensure that: (1) deeded homestead lots were inspected periodically and were used in accordance with the laws, regulations, and deed restrictions; and (2) homestead permits were awarded to applicants who were eligible or who had the greatest need in accordance with regulations. As a result, 208 recipients improperly received \$7 million from the unauthorized sale or lease of homestead lots, and 12 of the 23 permitted homestead lots we reviewed were awarded to applicants who were ineligible or who did not have the greatest need.

The Commonwealth Code (Title 2, Division 4, Chapter 3, Section 4332) authorizes the Corporation to implement the Village Homestead Program and to issue homestead lots to residents who do not have safe, decent, and sanitary dwellings for themselves and their families and who do not have sufficient means to purchase village lots. In addition, Section 4333 requires the Corporation to establish priorities for the issuance of a village homestead permit and to establish inspection and compliance procedures. Further, Section 4308 provides that the Corporation will issue a deed on a homestead lot 3 years after the homestead permit has been awarded. Finally, Section 4302 provides that the Corporation should determine and establish standards and requirements for the use, occupation, and development of the homestead tracts.

From October 1, 1989, through June 30, 1994, the Corporation awarded a total of 2,563 homesteads. As of June 30, 1994, the Corporation had 4,197 homestead applications on file, which were transferred to the Department of Lands and Natural Resources.

Use of Homesteads

The Corporation allowed homestead recipients to improperly transfer their interest in homestead lots and/or commercial structures to be built on the lots. Article XI, Section 5(a), of the Commonwealth Constitution prohibits the transfer of a freehold interest⁵ in a homestead for 10 years after receipt. In addition, in December 1990, the Corporation instituted more restrictive language in the village homestead deeds. The deeds state: "Grantees may not transfer a freehold interest, or an option, or

⁵Freehold is a tenure of real property by which an estate of inheritance (such as fee simple absolute) or an estate not of inheritance (such as estates for one's own life) is held.

leasehold interest of more than one year, for ten years after receipt of this deed.” However, the Corporation did not have written policies and procedures to ensure that deeded homestead lots were inspected periodically and were used in accordance with laws, regulations, and deed restrictions. As a result, from 1985 through 1994, at least 67 homesteaders received \$269,000 from improperly transferring freehold interests on their homestead lots, and 141 homesteaders received \$6.7 million from improperly leasing their homestead lots. In our opinion, these funds should accrue to the Commonwealth because the homesteaders did not use the property as required and as agreed to or in accordance with the intent of the Program, which was to provide a primary dwelling to the homesteader.

We reviewed land transactions for the period January 1985 through December 1994 that were on file at the Commonwealth recorder’s office, and in May and December 1994, we also visited three village homestead subdivisions on Saipan and Rota. During the site visits, we saw commercial development on homestead lots that included a two-story 25-unit apartment building, two 3-story office buildings, a restaurant, a grocery store, a video rental store, and a farm supply store. For example, on December 27, 1990, the Corporation issued a quitclaim deed for a village homestead lot on Saipan to an individual. However, on April 12, 1991, the homesteader entered into a 55-year lease that provided for a total of \$705,000 in payments over the lease term. In a similar case, on August 24, 1990, the Corporation issued a quitclaim deed to an individual for a village homestead lot on Saipan. However, 2 years later, on August 20, 1992, the homesteader entered into a 55-year lease that provided for a total of \$445,000 in payments over the lease term.

In addition, none of the 25 files we reviewed of homesteaders that had deeded lots contained documentation that the Corporation had monitored compliance with the land use requirement (use as a primary residence). The Homestead Administrator stated that between 1985 and 1994, he believed the Corporation had monitored compliance with homestead lot deed restrictions on only two occasions. First, a 1991 Corporation study concluded that almost 90 percent of the homesteads in a subdivision on Saipan had been either sold or leased. However, according to the Administrator, the documentation for the sales or leases could not be located because it had been given to a former Executive Director. Second, in July 1992, the Corporation reviewed a second subdivision on Saipan and determined that 25 homestead lots awarded since 1987 had already been leased or had the freehold interest transferred. However, Corporation legal counsel stated that as of October 1994, no action had been taken against any of the violators in either study.

Awards of Homesteads

The Corporation awarded homestead lots to applicants who were ineligible or who did not have the greatest need. The Commonwealth Code (Title 2, Division 4, Chapter 3, Section 4333) specifies that in order to be eligible to receive a village

homestead lot, an applicant must be of Northern Marianas descent and be at least 18 years old. Also, the applicant and/or spouse must not own or have any interest in a village lot or have been a recipient of a village homestead lot. Further, Section 4303 requires applicants to be residents of the same Senatorial District⁶ in which the homestead is being applied for. Finally, the Village Homestead Rules and Regulations published in the *Commonwealth Register* on June 15, 1990, established maximum income levels and asset eligibility requirements and also stated that eligible applicants had to be prioritized by class and category as follows: Class One - First Priority, applicant has at least one child and has an immediate need; Class Two - First Priority, applicant is without children but has an immediate need; Second Priority, applicant has only a general need;⁷ and Third Priority, applicant is temporarily residing outside the Commonwealth for the purposes of seeking health care, education, job training, employment, or other job-related reasons. However, the Corporation did not have written policies and procedures to ensure that homestead permits were awarded to applicants who were eligible and who had the greatest need in accordance with the regulations. As a result, 12 of 23 permitted homestead lots we reviewed were awarded to applicants who were ineligible or who did not have the greatest need.

For example, on March 25, 1992, a permit for a village homestead lot on Rota was awarded to a recipient who had applied for a lot on January 3, 1989. The application showed that the recipient was employed on Guam as a substitute teacher with the Government of Guam. The Rota Administrative Officer stated that the homestead lot was awarded in a public drawing based on priority in accordance with the regulations. The Administrative Officer said, however, that because of his personal knowledge of all the applicants, he did not require documentation to support any applicant's eligibility or need requirements. We determined that since the residency requirement was not met, the individual received the village homestead lot improperly. The Administrative Officer indicated that he knew the recipient was not a resident of Rota but that he issued the permit because the individual was originally from Rota and had returned for a few months prior to the drawing. After the drawing, the individual returned to Guam. However, we found that no action had been taken to cancel the permit.

⁶The Commonwealth Code (Title 1, Division 1, Chapter 4, Section 1402) identifies three Senatorial districts, and the islands of Saipan, Rota, and Tinian are each in different districts. Therefore, applicants must be residents of the island in which they are applying for a homestead.

⁷Priority 2 applicants are reclassified as Priority 1 after 3 years from the date of the application, in accordance with Section 4333 of the Code.

Subsequent Actions

During our audit, we discussed the homestead issues noted above with Commonwealth officials. To address these issues, the Governor issued a directive on January 19, 1995, that requires his written approval on any homestead deed or permit entered into by the Department of Lands and Natural Resources.

Recommendations

We recommend that the Governor of the Commonwealth of the Northern Mariana Islands ensure that the Secretary, Department of Lands and Natural Resources:

1. Develops and implements policies and procedures which require that deeded homestead lots be inspected periodically and be used in accordance with laws, regulations, and deed restrictions, and that homestead permits be awarded to applicants who, in accordance with the regulations, are eligible and who have the greatest need.

2. Reviews all previously issued homestead deeds and permits and performs on-site inspections so that assurance is provided that deeded homestead lots are being used in accordance with applicable laws, regulations, and deed restrictions.

3. Initiates administrative and/or legal action to reacquire those homestead lots which the recipients used or subleased improperly, which the recipients sold in violation of the 10-year Constitutional requirement for homestead ownership, and which were issued to ineligible applicants.

4. Requests an Attorney General's opinion on the possibility of seeking recovery of illegal and/or improper monetary gains resulting from the sale and/or lease of homestead lots and initiates action to recover such funds as appropriate.

Commonwealth of the Northern Mariana Islands Response and Office of Inspector General Reply

The Governor of the Commonwealth of the Northern Mariana Islands did not respond to the draft report; therefore, all of the recommendations are unresolved (see Appendix 4).

CLASSIFICATION OF MONETARY AMOUNTS

<u>Finding Areas</u>	<u>Lost Revenues*</u>	<u>Funds To Be Put To Better Use*</u>	<u>Potential Additional Revenues*</u>
Land Exchanges	\$25,085,390	\$118,437,541	
Lease Management			
Market Value	564,715		
Assessment			\$788,097
Collection			1,001,514
Homestead			
Sales/Leases		<u>6,954,107</u>	
Total	<u>\$25,650,105</u>	<u>\$125,391,648</u>	<u>\$1,789,611</u>

*Amounts represent local funds.

APPENDIX 2

SUMMARY OF LOSSES FROM LAND EXCHANGES

Individual Exchanges*

<u>Exchange</u>	<u>Date</u>	<u>Value Given Up</u>	<u>Value Received</u>	<u>Value Lost</u>	<u>Lease Revenues</u>
# 1	7/12/91	\$696,480	\$23,000	\$673,480	-
# 2	5/11/94	716,436	88,528	627,908	
# 3	4/11/90	556,640	168,700	387,940	\$2,000,000
# 4	5/27/93	4,345,992	700,000	3,645,992	545,940
# 5	5/28/93	<u>16,647,624</u>	<u>3,755,640</u>	<u>12,891,984</u>	<u>22,539,450</u>
Subtotal		\$22,963,172	\$4,735,868	\$18,227,304	<u>\$25,085,390</u>

Additional Land Areas Used in Completed Exchanges

	<u>Corporation Value</u>	<u>Audit Value</u>	<u>Value Lost</u>
Public Land	\$29,541,952	\$127,110,658	\$97,568,706
Private Land	13,948,284	11,306,753	<u>2,641,531</u>
Subtotal			<u>\$100,210,237</u>

Loss on Completed Exchanges	<u>\$118,437,541</u>
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Additional Land Areas in Pending Exchanges

	<u>Corporation Value</u>	<u>Audit Value</u>	<u>Value Lost</u>
Public Land	\$17,869,232	\$86,286,689	\$68,417,457
Private Land	3,982,050	2,335,941	<u>1,646,109</u>
Potential Loss on Pending Exchanges			<u>\$70,063,566</u>

*Amounts determined by audit.

APPENDIX 3

**SUMMARY OF LEASE REVENUES LOST, UNCOLLECTED,
OR AT RISK OF LOSS**

		<u>Lost Revenues</u>	<u>Uncollected Revenues Due</u>		<u>Revenues At Risk*</u>	
<u>Leases Reviewed</u>	<u>Lease Date</u>	<u>Leased Below Market Value</u>	<u>Assessments Not Made</u>	<u>Collections Not Pursued</u>	<u>Leased Below Market Value</u>	<u>Assessments Not Made</u>
Leases Executed by Corporation						
#1	5/28/87		\$162,434	-	-	\$637,218
#2	5/17/88		334,924	\$40,310	-	
#3	12/10/91	-	22,619	58,015	-	
#4	11/9/93	\$28,249	-	16,508	\$539,716	
#5	2/22/89	-	-	47,168	-	
#6	8/17/92	-	220,263	347,118	-	1,011,750
#7	3/15/88	536,466	-	492,395	-	
#8	10/28/89		-		95,282,910	
#9	10/13/89		<u>47,857</u>		<u>61,031,444</u>	
Subtotal		<u>\$564,715</u>	<u>\$788,097</u>	<u>\$1,001,514</u>	<u>\$156,854,070</u>	<u>\$1,648,968</u>
Leases Executed by Public Land						
#10	1/9/95	-	-	-	\$36,072,890	-
#11	10/17/94	-	-	-	29,397,950	-
#12	11/29/94	-	-	-	<u>243,460,558</u>	-
Subtotal					<u>\$308,931,398</u>	
Total		<u>\$564,715</u>	<u>\$788,097</u>	<u>\$1,001,514</u>	<u>\$465,785,468</u>	<u>\$1,648,968</u>
Combined Totals			<u>\$1,789,611</u>		<u>\$467,434,436</u>	

*Although not due, revenues may be lost under existing lease terms,

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A. 1	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for developing and implementing policies and procedures requiring that land exchanges be of comparable value based on current appraisals and serve a public purpose.
A.2	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for suspending all pending land exchanges until Recommendation A. 1 has been implemented.
B.1	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for developing and implementing policies and procedures requiring that lease agreements base minimum rentals on appraised value; lessee financial documents and rental calculations be provided and be accurate; and rental payments be collected or lease default provisions be pursued timely.

Finding/Recommendation Reference	Status	Action Required
C.1	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for developing and implementing policies and procedures which require periodic inspections of deeded homestead lots and which require that deeded homestead lots be used in accordance with laws, regulations, and deed restrictions.
C.2	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for reviewing all previously issued homestead deeds and permits and for performing on-site inspections.
C.3	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for initiating administrative and/or legal action to reacquire homestead lots that were used, subleased, or sold improperly, or that were issued to ineligible applicants.

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
C.4	Unresolved	Provide a response to the recommendation indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that identifies the target date and the title of the official responsible for requesting an Attorney General's opinion on the recovery of illegal and/or improper monetary gains from sale and/or lease of homestead lots and for initiating action to recover such funds as appropriate.

**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO
THE OFFICE OF INSPECTOR GENERAL BY:**

Sending written documents to:

calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1550 Wilson Boulevard
Suite 402
Arlington, Virginia 22210

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(703) 235-9399

TDD for hearing impaired
(703) 235-9403 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana Guam 96910

(700) 550-7279 or
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