

OVERVIEW

Financial Audit of the Department of Agriculture

Report No. 05-02, April 2005

Summary

The Office of the Auditor and the certified public accounting firm of Grant Thornton LLP conducted a financial audit of the Department of Agriculture, State of Hawai'i, for the fiscal year July 1, 2003 to June 30, 2004. 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 such adjustments, if any, as might have been determined to be necessary had they been able to examine evidence regarding certain capital asset costs and related accumulated depreciation, the financial statements present fairly, in all material respects, the department's financial position and changes in its financial position for the fiscal year ended June 30, 2004, 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 significant reportable conditions considered to be material weaknesses. In the first material weakness, we found that the department lacks formal written policies and procedures for many of its basic processes and management functions, including the administration of agricultural loans, certain accounts receivables, and contract management.

In another material weakness, we found that the department needs to improve its administration of agricultural loans. Our testing of the agricultural loan process revealed deficiencies in the following areas: loan file and loan system maintenance, monitoring and collection of delinquent loans, performing inspections, reconciling internal and external loan reports, and monitoring participation loans.

In another material weakness, we found that the department's calculation of its allowance for agricultural loan losses is not properly supported and does not comply with generally accepted accounting principles. Additionally, the department improperly accrues interest on loans greater than 90 days past due.

In another material weakness, we found that the department's management of its accounts receivables is ineffective. Our testing of accounts receivables revealed that collection procedures at one division are inadequate, while collection procedures at another division, while properly established, are not adhered to. Additionally, the department's allowance for doubtful accounts is not properly calculated or supported.

In another material weakness, we found that the department's year-end financial reporting process is ineffective. Several adjustments and footnote disclosures,



required by generally accepted accounting principles, were not included in the June 30, 2004 draft financial statements submitted to us by the department.

We also found that the department lacks adequate management controls over cash receipts and disbursements and annual inventory counts; has deficient procurement procedures that resulted in noncompliance with certain provisions of the Hawai'i Public Procurement Code; lacks formal policies and procedures to standardize its procurement and contract management practices; and did not file certain federal financial and performance reports on a timely basis.

Recommendations and Response

We recommend that the department establish formal policies and procedures for all functions. These policies and procedures should define the roles, responsibilities, and limitations of personnel and should be approved and periodically reviewed by the Board of Agriculture.

We also recommend that the department improve its administration of agricultural loans; revise its policies and procedures to incorporate a methodology for calculating an allowance for loan losses that is in accordance with generally accepted accounting principles; develop a comprehensive loan monitoring process that involves the participation of the Board of Agriculture; and discontinue accruing interest on loans greater than 90 days past due.

We also recommend that the department review and revise, as appropriate, its policies and procedures over accounts receivable collections, write-offs, and allowances; strengthen management oversight and collection efforts over delinquent accounts; and adhere to established policies and procedures.

We also recommend the department implement a process to ensure accurate and timely year-end financial reporting, including the use of financial statement disclosure checklists. Additionally, the department should maintain adequate support for its capital assets.

We also recommend that the department strengthen management controls over cash receipts and disbursements, and annual inventory counts; and amend policies and procedures and provide staff training to ensure compliance with the Hawai'i Public Procurement Code.

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

Marion M. Higa
State Auditor
State of Hawai'i

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