

# OVERVIEW

## *Financial Audit of the Department of Land and Natural Resources*

Report No. 06-04, June 2006

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### Summary

The Office of the Auditor and the certified public accounting firm of KMH LLP conducted a financial audit of the Department of Land and Natural Resources, State of Hawai'i, for the fiscal year July 1, 2004 to June 30, 2005. 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 any such adjustments that might have been determined to be necessary had the firm been able to examine evidence regarding the department's liability due to the state general fund as of June 30, 2005, reported in the Federal Grant Fund, 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, 2005, 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 two significant reportable conditions considered to be material weaknesses. The first material weakness is that the department lacks a comprehensive federal grant program management system. As a result, the firm was unable to obtain sufficient evidential matter supporting the department's liability due to the state general fund of \$8,302,509 recorded in the Federal Grant Fund and therefore, the scope of the firm's work was not sufficient to enable it to express an opinion on the fund as a whole. The second material weakness relates to the department's inadequate accounting and financial reporting process, which led to misstatements and the omission of required disclosures in its June 30, 2005 financial statements.

We also found that the operation and management of the Division of Boating and Ocean Recreation needs improvement. At the small boat harbors under the division's care, the condition of some facilities pose serious safety hazards. Also, internal controls over the handling of cash and issuance of boating permits are insufficient. For instance, at one of the small boat harbors the combination lock for the safe was not in use and the key was left hanging nearby. Additionally, while the division is supposed to be self-sufficient, the small boat harbors' fee structure has not changed since 1995, making it difficult to cover increasing operating costs.

We further found that there is no department-wide, comprehensive cash management policy. There is no formal, written policy governing the investment and monitoring of cash, accelerated billing and collection, deposit procedures, monitoring of accounts receivables, and planning for cash flow requirements. For example, we noted that the Divisions of Forestry and Wildlife and State Parks do not document



a daily closing cash reconciliation of transactions to receipts. Finally, we found that the Bureau of Conveyances does not effectively manage its human resources.

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## Recommendations and Response

We recommend that the department's management develop a centralized, comprehensive system to manage and be responsible for the department's federal programs; determine whether its federal program accounting policy complies with state law; and obtain documentation to support its assertion that the liability reflected in its financial statements as "Due to State Treasury" do not reflect actual moneys owed to the State. The department's management should also investigate the cause for the deficit in its Federal Grant Fund and implement an integrated accounting system for its federal programs.

We further recommend that the department improve the accuracy and effectiveness of its accounting and financial reporting processes by performing additional reviews of its financial statements and disclosures. The department should also perform periodic, supervisory reviews of fiscal staff; test leave record schedules more extensively; have its internal auditor report directly to the Board of Land and Natural Resources; perform periodic lease audits; and obtain and fill a procurement specialist position.

We also recommend that department management review the operations of the Division of Boating and Ocean Recreation, including performing safety inspections of all small boat harbors. Additionally, we recommend that the board and department develop a comprehensive cash management policy. Finally, the Bureau of Conveyances' administrator should work with the board and department director to resolve labor union issues, consider creating a customer service function, and consider streamlining certain functions.

In its written response, the department agrees with some of our findings and recommendations while strongly disagreeing with many of our comments and characterizations, especially with respect to the two material weaknesses noted. The department did point out an error contained in our draft report that we corrected. This led us to remove a qualification of our opinion on the fairness of the department's financial statements with respect to its Ocean-Based Recreation Fund as of June 30, 2005. However, we stand by our conclusions presented in the final report, including the classification of two findings as material weaknesses. Our Comments on Agency Responses that follows Chapter 3 discusses our respective points of view. We believe our audit report presents a balanced and accurate analysis of the department's financial operations.

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