



FINANCIAL AUDIT OF THE STATE DEPARTMENT OF REGULATORY AGENCIES

FOR THE FISCAL YEAR ENDED
JUNE 30, 1967



THE OFFICE OF THE LEGISLATIVE AUDITOR

The office of the legislative auditor is a public agency attached to the Hawaii State legislature. It is established by Article VI, Section 8, of the Constitution of the State of Hawaii. The expenses of the office is financed through appropriations made by the legislature.

The primary function of this office is to strengthen the legislature's capabilities in making rational decisions with respect to authorizing public programs, setting program levels, and establishing fiscal policies and in conducting an effective review and appraisal of the performance of public agencies.

The office of the legislative auditor endeavors to fulfill this responsibility by carrying on the following activities.

1. Conducting examinations and tests of state agencies' planning, programming, and budgeting processes to determine the quality of these processes and thus the pertinence of the actions requested of the legislature by these agencies.
2. Conducting examinations and tests of state agencies' implementation processes to determine whether the laws, policies, and programs of the State are being carried out in an effective, efficient and economical manner.
3. Conducting systematic and periodic examinations of all financial statements prepared by and for all state and county agencies to attest to their substantial accuracy and reliability.
4. Conducting tests of all internal control systems of state and local agencies to ensure that such systems are properly designed to safeguard the agencies' assets against loss from waste, fraud, error, etc.; to ensure the legality, accuracy and reliability of the agencies' financial transaction records and statements; to promote efficient operations; and to encourage adherence to prescribed management policies.
5. Conducting special studies and investigations as may be directed by the legislature.

Hawaii's laws provide the legislative auditor with broad powers to examine and inspect all books, records, statements, documents and all financial affairs of every state and local agency. However, the office exercises no control functions and is restricted to reviewing, evaluating, and reporting its findings and recommendations to the legislature and the governor. The independent, objective, and impartial manner in which the legislative auditor is required to conduct its examinations provides the basis for placing reliance on its findings and recommendations.



LEGISLATIVE AUDITOR
IOLANI PALACE
HONOLULU, HAWAII 96813

Foreword

This financial audit report of the department of regulatory agencies is the result of the examination of the financial statements and records of the department for the fiscal year ended June 30, 1967. The audit was conducted by the firm of Haskins & Sells, certified public accountants.

The audit was conducted in accordance with the generally accepted auditing standards adopted by the membership of the American Institute of Certified Public Accountants. In addition, the audit was governed by the *Instructions to Independent Certified Public Accountants on Audit Engagements of Agencies of the State of Hawaii*, issued by the office of the legislative auditor.

The audit report is divided into three parts. Part I entitled, *Accountant's Report—Financial Statements*, is concerned with displaying the financial statements of the department of regulatory agencies and expressing the auditor's opinion as to the reasonable accuracy of these statements.

Part II, the *Management Letter*, includes the auditor's evaluation of the adequacy and effectiveness of the system of internal control and the adequacy of the financial records, financial reporting, and budgetary controls. In addition, it discusses the weaknesses and inadequacies in the financial system and operations that the audit has uncovered and makes appropriate recommendations for their rectification.

It is our practice to request each of the agencies affected by our examination to submit in writing its comments on our findings and recommendations and to indicate what action it has taken or intends to take therefor. Agency responses resulting from this audit are shown in Part III of this report as *Memoranda of Comments by Affected Agencies*.

We wish to express our deep appreciation to the management and staff of the department of regulatory agencies. They were most helpful and cooperative.

Clinton T. Tanimura
Legislative Auditor

SUMMARY TABLE OF CONTENTS

	Page
PART I: FINANCIAL STATEMENTS	
. Scope and Opinion	1
. Statement of Revenues Collected	3
. Statement of Appropriations, Expenditures, and Unexpended Balance	4
. Statement of Changes in Trust and Agency Fund Balance	5
. Note to Statements	6
. Supplemental Schedules	7
 PART II: MANAGEMENT LETTER	
. Overall Evaluation of the System of Internal Control	1
. Operating Manual	2
. Other Matters Relating to Internal Control	4
. Comments Relating to Other Matters	
. Deficiencies of Accounting System	5
. Penalties	7
. Bank Examinations	7
. Bank Examiners' Charge Out Rates	8
. Other Matters	8
. Conclusion	9
 PART III: COMMENTS BY AFFECTED AGENCIES	
. Index of Recommendations by Affected Agencies	1
. Memoranda of Comments of Affected Agencies	2

PART I

FINANCIAL STATEMENTS

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
FINANCIAL STATEMENTS
JUNE 30, 1967

HASKINS & SELLS

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

FIRST NATIONAL BANK BUILDING
HONOLULU, HAWAII 96813
OTHER ISLAND OFFICES
HILO
LIHUE
KAHULUI

September 29, 1967

Mr. Clinton Tanimura, Auditor,
State of Hawaii,
Honolulu, Hawaii.

Dear Sir:

We have examined the following statements and supplemental schedules of the State of Hawaii, Department of Regulatory Agencies for the year ended June 30, 1967:

	<u>Page</u>
Statements:	
Statement of Revenues Collected as Trustee and Agent for State of Hawaii General Fund - Estimated and Actual.....	3
Statement of Appropriations, Expenditures, and Unexpended Balance.....	4
Statement of Changes in Trust and Agency Fund Balance.....	5
Note to Statements.....	6
Supplemental Schedules:	
Expenditures - Classified by Division and Object General Appropriation, Related Expenditures and Encumbrances, and Comparison.....	7 8

Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we

considered appropriate in the circumstances; as to expenditures, we made test checks of summary warrant vouchers and supporting documents, but it was impracticable to examine the warrants inasmuch as such warrants are issued by the State Comptroller.

The accounts of the Department and the accompanying statements have been prepared generally on the cash basis, as required by the Laws of Hawaii (as the laws relate to the individual units of the State Government). Under this basis of accounting, as explained in the Note to Statements, revenues are recorded when collected, and expenditures are recorded at the time vouchered claims are filed with the State Comptroller.

In our opinion, the accompanying statements and supplemental schedules present fairly the revenues collected by the Department as trustee and agent for the State of Hawaii and the Department's expenditures for the year ended June 30, 1967, on the basis indicated in the preceding paragraph, which basis is consistent with that of the preceding year.

Yours truly,

Hackins & Sells

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

STATEMENT OF REVENUES COLLECTED AS TRUSTEE AND AGENT
 FOR STATE OF HAWAII GENERAL FUND - ESTIMATED AND ACTUAL
 FOR THE YEAR ENDED JUNE 30, 1967

	ESTIMATED REVENUE	ACTUAL REVENUE	ACTUAL OVER (UNDER) ESTIMATED
BANK EXAMINATION:			
Licenses and permits.....	\$ 11,100	\$ 12,668	\$ 1,568
Charges for current services...	93,246	83,035	(10,211)
Total.....	<u>104,346</u>	<u>95,703</u>	<u>(8,643)</u>
BUSINESS REGISTRATION:			
Licenses and permits.....	73,295	80,558	7,263
Charges for current services...	191,705	196,494	4,789
Total.....	<u>265,000</u>	<u>277,052</u>	<u>12,052</u>
FIRE MARSHAL - Charges for current services.....			
	<u>6,500</u>	<u>4,315</u>	<u>(2,185)</u>
INSURANCE:			
Premium taxes.....	4,256,829	3,931,937	(324,892)
Licenses and permits.....	65,580	64,781	(799)
Charges for current services...	33,401	44,335	10,934
Total.....	<u>4,355,810</u>	<u>4,041,053</u>	<u>(314,757)</u>
REGULATORY BOARDS AND COMMISSIONS:			
Licenses and permits.....	261,692	297,014	35,322
Fines, forfeitures, and penalties.....		375	375
Charges for current services...	142,539	131,182	(11,357)
Total.....	<u>404,231</u>	<u>428,571</u>	<u>24,340</u>
PUBLIC UTILITIES COMMISSION:			
Fines, forfeitures, and penalties.....		112	112
Charges for current services...	423,603	418,759	(4,844)
Total.....	<u>423,603</u>	<u>418,871</u>	<u>(4,732)</u>
TOTAL.....	<u>\$5,559,490</u>	<u>\$5,265,565</u>	<u>\$(293,925)</u>

NOTE - Estimated revenues from insurance premium taxes differ from actual revenues mainly because of the State's practice of recording revenues on a cash basis. Revenues for the year ended June 30, 1967 include insurance premium taxes of approximately \$208,000 due to the State at June 30, 1966 and collected after that date. Insurance premium taxes of approximately \$458,000, due to the State at June 30, 1967 and collected subsequently, are not reflected in the accompanying statements.

See Note to Statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

STATEMENT OF APPROPRIATIONS, EXPENDITURES, AND UNEXPENDED BALANCE
 FOR THE YEAR ENDED JUNE 30, 1967

	UNEXPENDED BALANCE JULY 1, 1966	APPROPRIA- TIONS (NOTE)	OTHER CREDITS	EXPENDITURES (See page 7)	LAPSED APPROPRIA- TIONS (NOTE)	UNEXPENDED BALANCE JUNE 30, 1967 (NOTE)
GENERAL ADMINISTRATION.....	\$ 5,971	\$ 158,642		\$ 136,227	\$ 69	\$28,317
BANK EXAMINATION.....	393	149,206		146,224	2,866	509
BUSINESS REGISTRATION.....	1,048	60,098		59,905	810	431
FIRE MARSHAL.....	428	37,296		37,601	97	25
INSURANCE.....	133	106,921		105,535	232	1,287
REGULATORY BOARDS AND COMMISSIONS.....	171	26,051		24,153	1,309	760
PROFESSIONAL AND VOCATIONAL LICENSING.....	2,509	290,461	\$208	290,274	445	2,460
PUBLIC UTILITIES COMMISSION.....	5,220	318,844		294,404	18,865	10,795
TOTAL.....	<u>\$15,873</u>	<u>\$1,147,519</u>	<u>\$208</u>	<u>\$1,094,323</u>	<u>\$24,693</u>	<u>\$44,584</u>

. Appropriations for Department's expenditure from State of Hawaii General Fund for the year ended June 30, 1967 were authorized under the following Acts:

Session Laws of Hawaii, 1966 - General Appropriations, Act 8, Section 1.....	\$1,127,519
Session Laws of Hawaii, 1967 - Prevention of Discrimination in Real Property Transactions, Act 193, Section 21 (allocated to General Administration).....	<u>20,000</u>
	<u>\$1,147,519</u>

The \$20,000 appropriated under Act 193 is included in the appropriation figure for General Administration Division.

- . Appropriations of \$24,693 were permitted to lapse during the year ended June 30, 1967. Of this amount \$23,384 pertained to appropriations for the current year and the remainder, \$1,309, related to unexpended balances at June 30, 1966.
- . Unexpended balance of \$44,584 at June 30, 1967 represented an unallotted appropriation of \$20,000 for "Prevention of Discrimination in Real Property Transactions" mentioned above, and encumbrances of \$24,584.

See Note to Statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

STATEMENT OF CHANGES IN TRUST AND AGENCY FUND BALANCE

FUND BALANCE, JULY 1, 1966.....	\$2,254
DEPOSITS (net of \$17,500 refund).....	1,545
REVENUES AND ASSESSMENTS COLLECTED AS TRUSTEE AND AGENT FOR STATE OF HAWAII:	
General Fund.....	\$5,265,565
Special Fund - Workmen's Compensation Assessments.....	<u>141,654</u>
	5,407,219
Less - Transfers to State of Hawaii, Department of Accounting and General Services.....	<u>5,407,219</u>
FUND BALANCE, JUNE 30, 1967.....	<u>\$3,799</u>

Balance at June 30, 1967 consists primarily of funds deposited by various individuals and companies as required by law in connection with matters pending before the Department. These deposits will be refunded in the future.

See Note to Statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

NOTE TO STATEMENTS

The State of Hawaii, Department of Regulatory Agencies records its financial transactions, and the accompanying statements have been prepared, generally on the cash basis. Revenues are recorded when the cash is collected. Expenditures are recorded at the time vouchered claims are filed with the State Comptroller inasmuch as payment immediately follows such filing. Unvouchered claims against appropriations are encumbered but are not recorded as expenditures until the encumbrances are liquidated.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

SCHEDULE OF EXPENDITURES (CLASSIFIED BY DIVISION AND OBJECT)
 FOR THE YEAR ENDED JUNE 30, 1967

	GENERAL ADMINIS- TRATION	BANK EXAMINATION	BUSINESS REGISTRATION	FIRE MARSHAL	INSURANCE	REGULATORY BOARDS AND COMMISSIONS	PROFESSIONAL AND VOCATIONAL LICENSING	PUBLIC UTILITIES COMMISSION	TOTAL
PERSONAL SERVICES.....	\$118,567	\$138,651	\$52,541	\$34,476	\$ 95,901	\$ 2,988	\$247,792	\$216,087	\$ 907,003
OTHER CURRENT EXPENSES:									
Travel and subsistence.....	4,602	5,612	13	896	2,690	18,895	10,285	22,029	65,022
Service fees.....			620				4,497	39,944	45,061
Materials and supplies.....	1,625	668	2,140	1,344	1,436		9,851	6,919	23,983
Repairs and maintenance.....	1,273	113	191	129	384		1,167	759	4,016
Communication.....	707	300	1,602	474	1,228		6,109	1,439	11,859
Printing and advertising.....	772		705		2,272		2,769	1,565	8,083
Dues and subscriptions.....	139	487	124	87	780	1,890	422	2,532	6,461
Examination services.....							4,540		4,540
Rentals.....	2,175						1,340	21	3,536
Miscellaneous.....	969	36		27		380	120	681	2,213
Total other current expenses.....	12,262	7,216	5,395	2,957	8,790	21,165	41,100	75,889	174,774
EQUIPMENT PURCHASED.....	5,398	357	1,969	168	844		1,382	2,428	12,546
TOTAL.....	\$136,227	\$146,224	\$59,905	\$37,601	\$105,535	\$24,153	\$290,274	\$294,404	\$1,094,323

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

SCHEDULE OF GENERAL APPROPRIATION, RELATED EXPENDITURES AND ENCUMBRANCES, AND COMPARISON
 FOR THE YEAR ENDED JUNE 30, 1967

	GENERAL ADMINIS- TRATION	BANK EXAMINATION	BUSINESS REGISTRATION	FIRE MARSHAL	INSURANCE	REGULATORY BOARDS AND COMMISSIONS	PROFESSIONAL AND VOCATIONAL LICENSING	PUBLIC UTILITIES COMMISSION	TOTAL
GENERAL APPROPRIATION FOR THE YEAR ENDED JUNE 30, 1967 UNDER SESSION LAWS OF HAWAII, 1966, ACT 8, SECTION 1 (before transfers between programs under Act 8, Section 14).....	\$128,153	\$154,838	\$58,468	\$37,783	\$106,774	\$27,770	\$293,432	\$320,301	\$1,127,519
EXPENDITURES RELATING TO CURRENT YEAR'S GENERAL APPROPRIATION (not including expenditures of \$14,564 relating to encumbrances at June 30, 1966).....	130,324	145,846	58,876	37,184	105,422	24,005	287,846	290,256	1,079,759
ENCUMBRANCES AT JUNE 30, 1967 RELATING TO CURRENT YEAR'S GENERAL APPROPRIATION...	8,317	509	431	25	1,287	760	2,460	10,795	24,584
TOTAL EXPENDITURES AND ENCUMBRANCES RELATING TO CURRENT YEAR'S GENERAL APPROPRIATION.....	138,641	146,355	59,307	37,209	106,709	24,765	290,306	301,051	1,104,343
OVER (UNDER) GENERAL APPROPRIATION.....	\$ 10,488	\$ (8,483)	\$ 839	\$ (574)	\$ (65)	\$(3,005)	\$ (3,126)	\$(19,250)	\$ (23,176)

PART II

MANAGEMENT LETTER

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

MANAGEMENT LETTER

JUNE 30, 1967

HASKINS & SELLS

TABLE OF CONTENTS

	<u>Page</u>
Auditors' Scope and Overall Evaluation of the System of Internal Control.....	1
Comments Relating to Internal Control:	
Operating Manual.....	2
Mail Receipts.....	4
Other Matters Pertaining to Internal Control.....	4
Comments Relating to Other Matters:	
Deficiencies of Accounting System.....	5
Penalties.....	7
Bank Examinations.....	7
Bank Examiners' Charge Out Rates.....	8
Other Matters.....	8
Conclusion.....	9

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

FIRST NATIONAL BANK BUILDING
HONOLULU, HAWAII 96813
OTHER ISLAND OFFICES
HILO
LIHUE
KAHULUI

September 29, 1967

Mr. Clinton Tanimura, Auditor,
State of Hawaii,
Honolulu, Hawaii.

Dear Sir:

We have examined the financial statements of the State of Hawaii, Department of Regulatory Agencies for the year ended June 30, 1967, on which we rendered our opinion dated September 29, 1967. As part of our examination, we reviewed the Department's system of internal control, including its financial reporting system, the propriety of the Department's expenditures in accordance with the appropriation acts and other applicable laws, and the Department's controls over revenues collected.

We present for your information and consideration comments and recommendations relating to internal control and accounting procedures which came to our attention during the course of our examination.

OVERALL EVALUATION OF THE SYSTEM OF INTERNAL CONTROL

The Committee on Auditing Procedure of the American Institute of Certified Public Accountants has defined internal control as comprising the plan of organization and all of the coordinate methods and measures adopted within an organization to safeguard

its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.

The Committee goes further to say that a satisfactory system of internal control includes the following characteristics:

- A plan of organization which provides appropriate segregation of functional responsibilities;
- A system of authorization and record procedures adequate to provide reasonable accounting control over assets, liabilities, revenues, and expenses;
- Sound practices to be followed in performance of duties and functions of each of the organizational departments; and
- A degree of quality of personnel commensurate with responsibilities.

OPERATING MANUAL

All functions and activities of the Department describing approved practices need to be incorporated in the organizational structure and documented in an operating manual. While the Department has an organization chart for managerial personnel and general job descriptions for its employees, there is no documentation of specific lines of authority and segregation of responsibilities knitting individual positions together in a compact whole.

The present accounting procedures are based on Act 181, S.L.H. 1923, as amended, circulars, instructions, and regulations issued by the Department of Accounting and General Services and its

predecessors, and knowledge gained through past experience. The Manual of Accounting, Reporting, and Business Procedure for the Territorial Government of Hawaii written by Henry P. Seideman and published in 1928 is also used as a guide, but its circulation is limited.

We recommend that an operating manual be prepared, possibly by the State systems accounting personnel, to avoid confusion within the Department and to prevent variations in accounting methods. This manual should be in a loose leaf form to allow ease in revision. It should define accounting procedures and policies, describe the various funds and their purposes, and include a chart of accounts with appropriate descriptions, purpose, authorized usage, and content of each account. At the departmental level the manual should include organization charts and job descriptions clearly defining responsibility and authority of each position and the relationship of that position to other positions, to superiors, to subordinates, and to coordinates. It should also include step-by-step instructions, diagrams of paper flow, and instructions on office routines.

Some of the benefits to be derived from adopting an operating manual follow:

- . It would facilitate training; new personnel could be assimilated into a position with minimal loss of time and effort in acquainting them with their responsibilities;
- . It would require management to state its position as to what, how, and when a job should be done.

MAIL RECEIPTS

Mail receipts are handled by several employees before they are handed to the cashier for recording and depositing. Occasionally checks are held by employees for two or three days, and in certain instances the checks have been returned to the remitter by the employees without independent authorization. These procedures weaken internal control and make it difficult to fix responsibility should an irregularity occur.

We recommend that all mail receipts be delivered by the mail clerk directly to the cashier for prompt recording and depositing. Employees of the various divisions should then use a copy of the cash receipt tags prepared by the cashier for posting to detail records and other further processing.

OTHER MATTERS PERTAINING TO INTERNAL CONTROL

Cash Receipts

The cash receipt tags used by the cashier are pre-numbered; however, the account clerk responsible for auditing the cashier's daily reconciliation of collections does not account for the numerical sequence of cash tags nor does he account for the sequence of numbers generated by the validating machine.

We recommend that the numerical sequence of both the cash receipt tags and the validating machine tape be accounted for by the account clerk as a part of auditing the cashier's report, and any missing numbers be investigated.

Agreement of Divisional Records to Revenue Reports

Procedures in the various divisions are not adequate to insure that revenues collected are properly recorded by the

accounting office. In several divisions, records are available as a basis for independent check. However, such records are not being compared or agreed with the monthly revenue statement prepared by the accounting office. In other divisions, a slight modification of present records would provide the necessary information.

We recommend that the Department establish procedures within each division to ascertain that revenues are being properly recorded in the monthly revenue statement.

COMMENTS RELATING TO OTHER MATTERS

DEFICIENCIES OF ACCOUNTING SYSTEM

As indicated in our opinion on the Department's financial statements and in Note 1 thereto, the Department records its transactions generally on the cash basis. Under such practices, expenditures are recorded at the time vouchered claims are filed with the State Comptroller; unvouchered claims against an appropriation at the end of each year are recorded in an encumbrance account, but are not recorded as an expenditure until the encumbrances are liquidated; revenues collected as trustee and agent for the State are recorded on a cash basis.

Governmental units generally follow one or more of three bases of accounting:

- a. The cash basis, under which revenues are recorded when received and expenditures are recorded when paid.
- b. The accrual basis, under which revenues are recorded when earned and expenditures are recorded as soon as they result in liabilities for benefits received,

notwithstanding that the receipt of the revenues or payment of the expenditures may take place, in whole or in part, in another accounting period.

- c. The modified accrual basis of accounting, under which expenditures are recorded when liabilities are incurred and revenues are recorded when received in cash, except for material and/or available revenues, which should be accrued to reflect properly the revenue earned.

The modified accrual basis of accounting is recommended by the National Committee on Governmental Accounting to be used for all funds established or based upon the general governmental concept or approach, which would normally include the general, special revenue, and debt service funds.

The accrual basis of accounting is recommended to be used in all enterprise funds used to account for governmental transactions closely akin to commercial organizations. The accrual basis is also recommended to be used in capital projects, intra-governmental service, special assessment, and trust funds.

The cash basis of accounting, as such, is not recommended by the National Committee for use in any governmental unit, although its use is frequently encountered.

Reporting insurance premium taxes as revenues when collected (cash basis) rather than when the State is entitled to the taxes (accrual basis) is cited as an example of reporting information that could be misleading to the reader of the State's financial statements. Insurance premium taxes for the year ended June 30, 1967 were understated by approximately \$250,000 because taxes due to the State were not reflected in its financial statements.

The laws governing the State's accounting system have been on the statute books for a great many years, while the whole

field of governmental accounting, finance, and fiscal control has achieved marked improvements within comparatively recent years. Coordination between sound fiscal aims and statutory provisions can only be accomplished by changing the latter.

We recommend that consideration be given to requesting the Legislature to change the law pertaining to the State's accounting system by adopting the accrual method of accounting.

PENALTIES

Each financial institution under the regulations of the Bank Examination Division is required to submit semi-annual financial statements to the Division. Regulations require that this report must be submitted by January 30 or July 30 of each year, or a penalty of \$10 a day should be assessed. We noted that certain reports are submitted fifteen to thirty days after the deadline without the assessment of penalties. We also noted a few cases in the Business Registration Division where penalties apparently should have been assessed in connection with the collection of foreign licenses and corporate exhibit fees.

We did not attempt to determine the dollar amounts of penalties not assessed because the time required could not be justified.

We recommend that the Director of the Department institute procedures to insure collection of all penalties in accordance with the Regulations.

BANK EXAMINATIONS

Under the Revised Laws of Hawaii 1955, Chapter 135-3, the Bank Examination Division is required to audit every banking

and related institution doing business in the State each calendar year unless otherwise provided by law. We observed that the Bank Examination Division is not auditing all financial institutions each year; some institutions are audited every other year.

We suggest that the Director consider requesting either changing the law or increasing the number of bank examiners.

BANK EXAMINERS' CHARGE OUT RATES

Fees charged to institutions audited by the bank examiners are not sufficient to recover the cost of examiners' time spent on the audit. On an overall basis, the rates per service hour are approximately 62¢ an hour less than the amount necessary to recover the cost of examiners' salaries during the course of an examination. (Computed by converting the bank examiners' salaries into average hourly rates.)

We recommend that bank examiners' service rates be reviewed annually and set at rates which would recover the pro rata share of examiners' salaries.

OTHER MATTERS

Accounting Treatment of Insurance Company Examinations

Revenues from insurance examination fees are not recorded on a consistent basis. Advances on examination fees received from insurance companies are usually treated as a recovery of expenses, whereas their final payments are treated as revenues. This inconsistent treatment results in misleading financial information being reported for insurance examinations.

We recommend that insurance examination fees be consistently recorded as revenues.

License Renewal Cards

Personnel in the Professional and Vocational Licensing Division assigned to specific Boards and Commissions keep a current supply of blank renewal cards in their desks. The blank renewal cards are not prenumbered and may be taken by others and put to unauthorized use.

We suggest that blank renewal cards be prenumbered and all cards be accounted for. These cards should also be kept in locked cabinets and drawers.

CONCLUSION

Internal control is a basic device available to the chief administrative officer of the Department for discharging his responsibilities. We believe that the development of an operating manual, an integral part of internal control, will be of great benefit to the Department and the State of Hawaii.

Other major recommendations are summarized as follows:

- . Adopt the accrual method of accounting.
- . Improve control over mail receipts.
- . Enforce assessment of penalties.
- . Audit all financial institutions as required by law.
- . Adjust bank examiners' rates to recover costs.

We would be pleased to discuss the above comments with you in greater detail and answer any related questions that you may have. We are also available to assist you to whatever extent you may request in implementing any of our recommendations.

We thank you for the opportunity to serve you and we would also like to extend our appreciation to the personnel of the

Departments of Regulatory Agencies and Accounting and General
Services for their cooperation in our examination.

Yours truly,

Hackins & Sells

PART III

COMMENTS BY AFFECTED AGENCIES

**INDEX OF RECOMMENDATIONS
BY STATE AGENCIES AFFECTED
(Part II – Management Letter)**

Accounting and General Services 3, 7

Regulatory Agencies 4-5, 7-9

MEMORANDA OF COMMENTS OF AFFECTED AGENCIES

This financial audit report of the department of regulatory agencies was completed in December 1967 by the certified public accounting firm, Haskins & Sells, whose services were contracted by this office. On January 4, 1968, we distributed copies of the report to the following agencies affected by this report:

State department of regulatory agencies (Attachment No. 3)
State department of accounting and general services (Attachment No. 4).

A copy of the transmittal letter is attached as Attachment No. 2. Each agency was requested to submit its comments on the recommendations contained in the report, including information as to the specific action it has taken or intends to take with respect to the recommendations. Both of the above agencies submitted their responses (Attachment Nos. 3 and 4), wherein they have indicated general agreement with the recommendations and are implementing or will implement most of the changes recommended.

After receiving the replies from the agencies, we requested the contract auditor to submit his comments on the agencies' responses. The contract auditor had no comment to make on the agencies' replies (see Attachment No. 1).

Our comments below are limited to the ones made by the department of regulatory agencies. *First*, with respect to the matters regarding the cash receipt tags and revenue recordkeeping, we understand that at the time the audit was being conducted, the deficiencies did exist. *Second*, with respect to the recommendation for a change from the cash to the accrual method of accounting, since such method has statewide implications, we reserve comment until we have had an opportunity to audit the statewide system of accounting. *Third*, with respect to the license renewal cards, we believe that the prenumbering and safekeeping of the cards are proper and practical safeguards against any unauthorized use of such cards.

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

FIRST NATIONAL BANK BUILDING
HONOLULU, HAWAII 96813
OTHER ISLAND OFFICES
HILO
LIHUE
KAHULUI

January 30, 1968

Mr. Clinton T. Tanimura, Auditor,
State of Hawaii,
Honolulu, Hawaii.

Dear Sir:

We acknowledge receipt of copies of letters from Mr. Edwin H. Honda, Director, Department of Regulatory Agencies, State of Hawaii, dated January 22, 1968; and from Mr. Kenam Kim, Comptroller, State of Hawaii, dated January 18, 1968, responding to certain comments contained in our management letter dated September 29, 1967 on our examination of the financial statements of the Department of Regulatory Agencies for the year ended June 30, 1967.

Yours very truly,

Haskins & Sells

Clinton T. Tanimura
Auditor

THE OFFICE OF THE AUDITOR

State of Hawaii

Iolani Palace

Honolulu, Hawaii 96813

January 4, 1968

Mr. Mike Tokunaga
Acting Director
Department of Regulatory Agencies
State of Hawaii
Honolulu, Hawaii

Dear Mr. Tokunaga:

Under a contract with this office, Haskins & Sells, certified public accountants, conducted an examination of the accounting records of your department for the fiscal year ended June 30, 1967. The examination was conducted pursuant to the duties and powers vested in our office by Article VI, Section 8, of the Constitution of the State of Hawaii, and Chapter 2, Part III, of the Revised Laws of Hawaii 1955, as amended. We are deeply thankful for the help and cooperation extended by your staff to our contract auditors.

Enclosed is a copy of the preliminary report of the audit. The report is presented in two parts—the first entitled *Accountants' Report*, and the second, *Management Letter*. The term, *preliminary*, indicates that the report has not been released for general distribution. However, copies of this report have been submitted to the Governor, the Speaker of the State House of Representatives, the President of the State Senate, and all State and local agencies directly affected by the examination.

The report contains a number of recommendations, some of which apply to your department. I would appreciate receiving your written comments on those recommendations which are directed to your department, including information as to the specific actions you have taken or intend to take with respect to each of them. Your comments must be in our hands by January 19, 1968. The report will be finalized and released shortly thereafter.

If you wish to discuss the report with us, we will be pleased to meet with you on or before January 12, 1968. We await a call from your office to fix the appointment. A *no call* will be assumed to mean that a meeting is not required.

Yours truly,



Clinton T. Tanimura
Legislative Auditor

Encl.

cc: Governor John A. Burns
Haskins & Sells



JOHN A. BURNS
GOVERNOR

OFFICE OF THE AUDITOR
THIS DOCUMENT IS UNCLASSIFIED

Edwin H. Honda
~~EDWIN H. HONDA~~
DIRECTOR
BANK EXAMINER
COMMISSIONER OF SECURITIES
FIRE MARSHAL
INSURANCE COMMISSIONER

State of Hawaii
OFFICE OF THE DIRECTOR
Department of Regulatory Agencies
424 S. Beretania St.
P. O. Box 541
Honolulu, Hawaii 96809
January 22, 1968

Mr. Clinton T. Tanimura, Auditor
Office of the Auditor
Iolani Palace
Honolulu, Hawaii

Dear Mr. Tanimura:

Subject: Comments on Recommendations Contained in Preliminary Report of Accounting Records of the Department of Regulatory Agencies, Pursuant to Examination Made by Haskins and Sells, CPA Firm.

Thank you for your letter of January 4, 1968, wherein you invited written comments on each recommendation made by the firm of Haskins & Sells and what we intend to do about it. Our comments follow in the sequence presented in the report.

OPERATING MANUAL Page 2 - 3

As to the recommendation that an operating manual be prepared delineating the responsibilities and functions of various personnel, describing accounting policies and procedures and the like, is being developed; this particular matter has been under extensive review. This Department, in cooperation with the Systems Branch of the Department of Accounting & General Services, has, during the past year done extensive work on this matter. This Department has assisted the Department of Accounting & General Services in finalizing a completely new accounting and business procedure for the State Government. We are advised by the Comptroller that the Department of Accounting & General Services has completed a preliminary report on a proposed new system which hopefully, will be put into effect some time before the end of the next fiscal year (1968-69). Since this procedure covers all accounting phases throughout the State Government, it has taken quite a while to develop. In addition to the efforts of the Department of Accounting & General Services, the Administrative Services Office of the Department of Regulatory Agencies is currently developing a revised organizational structure, which will include a functional statement and will provide for distribution of work responsibilities of fiscal and staff personnel.

MAIL RECEIPTS Page 4

The recommendation that mail receipts be directed to the cashier for immediate recording and depositing is under serious consideration for possible implementation.

However, due to the huge volume of transactions, combined with the large variety of sources from which monies are received, we need to and are studying the development of a suitable method for proper control of mail receipts. Also, with reference to the criticism about unauthorized return of checks to senders, this Department will no longer allow this to occur without endorsement by a duly authorized officer.

OTHER MATTERS PERTAINING TO INTERNAL CONTROL

Cash Receipts Page 4

The recommendation concerning cash receipt tags of the cashier being audited by an account clerk to reconcile the collections and numerical sequence of cash tags has already been in effect for some time. Whenever the numerical sequence of cash tags or the sequence of numbers by the validating machine differs from the proper sequence, the account clerk investigates the discrepancy.

Agreement of Divisional Records and Revenue Reports Page 4 - 5

We believe that we do have an adequate system enabling the divisions to ascertain whether their particular revenues have been properly recorded by the fiscal staff through the monthly revenue statement issued and distributed by the fiscal office.

COMMENTS RELATING TO OTHER MATTERS

DEFICIENCIES OF ACCOUNTING SYSTEM Page 5 - 7

We believe that the accrual system recommended for use in accounting for governmental transactions is impractical. It is our conviction that where collections are involved, a cash accounting basis offers a more accurate and truer picture of the financial situation than would the use of the accrual basis. Furthermore, employing the accrual basis would require numerous minor changes which will not significantly change the financial picture, but which will nevertheless require a considerable amount of manpower time expended. We feel that further study and consideration should be made before accepting the recommendation calling for the Legislature to change the law pertaining to the accrual method of revenue accounting.

Please be informed that positive steps have been taken to prevent occurrence of the kind of "understating" of revenues as noted by the auditor's reference to reporting of all insurance premium taxes payable during a current fiscal year period but in one instance a \$250,000 payment was received in the next fiscal year. This Department recommended and the Legislature, in 1967, acted to alleviate this problem by changing the tax due date from June 30, to March 15. By this simple amendment, the problem of "carrying out" payment has been cured.

PENALTIES Page 7

The Bank Examination and Business Registration divisions have been directed to collect all penalties as prescribed by law and steps are being taken to insure that such collections may be verified by accounting personnel in this Department.

BANK EXAMINATIONS Page 7 - 8

We believe that the law requiring the Bank Examination Division audit all financial institutions once in each calendar year provides sufficient latitude for compliance with the requirements.

In the past, we were unable to comply fully with the requirement that all institutions be audited once each calendar year because of staff turnover and the extended illness of two former employees. However, during the past year, as new staff members became better oriented and new systems were implemented, we were able to audit all except 12 of the financial institutions which we were required to audit.

BANK EXAMINERS' CHARGE OUT RATES Page 8

The recommendation concerning fees charged to institutions audited by the bank examiners should be sufficient to recover the cost of examiners' time spent on such audits. Initially, the examination fees were based on the average cost per hour for each class of examiner and his respective salary range. This was generally established under authority of Act 32, SLH 1964 and was done to avoid cumbersome administrative computations. However, since the adoption of this regulation, we have made the same observation noted in the report of Haskins & Sells. This fee schedule will be thoroughly evaluated for reconsideration and determination by the new Director of Regulatory Agencies.

OTHER MATTERSAccounting Treatment of Insurance Company Examination Page 8

We agree that present methods of recording "revenues" from the fees charged for examination of insurance company seem to appear as misleading financial information and that the auditors believe there was inconsistency. Such is not the case. The procedure for recording such monies are proper as said monies are deposited in advance for examination services not yet collected. Thus it should not be recorded as a revenue or government realization until the actual examination service has been performed.

The net amount after recovery of expenses for our Contract Examiner is then a full government realization and can then be treated as a revenue for the cost of travel monies advanced by general appropriation and the services of our staff examiner, whose salary is included in the appropriation.

LICENSE RENEWAL CARDS Page 9

The recommendation to prenumber blank renewal cards for accountability appears ideal in theory. However, it may not be practical because thousands of cards are pre-run through the automatic feeder of our addressograph machine at the time of annual renewal.

We would add to our workload if all cards were prenumbered since a great number are destroyed during pre-run of such cards. Also, the cards have to

Mr. Clinton T. Tanimura

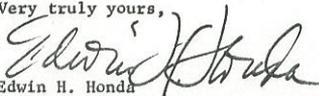
- 4 -

January 22, 1968

be reissued because of changes to names, addresses, forfeitures, etc. We believe a simple method of control may be installed that no license card is official unless a cashiers' validation appears on the face thereof.

Thank you for your observations and suggestions. We will effectuate your recommendations which we find feasible.

Very truly yours,



Edwin H. Honda
Director of Regulatory Agencies

JOHN A. BURNS
GOVERNOR



KENAM KIM
COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES
HONOLULU, HAWAII 96810

January 18, 1968

RECEIVED
JAN 19 1968
OFFICE OF THE AUDITOR
TIME

Mr. Clinton Tanimura
Legislative Auditor
The Office of the Auditor
State of Hawaii
Honolulu, Hawaii

Dear Mr. Tanimura:

We appreciate the opportunity to review and comment on the following audit reports:

Department of Regulatory Agencies
Department of Planning and Economic Development
Department of Health.

We list our comments on recommendations directed to the Department of Accounting and General Services:

Audit Recommendations

Our Comments

Department of Regulatory Agencies

- | | |
|--|--|
| <p>1. Prepare an operating manual, possibly by the State systems accounting personnel, to avoid confusion within the department and to prevent variations in accounting methods.</p> | <p>Each department should prepare its own operating manual. When the State-wide uniform accounting system is fully developed and implemented, it should be incorporated into the operating manual.</p> |
| <p>2. Consider legislation to adopt the accrual method of accounting.</p> | <p>This matter is under consideration in our present accounting system study.</p> |

Department of Planning and Economic Development

- | | |
|--|--|
| <p>1. Failure to provide a procedural manual resulted in inadequate reports to program managers.</p> | <p>Each department should prepare its own operating or procedural manual and incorporate applicable sections of the Statewide accounting system being developed.</p> |
| <p>2. Review the present method for the accounting of property and equipment.</p> | <p>This matter is under consideration in the Statewide accounting system study.</p> |

January 18, 1968

Audit Recommendations

Our Comments

Department of Health

1. Prepare accounting manual and convert from the cash to the accrual basis of accounting.
2. Eliminate duplicate recordkeeping between the Department of Health and the Department of Accounting and General Services.
3. Provide necessary format and guidance for preparing reports to the State Comptroller in accordance with the requirement of Section 34-15 R.L.H. 1955.
4. Representatives of the Director of Budget and Finance, the State Comptroller, and Director of Health jointly review the necessity for maintaining certain Special Funds.

An accounting manual will be prepared in connection with the present accounting system study. A procedural or operating manual should be prepared by the department.

This matter will be reviewed in our study of the Statewide accounting system.

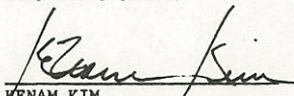
We plan to handle this matter on an individual basis. The funds mentioned in this report will be reviewed within this fiscal year and appropriate recommendations will be made to the department.

We will be glad to participate in this matter. We will contact the other departments involved for the review and make adjustments where necessary.

Other findings and recommendations relating to fiscal and internal control matters will be reviewed at our next audit of the departments involved to determine the adequacy of the action taken by the respective departments.

If you have any questions regarding our comments, please call us.

Very truly yours,



KENAM KIM
STATE COMPTROLLER