

OVERVIEW

Financial Audit of the Department of Defense

Report No. 04-06, March 2004

Summary

The Office of the Auditor and the certified public accounting firm of PricewaterhouseCoopers LLP conducted a financial audit of the Department of Defense, State of Hawaii, for the fiscal year July 1, 2002 to June 30, 2003. 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.

In the opinion of the firm, except for the effects of the adjustments, if any, resulting from the FY2001-2002 capital asset issues, the financial statements present fairly the department's financial position and changes in its financial position for the fiscal year ended June 30, 2003, in conformity with generally accepted accounting principles.

With respect to the department's internal control over financial reporting and operations, we found several deficiencies, including a significant reportable condition considered to be a material weakness. In the material weakness, we found that the department has not properly accounted for its capital assets. The department was unable to provide adequate documentation to support \$12.2 million of \$17.2 million in capital asset costs and related accumulated depreciation of \$4.5 million of \$4.8 million. This information should have been recorded upon the implementation of GASB Statement No. 34 as of June 30, 2002, and is reflected in the \$12 million restatement as of July 1, 2002, in the financial statements, and the recording of depreciation expense thereon of \$373,000 in the fiscal year ended June 30, 2003. Additionally, the department restated the prior-period capital assets balance to reflect additional capital assets that should have been capitalized and depreciated in previous years.

We also found that the department's poor management of contracts resulted in noncompliance with certain provisions of the Hawaii Public Procurement Code. Our testing of the department's procurement practices revealed that contract records were not properly maintained; bid opening procedures were not followed; a justification for the selection of a small purchase vendor was not properly documented; screening committee requirements for professional services were not followed; and services were rendered before contracts were executed. As a result, there was no assurance that fair competition was sought by the department and that state funds were spent in an effective and cost-beneficial manner.

Moreover, we found that the department did not make changes to the allocation of payroll wages on a timely basis, which resulted in inaccurate federal reimbursements. In our review of six pay periods for five Disaster Program employees (total of 30 items tested), we found eight instances where the employees' wages were



incorrectly charged 100 percent to federal funds rather than 75 percent to federal funds and 25 percent to state (general) funds. As a result, the department overcharged the federal government by \$11,751, since employees' wages were not allocated to the proper appropriation codes. The department does not have any formal written procedures to ensure that changes to the payroll wage allocation are completed in a timely fashion.

Finally, we found that the department did not file certain federal financial status reports on a timely basis. In 15 instances out of a sample of 68 Financial Status Quarterly Reports filed in FY2002-03, the department submitted the financial status reports for five grants eight days after the required submittal date. The department does not have any formal written procedures assigning responsibility to ensure that the financial status reports are filed on a timely basis. Although the department was not assessed any penalty due to this late filing, untimely submittal of reports to the federal government could result in penalties to the department or jeopardize future federal funding.

Recommendations and Response

We recommend that the department ensure that adequate supporting documentation is maintained for the capital assets to support the propriety of these assets. The department should also ensure the capital assets are properly accounted for by department staff, and their work is reviewed and approved by the appropriate supervisor.

We also recommend that the department comply with the Hawaii Public Procurement Code and procurement rules for the procurement of goods and services, ensure proper contract execution prior to the commencement of the contracted work, and provide periodic employee training. Moreover, the department should ensure proper and timely processing of the changes in the payroll wage allocation among appropriation codes through strengthened procedures. Finally, the department should establish and enforce formal written procedures to delineate the responsibilities and deadlines for completing and submitting required federal financial status reports.

The department generally concurred with most of our findings and recommendations, and provides additional information to explain its current procedures and corrective actions planned to address the internal control deficiencies identified in our report.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830