OVERVIEW

Review of Revolving Funds, Trust Funds, and Trust Accounts of the Department of the Attorney General, the Department of Business, Economic Development, and Tourism, and the University of Hawaii

Report No. 04-13, December 2004

Summary

Section 23-12, Hawaii Revised Statutes, requires the State Auditor to review all existing revolving and trust funds every five years. The review is to include a five-year financial summary for each fund or account, an evaluation of the original intent and purpose of each fund or account, and determine the degree to which each fund or account achieves its stated and claimed purpose. The reviews are scheduled so that the funds administered by each state department will be reviewed once every five years. This is our third review of the revolving and trust funds and trust accounts of these three departments.

Revolving funds are often established with an appropriation of seed money from the general fund. Revolving funds must demonstrate the capacity to be self-sustaining. Activities financed by revolving funds include loan programs that are initially established by general fund seed moneys and then replenished through the repayment of loans. *Trust funds* invoke a fiduciary responsibility of state government to care for and use the assets held for the benefit of those with a vested interest in the assets. A pension fund is an example of a trust fund. *Trust accounts* are typically separate holding or clearing accounts for state agencies. A trust account is often used as an accounting device to credit or charge agencies or projects for payroll or other costs.

Of the 92 funds and accounts we reviewed this year, 60 were revolving funds, 16 were trust funds, and 16 were trust accounts. We used criteria developed by the Legislature as well as criteria developed by our office from a review of public finance and accounting literature. These funds must continue to serve the purpose for which they were created and not require continuing general fund appropriations. In addition, a revolving fund must reflect a linkage between benefits sought and charges made upon users and also be an appropriate financial mechanism for the program or operation. A trust fund must also meet the statutory definition of a trust fund. For each fund, we present a five-year financial summary, the purpose of the fund, and conclusions about its use. We do not present any conclusions about the effectiveness of the program, its management, or whether the program should be continued.

Responses

We transmitted a draft of this review to the Department of the Attorney General, the Department of Business, Economic Development, and Tourism, and the University of Hawaii.

The Department of the Attorney General disagrees with our conclusion that the Criminal Forfeiture Revolving Fund does not meet all four criteria of a revolving fund. The department stated that the program is funded by criminal forfeitures, which really are charges assessed on the criminals, who are the "users" of the criminal justice system. However, as previously stated by our office, in maintaining that crime reduction and deterrence are the benefit of this fund, the department disregards the direct linkage requirement—that those who pay into a revolving fund should benefit from that fund. In this case, the criminals whose property is seized receive no benefits from this program.

The department also provided additional information regarding the Antitrust Trust Fund, but did not disagree with our conclusion that it is improperly classified as a trust fund.

The Department of Business, Economic Development, and Tourism disagrees with our conclusion that the Hawaii Strategic Development Corporation Revolving Fund does not meet all four criteria of a revolving fund because it has not demonstrated financial self-sustainability. The department stated the definition of a revolving fund does not constrain the self-sustainability requirement of a revolving fund to an annual basis, as our conclusion implies. The department further explains that loans or investments made under this program can take ten years or longer to repay and, as such, "revolve" over a longer period of time, but nonetheless are self-sustaining. We agree wholeheartedly that the definition of a revolving fund does not specify any timeframe, annual basis or otherwise, when determining self-sustainability. However, it does require a revolving fund to be self-sustaining. As stated in our report, we do not disagree that this fund could demonstrate self-sustainability if and when these longer term loans or investments do provide returns, but the fact remains that this fund had not achieved self-sustainability during the period covered by this report.

The department further stated that while our report cited transfers into this fund from the Hawaii Capital Loan Program as support for our conclusion of a lack of self-sustainability, the definition of a revolving fund does, in fact, allow for transfers from other funds or accounts. We agree that the definition of a revolving fund does allow for transfers to be received from other funds or accounts, however, the direct linkage criteria would still apply, meaning the Hawaii Capital Loan Program would have to be a direct beneficiary of the Hawaii Strategic Development Corporation Revolving Fund. On the contrary, all moneys received by this fund, regardless of source, are used to support private organizations or individuals. Finally, the department stated that the auditor failed to recognize or ignored the fact that $2,000,000 was received as a return on investment in FY2000 and that this distribution clearly fits the parameters of a revolving fund and could have supported operations for many subsequent years had it not been re-invested. This return on investment is, in fact, reflected in our report and included in the total revenues of $2,006,000 reported for FY2000. Additionally, this amount would not be sufficient to cover many subsequent years of operations considering the fund's reported expenditures during FY2000 through FY2003 totaled $12,323,000.

The department also provided additional information regarding the Hawaii Community-Based Economic Development Revolving Fund, but did not disagree with our conclusion that it does not meet all the criteria of a revolving fund.

The University of Hawaii did not disagree with any of our findings. The university did submit a detail of the corrective actions it plans to take in response to our findings. We have reviewed these corrective actions and they appear to be appropriate.

A point of clarification provided by the Department of Business, Economic Development, and Tourism was incorporated into our report.

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