

# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Financial Audit of the Department of Defense

### Summary

The Office of the Auditor contracted with the certified public accounting firm of Grant Thornton LLP to conduct a financial audit of the Department of Defense for the fiscal year July 1, 1995 to June 30, 1996. The audit examined the department's financial records and its systems of accounting and internal controls and tested these for compliance with applicable laws and regulations. Because of the severity of problems noted, Grant Thornton LLP was unable to express an opinion on the combined financial statements of the department.

We found that the financial records of the department were too incomplete to be audited in a timely manner. Audits of the department for the fiscal years ending June 30, 1994 and 1995 were not completed within the time period required by the federal government. Because the audit for FY 1994-95 was not completed, Grant Thornton LLP was unable to perform the required audit procedures necessary to express an opinion on the financial statements of the department for the year ended June 30, 1996.

The department failed to transfer moneys to the general fund. The moneys were federal reimbursements for expenditures paid with general fund appropriations. The department's budget requests did not sufficiently identify these federal reimbursements to reduce its request for general fund appropriations. The reimbursements have been used for other expenditures. The failure to return these moneys to the general fund is considered a material weakness by Grant Thornton LLP.

We also found improper procurement practices that were considered to be a reportable condition by Grant Thornton LLP. In one particular instance, the department apparently parceled the purchase of a lawn mower and related lawn mower parts. One Summary Vendor Quotation form had been altered with correction fluid and new quotes written in. Our examination of the form indicated all three of the original quotes exceeded the \$10,000 threshold for informal quotes such as this. The department apparently parceled the purchases to avoid the formal bidding requirements of the procurement law and the loss of the funds on the fiscal year end lapse date. We found two contracts which had been executed after the contractors began providing services.



## Recommendations and Response

We recommend that the department immediately transfer balances due to the State's general fund and transfer any future amounts due the general fund on a timely basis. We also recommend the department ensure that its accounting and financial reporting records are properly maintained and that financial audits are completed by the required deadlines. We further recommend the department ensure that it complies with the procurement code, applicable procurement rules and regulations, and the related executive memoranda.

The department generally disagrees with our findings. It claims that amounts received from the federal government are not "reimbursements" for general fund advances. It claims the moneys are needed to maintain departmental operations. We disagree. Prior audit reports reflect amounts due to the general fund and our audit revealed not all were transferred to the general fund. The department's transfers of about \$500,000 in federal reimbursements to the general fund in June 1996, support our finding.

The department does acknowledge the lateness of the single audit reports for the fiscal years ended June 30, 1994 and 1995. The department takes exception to our discussion of the causes of the lateness of the reports. It believes that, on balance, its financial records are sufficient for the purposes of effecting internal financial controls and facilitating the completion of annual financial audits. It also disagrees that Federal Emergency Management Agency (FEMA) revenues it receives and then passes on to other agencies and government units should be recorded in its financial records because these are "pass through" moneys. Regardless of the classification of the moneys, the department is responsible to FEMA for ensuring that these "pass through" funds are properly accounted for and used. This responsibility should be reflected in its financial accounting records and reports.

With respect to improper procurement practices, the department states that it will move to improve its internal procedures to minimize, if not avoid altogether, instances of noncompliance. The department should strive to comply with procurement laws rather than to simply minimize noncompliance.

The department defended many of its actions we cited in our report. With respect to the issue of parceling, the department contends that these were two unrelated purchases. It does not discuss the alteration of the Summary Vendor Quotation form. It states that our finding on contract services that were provided prior to execution of contracts is in error. It states these services were provided under existing five year contracts. We found no five year contracts. We did find, however, that the contracts had options for renewal. The options were exercised and new contracts negotiated and executed—after services were provided. It is questionable whether the department can use renewal options to execute new contracts without competitive solicitation.

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