OVERVIEW

Financial Audit of the Department of Hawaiian Home Lands

Report No. 02-13, September 2002

Summary

The Office of the Auditor and the certified public accounting firm of Grant Thornton LLP conducted a financial audit of the Department of Hawaiian Home Lands, State of Hawaii, for the fiscal year July 1, 2000 to June 30, 2001. The audit examined the financial records and transactions of the department; reviewed the related systems of accounting and internal controls; and tested transactions, systems, and procedures for compliance with laws and regulations.

We found deficiencies in the financial accounting and internal control practices of the department. The deficiencies included material weaknesses, the worst possible type of reportable condition. In the first material weakness, we found that the department does not have documentation to support its methodology to determine the allowance for doubtful accounts for loans receivable. The department relied on its external auditors to recommend an allowance based on those auditors' professional judgment. Financial statements are the responsibility of management; however, the department is unable to compute its own allowance for doubtful accounts for loans receivable and is unable to provide the necessary details to support the balance presented in the financial statements.

We identified infrastructure improvements of $1.8 million recorded in the incorrect accounting period as another material weakness. This error resulted in the underreporting of liabilities and expenditures in FY1999-00 and the overreporting of expenditures in FY2000-01. Failure to report all expenditures and liabilities in the proper period provides an inaccurate picture of the department's financial condition.

We also found that management has failed to ensure that all departmental accounting policies and procedures are in place and enforced. This could cost the State and Hawaii's taxpayers millions of dollars; also, this could cost qualified, eligible beneficiaries the opportunity to receive assistance because loan moneys are tied up in delinquent loans that are unlikely to be repaid. The department does not enforce written collection policies for its outstanding loans, documentation for follow-up on delinquent loans is not maintained consistently, loan records contain invalid addresses, increasing financial assistance is being given to lessees, and interest is accrued on loans related to cancelled leases.

In addition, management does not require accurate and timely financial reporting, potentially resulting in non-compliance with bond covenants. Also, the department does not properly record ancillary charges related to fixed asset costs and to construction costs related to the inventory of homes for sale. Furthermore, the department is authorized to guarantee up to $50 million in loans originally made by other agencies; however, it has failed to maintain the details on the loans that it guarantees.

Finally, the department does not have written policies and procedures for the collection of lease and license receivables. Existing procedures to follow up on delinquent receivables are not formally documented nor consistently executed.

Recommendations and Response

We recommend that the department reevaluate its methodology for determining its allowance for doubtful accounts for loans, obtain enough documentation to support the methodology it uses, and ensure the allowance estimate is properly calculated. The department should also review its internal control policies and procedures and ensure that all expenditures and liabilities are properly recorded.

The department must review its loan collection policies and procedures for reasonableness and determine and document the steps necessary to enforce them. Also, the department should consider purchasing a software program similar to those used by commercial institutions for managing its outstanding loans. Current and accurate information on all guaranteed loans should be maintained.

In addition, financial accounting records should be properly maintained and financial reporting and audits should be completed on a timely basis. Written policies and procedures for the collection of lease and license receivables should be established and staff should be properly trained. The department should assume more responsibility for the proper recording of transactions under generally accepted accounting principles. Finally, the department should update its waiting lists to ensure they contain current and accurate information on all applicants.

The department disagreed with the majority of our findings and recommendations. It does not believe that a qualified opinion is warranted. Yet the department is unable to provide us with the documentation to support the methodology for determining the allowance for doubtful accounts for loans receivable because its external auditors, not its own staff, prepared the calculation.

The department also considers as immaterial to its financial statements the $1,816,100 of expenditures and $647,267 of home construction costs recorded in the incorrect period, and unrecorded infrastructure and ancillary costs for which it is unable to quantify. The department believes it is sufficient to identify the $1,816,100 prior period error in the footnotes to the financial statements. The department agrees, with caveats, with our recommendations for implementing and enforcing policies and procedures.

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