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AUDIT REPORT NO. 68-4
FEBRUARY 1968

**FINANCIAL AUDIT
OF THE DEPARTMENT
OF HAWAIIAN
HOME LANDS**

FOR THE FISCAL YEAR ENDED JUNE 30, 1967

A REPORT TO THE GOVERNOR AND THE
LEGISLATURE OF THE STATE OF HAWAII



SUBMITTED BY THE LEGISLATIVE AUDITOR OF THE STATE OF HAWAII

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 are 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 his examinations provides the basis for placing reliance on his findings and recommendations.



LEGISLATIVE AUDITOR
IOLANI PALACE
HONOLULU, HAWAII 96813

FOREWORD

This financial audit report is the result of our examination of the financial books and accounts of the department of Hawaiian home lands and the transactions noted therein for the fiscal year ended June 30, 1967.

The audit was conducted to determine the legality of the department's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the department's controls to safeguard its assets against loss, waste, fraud and extravagance.

The format of this audit report departs from that usually employed by the accounting profession. Rather than simply displaying the financial statements as is usually done in an audit report, this report attempts to describe and explain the financial system, its statements and accounts, and the significant transactions noted therein. In this way, we have tried to make the report meaningful, not only to the department's management, but also to those who have little or no prior acquaintance with the operations of the department.

In the overall, the audit conclusion is that the financial operation of the department of Hawaiian home lands is being administered properly and adequately. However, we have made several recommendations in this report which we believe will further strengthen the financial administration of the department. The department's response to our recommendations is shown in Part IV of this report as *Memorandum of Comments*.

We wish to express our deep appreciation to Mr. Abraham Piianaia, Chairman of the Hawaiian Homes Commission, Department of Hawaiian Home Lands, and the members of his staff for their very fine assistance and cooperation.

Clinton T. Tanimura
Legislative Auditor

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PART I. INTRODUCTION AND SOME BACKGROUND

Chapter 1

INTRODUCTION

This is a report on our post-audit of the transactions, books and accounts of the department of Hawaiian home lands. The audit was conducted pursuant to section 32, chapter 2, Revised Laws of Hawaii 1955, as amended, which requires the office of the auditor to conduct post-audits of all transactions and of all books and accounts kept by State departments.

Purpose of Audit

The purpose of our audit was to examine the legality of the department's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the department's controls to safeguard its assets against loss, waste, fraud and extravagance.

Scope of Audit

This audit examined the department's financial records for, and the transactions had during the fiscal year July 1, 1966 to June 30, 1967. Our examination was made in accordance with generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants and as set forth in the *Manual of Guides of the Office of the Legislative Auditor*. It included tests of the

accounting records and the use of such auditing procedures as we considered necessary.

Organization of the Report

This report is organized into three parts. Part I consists of this introduction (chapter 1) and some background on the Hawaiian homes program (chapter 2).

Part II (chapters 3 through 13) contains our opinions, findings and recommendations regarding the department's system of internal control, its financial statements, and its transactions.

Part III contains a summary of our findings and recommendations.

Definition of Terms

There are certain accounting terms which are used throughout this report. The terms and their definitions are as follows:

Balance sheet means a statement or summary balances of the assets and equities of a department as of the closing of the department's books of account kept according to principles of accounting.

Cash flow means the flow of money, both revenues and expenditures, during a given period.

Statement of changes in cash balance means a statement showing the cash flow in a fiscal year.

Exception means the auditor's disagreement with an entry, item, or figure contained in a financial statement.

Chapter 2

SOME BACKGROUND

The department of Hawaiian home lands is responsible for the administration of the Hawaiian homes commission act, 1920, enacted by the Congress of the United States. The department is headed by a commission consisting of seven members, four from the city and county of Honolulu and one each from the counties of Hawaii, Maui, and Kauai. The members of the commission, which includes a full-time chairman, are appointed by the governor, with the consent of the senate.

Purpose of the Act

The purpose of the act is not specifically stated in the act itself. However, according to the attorney general's opinion letter, dated November 13, 1951, the purpose of the act is to:

... save the native Hawaiian race from extinction by reason of its inability to meet successfully the economic and sociologic changes brought about in the islands by reason of the influx of white and asiatic races Hawaiians would be removed from the slums, be given land to work, and be taught to successfully live in the new cosmopolitan society

In essence, the goal of the act is to rehabilitate the Hawaiian people.

The Hawaiian Homes Programs

There are two programs to achieve the act's goal: homesteading and education.

1. **Homesteading program.** The homesteading program involves (a) the development and leasing to Hawaiians of available lands for farming, ranching, and residential purposes; (b) the lending of money at low interest rates to Hawaiians for the purchase or construction of homes, for making improvements or additions to existing homes, and for ranching and farming purposes; (c) the construction, reconstruction and maintenance of revenue producing improvements; and (d) the providing of supplies and services to Hawaiian home land lessees on a charge basis.

To carry out this program, the Hawaiian homes commission has under its management some 186.7 thousand acres of land, located on the islands of Oahu, Hawaii, Molokai, Maui and Kauai. Of this amount, 24% is currently being used by the commission in its program; 56% is leased to others (such as the sugar plantations); 9% is presently idle; and 11% is set aside by executive order for use chiefly as forest reserves.¹

The homesteading program is financed by the following funds.²

¹Horwitz, Robert H. and Finn, Judith B., *Public Land Policy in Hawaii: Major Landowners*, Legislative Reference Bureau Report No. 3, 1967.

²All of the funds, except those described in footnotes 3, 4, 5, and 6, were incorporated in the Hawaiian homes commission act, 1920, by the Congress of the United States and were parts of the act on the date of Hawaii's admission into

<i>Fund</i>	<i>Use</i>		
Hawaiian home-development fund and Additional receipts-development fund portion ³	To develop Hawaiian home lands for leasing to Hawaiians for ranching, farming and residential purposes.	Additional receipts-loan fund portion ³	To make loans to Hawaiians for the purpose of purchasing, erecting or improving homes on either Hawaiian home lands or on non-Hawaiian home lands.
Hawaiian home-loan fund	To make loans to Hawaiians for the purpose of constructing and making additions to homes and operating farms and ranches on Hawaiian home lands.	Anahola-Kekaha loan fund ⁴	To make loans to Hawaiians for the purpose of constructing homes on Hawaiian home lands at Anahola and Kekaha, Kauai.
		Hawaiian farm loan fund ⁵	To make loans to Hawaiians for the purpose of ranching and farming on Hawaiian home lands.
		Operating fund	To construct, reconstruct, and maintain revenue-producing improvements; to provide supplies and services to Hawaiian home land lessees on a charge basis.

the Union. The funds described in footnotes 3, 4, 5, and 6, were added to the act by the Hawaii legislature subsequent to statehood. Article XI of the Constitution of the State of Hawaii (as amended) provides:

As a compact with the United States relating to the management and disposition of the Hawaiian home lands, the Hawaiian Homes Commission Act, 1920, as amended, shall be adopted as a provision of the Constitution of said State, as provided in section 7, subsection (b) of [Public Law 86-3, 86th Congress], subject to amendment or repeal only with the consent of the United States, and in no other manner. Provided, That (1) . . . provisions relating to the powers and duties of officers other than those charged with the administration of said [Public Law], may be amended in the constitution, or in the manner required for State legislation, but the Hawaiian home-loan fund, the Hawaiian home-operating fund, and the Hawaiian home-development fund shall not be reduced or impaired by any such amendment, . . . ; (2) that any amendment to increase the benefits to lessees of Hawaiian home lands may be made in the constitution, or in the manner required for State legislation,

³This is a revolving account established pursuant to Act 4, SLH 1965.

2. Education program. This program seeks to improve the educational opportunities for children of Hawaiian home land lessees. It is financed by a fund called *additional receipts-development fund portion for educational projects*.⁶ Money may be withdrawn from

⁴See Act 201, SLH 1963; Act 52, SLH 1964; Act 195, SLH 1965.

⁵This fund was created by Act 238, SLH 1965.

⁶Act 4, SLH 1965, provides that 85% of the money in *additional receipts-development fund portion* shall be segregated into a special account and be used for this educational purpose.

the fund from time to time by the department of education, with the prior written approval of the governor, for such educational projects as are developed and directed by the department of education upon consultation with the university of Hawaii and the department of Hawaiian home lands. The funds are primarily for use at the pre-school and elementary grade levels.

Administration

The day-to-day operations of the Hawaiian homes commission is administered by the commission chairman and some 25 employees. The expenses for administration are paid out of the account known as the *administration account*.

**PART II. FINDINGS AND RECOMMENDATIONS ON INTERNAL CONTROL,
FUND MANAGEMENT AND OPERATIONS; AND OPINION ON FINANCIAL STATEMENTS**

Chapter 3

INTERNAL CONTROL

This chapter contains our findings and recommendations regarding the department's internal control system in general. Our findings and recommendations with respect to specific transactions, statements and funds are noted in the subsequent chapters.

The term, *system of internal control*, means the plan of organization and methods and measures adopted within a department to insure the accuracy and reliability of accounting data, to promote operational efficiency, and to assure adherence to prescribed laws, policies, and rules and regulations of the department and the State of Hawaii. A sound system of internal control includes two basic elements: (1) the adoption of procedures requiring prior authorization for expenditures, prompt collection of revenues, accurate and timely recording of transactions and control of assets and liabilities; and (2) the assignment of duties in such manner that no one individual controls all phases of a transaction without a cross check by some other individual.

Reconciliation of Cash Account Balances

The various funds of the department of Hawaiian home lands are maintained by the

State treasury. Thus, all revenues collected by the commission are deposited in the State treasury. All expenditures of the commission are by checks drawn by the State comptroller.

Both the department of Hawaiian home lands and the department of accounting and general services maintain records of revenues into and expenditures from the various funds. However, for more than a year, the records of the two departments have not been reconciled. Our examination of the funds revealed the following fund balance discrepancies in the records of the two departments as of June 30, 1967 :

	<i>Cash Balances</i>		<i>Haw'n.</i>
	<i>Haw'n.</i>	<i>DAGS'</i>	<i>Homes</i>
	<i>Records</i>	<i>Records</i>	<i>Over</i>
			<i>(Under)</i>
Hawaiian Home-Loan Fund	\$304,798	\$304,924	\$ [126]
Hawaiian Home-Development Fund	201,991	199,484	2,507
Operating Fund	383,573	385,053	[1,470]
Net Overage			<u>\$ 911</u>

There is need for both the department of Hawaiian home lands and the department of accounting and general services to maintain records of the funds—the former because it requires record-keeping to maintain control over its day-to-day operations, and the latter because it is the official agency charged with the records of the State as a whole. The records of one department act as a check against the records of the other department. Such checks are meaningful, however, only if the records of the two departments are reconciled at frequent intervals. More frequent the checks, the sooner will discrepancies, if any, become evident and more easily the causes of the discrepancies traced.

We recommend that a reasonable attempt be made to ascertain the cause of the discrepancies which exist as of June 30, 1967, in the records of the department of Hawaiian home lands and the department of accounting and general services. We are mindful that such an attempt may involve the tracing of prior years' transactions, since the accounts have not been reconciled for over a year. We further recommend that hereafter the cash account records of the department of Hawaiian home lands be reconciled on a monthly or at least quarterly basis with those of the department of accounting and general services, and any differences be promptly investigated.

Count of Petty Cash and Cash Receipts

Petty cash funds are maintained and cash collections are made at the main office in Honolulu and at the branch offices on the

neighbor islands. A sound system of internal control requires that a responsible employee, other than the person or persons handling cash or accounts receivable, make periodic, unannounced cash counts of the petty cash and cash collections to determine whether all cash is properly accounted for. Internal control also requires that periodic, unannounced checks of all prenumbered cash receipt slips be made to insure that all such slips are being used for proper purposes. Such periodic, unannounced cash counts and checks of prenumbered cash slips are not being made at the neighbor island branch offices.

We recommend that periodic, unannounced cash counts of cash and cash collections and checks of prenumbered cash receipt slips be made at all neighbor island branch offices. Due to the limited personnel at these neighbor island offices, we recommend that such cash counts and checks be made by someone from the commission's main office. Trips to the neighbor islands for purposes of making cash counts and checks can be combined with other departmental businesses, provided that the counts and checks contain the element of "surprise."

Financial Reports

Financial reports on all funds are made and submitted monthly to the chairman of the commission and the commission members. We note, however, that the financial reports on the administration account and the operating fund reveal only the receipts and expenditures of the account and fund for the month for which the reports are prepared.

It appears that the monthly financial report on these funds would perhaps be more meaningful and useful to the commission members if they contain additional information, as follows:

1. **Operating fund.** Generally, non-lease revenues are deposited into the operating fund and the money is used for the construction, reconstruction, and maintenance of revenue producing improvements, such as the Molokai water system. The inclusion in the monthly report of the cumulative total receipts and expenditures from the beginning of the fiscal year to the current reporting date will provide the commission with information as to the total balance in the fund available for use.

2. **Administration account.** Generally, income from leases is deposited into the administration account. Expenditures include the payment of all administration expenses and the transfer of all amounts in excess of the amount needed to pay for administration expenses for the fiscal year into the Hawaiian home development fund. Administration expenses are limited by the annual appropriation amount approved by the legislature and included in the annual appropriations act. Transfer of the excess to the Hawaiian home-development fund is required to be made as soon as the receipts of the fund equal the amount of the appropriations approved by the legislature. It will be useful to the commission, if the monthly financial report includes (a) cumulative totals, from the beginning of the fiscal year to the current reporting date,

of all receipts and all transfers to the development fund and (b) cumulative totals for the fiscal year of all expenditures made on account of administration, shown together with the commission's budget for the year. Such information will enable the commission to insure that all excess funds are being expeditiously and properly transferred to the Hawaiian homes development fund and to ascertain whether or not the department is closely adhering to its budget for the year, and, if not, the reasons therefor.

Chapter 4

HAWAIIAN HOME-LOAN FUND

The Hawaiian home-loan fund is a revolving fund, used principally to make loans to lessees of Hawaiian home lands for the construction of dwellings and improvements and for the development and operation of farms and ranches on the leased lands. Section 213(b) of the Hawaiian homes commission act provides that 30% of the receipts derived from the leasing of cultivated sugar-cane lands or from water licenses shall be deposited into this fund until the aggregate received equals \$5,000,000. (The \$5,000,000 aggregate was reached in January 1964.) Section 213(b) further provides that 25% of the moneys deposited into the home-loan fund annually shall be transferred to the Hawaiian home-development fund. The home-loan fund is

replenished by covering into it the installments of principal paid by lessees upon loans made to them from the fund.

The maximum amount which may be loaned to a lessee is \$10,000 for residential construction and improvement and \$15,000 for farming and ranching purposes. The maximum term of any loan is 30 years, and all

loans bear interest at the rate of 2-1/2% per annum on the unpaid principal.

Balance Sheet as of June 30, 1967

The balance sheet of the loan fund as of June 30, 1967 is shown in Table I. A detailed discussion of the items noted in the balance sheet follows the table.

TABLE I. BALANCE SHEET
Hawaiian Home-Loan Fund
June 30, 1967

Assets		
Cash in State treasury (See Table II):		
Unrestricted	\$ 77,367	
Restricted	<u>77,430</u>	\$ 154,797
Investment in time certificate of deposit		150,000
Loans receivable:		
Oahu	1,893,062	
Hawaii	463,440	
Maui	429,117	
Molokai	327,267	
Kauai	<u>300,037</u>	3,412,923
Improvements purchased from homesteaders upon cancellation or surrender of lease		<u>32,097</u>
Total assets		<u>\$3,749,817</u>
Fund Balance		
Balance, July 1, 1966		\$3,751,456
Less write-off of uncollectible loan receivables		<u>1,639</u>
Balance, June 30, 1967		<u>\$3,749,817</u>

Cash in State Treasury

1. Cash flow. The balance sheet (Table I) shows \$154,797 as the total loan fund cash

balance as of June 30, 1967. This sum represents the cash flow for the fiscal year, the details of which are shown in Table II.

TABLE II. STATEMENT OF CHANGES IN CASH BALANCES

Hawaiian Home-Loan Fund
Year Ended June 30, 1967

	Unrestricted	Cash Restricted
Balance, July 1, 1966	\$111,483	\$360,931
Add [deduct]:		
Restriction of cash for:		
Loan commitments to homesteaders	[493,194]	493,194
Allotment for repairs to improvements purchased	[6,115]	6,115
Disbursement of loans to homesteaders		[682,810]
Repayments of principal on loans	418,075	
Investment in time certificate of deposit	[200,000]	[500,000]
Expiration of time certificate of deposit	245,000	400,000
Advances to homesteaders for insurance premiums	[15,632]	
Repayments by homesteaders for advances on insurance premiums	18,362	
Net refunds and adjustments	[612]	
Balance, June 30, 1967	<u>\$ 77,367</u>	<u>\$ 77,430</u>

2. **Restricted cash.** Included in the total cash balance of \$154,797, is a *restricted* amount of \$77,430. Cash is *restricted* whenever a loan is approved by the commission. There is often a time lapse between approval of the loan and disbursement of the loan amount. For example, it is only after approval of his loan application that a lessee is able to begin construction of his home, and the loan amount is disbursed by the department as construction progresses. Thus, the term *restricted* means ear-marked or committed for disbursement on loans approved by the commission.

A review of the \$77,430 revealed that approximately \$34,000 had been restricted for more than a year. Among the reasons for non-disbursement of this sum are (a) one or more lessees were unable, for one reason or another, to proceed with the construction of their dwellings or to use the loan and (b) the actual cost of construction of a dwelling was less than the loan amount, leaving an unrequired loan balance. It appears that cash is being restricted when it is quite clear that the amount would not be required. A continued restriction of such sum lessens the amount of money available for new loans.

We recommend that the restricted cash amounts be reviewed monthly for any unrequired loan commitments and that all unrequired amounts be transferred as quickly as possible to the unrestricted category.

Investments in Time Certificates of Deposit

The balance sheet (Table I) shows that as of June 30, 1967, \$150,000 was invested in

time certificates of deposit. As shown in Table II, during the fiscal year, \$200,000 of the unrestricted cash and \$500,000 of the restricted cash were invested in time certificates of deposit; and \$245,000 of the unrestricted and \$400,000 of the restricted amounts were withdrawn from time certificates of deposit and converted to cash.

It is the practice of the department to make short-term investments of cash in time certificates of deposit whenever any cash in any of the funds is not immediately needed for loans or projects. We find that this practice enables the department to generate revenue in the form of interests on cash which would otherwise remain temporarily unproductive.

It should be noted here that the interests received on investments in time certificates of deposit are not shown in the statement of changes in cash balances (Table II) as having been received. This is because the interests, when received, were deposited in the Hawaiian home-operating fund as required by section 213(d) of the Hawaiian homes commission act.¹

Loans Receivable

As shown on Table I, the amount of loans outstanding as of June 30, 1967 was \$3,412,923. Table I also shows a breakdown of this sum by islands.

The sum of \$3,412,923 represents 946 loans. A breakdown of this number of loans

¹See chapter 11, *infra*.

by islands is as follows. The number in () is the number of new loans made during fiscal year July 1, 1966 to June 30, 1967.

Island	Loan Amount Outstanding	Number of Loans Outstanding
Oahu	\$1,893,062	519 (84)
Hawaii	463,440	174 (11)
Molokai	327,267	135 (22)
Kauai	300,037	66 (1)
Maui	429,117	52 (1)
Total	<u>\$3,412,923</u>	<u>946 (119)</u>

In the course of our examination, we noted certain loan practices which we believe deserve some comment.

1. **Repair loans.** Among the 119 new loans made during the fiscal year are 38 loans for home repairs, totaling \$30,037. We are informed that the department has for many years loaned money from the home loan fund to lessees of Hawaiian home lands for repairs to their dwellings. Section 214 of the Hawaiian homes commission act provides that loans may be made from the home-loan fund for . . . *the erection of dwellings on any tract and the undertaking of other permanent improvements thereon; . . .*

The term, *permanent improvements*, is generally defined as valuable additions to property

or an amelioration in its condition, amounting to more than mere repairs. Permanent improvements are intended to add materially to the value of the property. The term, *repairs*, on the other hand, refers to the act or process of restoring property to good or sound condition or work done to property to keep it in good order.

The 38 loans made during the fiscal year for home repairs averaged less than \$1,000 per loan. The loans were used for the purpose of repairing roof, kitchen, bathroom, etc., and painting existing dwellings. In our opinion, these acts did not constitute *improvements* within the meaning of the Hawaiian homes commission act, but were merely acts to keep the dwellings in good or sound condition. In our view, *improvements* includes the construction of such items as an additional room, a patio, a retaining wall, etc.

Although it is our opinion that the department is not authorized to make loans for repairs, we recommend that the department request a legal opinion on this matter from the State attorney general.

2. **Delinquencies.** Included in the \$3,412,923 (total amount of loans outstanding as of June 30, 1967), is the sum of \$20,726, which represents the amounts which were delinquent on various loans for three or more months on June 30, 1967. The following is a summary of the delinquencies. Next to each dollar figure is noted, in parentheses, the number of loans the dollar figure includes.

Island	Months						Total
	3	4	5 - 8	9 - 12	12 and over		
Molokai	(5) \$ 595	(5) \$ 612	(3) \$ 603	(3) \$ 908	\$ -	(16) \$ 2,718	
Hawaii	(8) 809	(4) 640	(7) 2,040	(1) 283	(2) 701	(22) 4,473	
Kauai	(1) 165	(2) 280	(1) 182	-	-	(4) 627	
Oahu	(19) 2,745	(3) 586	(5) 2,765	(6) 2,509	(5) 3,598	(38) 12,203	
Maui	(5) 705	-	-	-	-	(5) 705	
	<u>(38) \$5,019</u>	<u>(14) \$2,118</u>	<u>(16) \$5,590</u>	<u>(10) \$3,700</u>	<u>(7) \$4,299</u>	<u>(85) \$20,726</u>	

We noted in our examination that the above accounts were delinquent for four to five months before citations were issued to the delinquent homesteaders to appear before the commission. The department's practice has been to send four to five monthly, warning letters before issuing a citation.

We recommend that the department tighten its delinquency policy by shortening the period for the issuance of citations to not more than 90 days. Such tightening of policy is needed if the number, amount, and age of delinquent receivables are to be kept to a minimum. By minimizing delinquencies, there will be a corresponding increase in the turnover of funds, which means that more loans will be available to other native Hawaiians. Further, a delinquent homesteader will find it easier to settle a two or three month, rather than a four or five month, delinquent account.

3. **Write-off of uncollectible loans.** The balance sheet (Table I) notes that the department had, as of June 30, 1967, written off as uncollectible, \$1,639 in loan receivables.

4. **Interests on loans.** The statement of changes in cash balances (Table II) shows receipt of principal on loans of \$418,075. However, no interest is shown as having been received. This is because all interests received on loans are required by section 213(f) of the Hawaiian homes commission act to be deposited into the Hawaiian home-operating fund.²

Improvements Purchased

The item *improvements purchased*—\$32,097, noted on the balance sheet (Table I), represents the purchases made by the Hawaiian homes commission of dwellings and other improvements placed upon Hawaiian home lands by lessees who died leaving no qualified heir or whose leases were cancelled or who surrendered their leases. Section 209 of the Hawaiian homes commission act provides as follows:

Upon the death of a lessee leaving no such relative qualified to be a lessee of

²See chapter 11, *infra*.

Hawaiian home lands, or the cancellation of a lease by the department, or the surrender of a lease by the lessee, the department shall appraise the value of all such improvements and growing crops and shall pay to the legal representative of the deceased lessee, or to the previous lessee, as the case may be, the value thereof, less any indebtedness to the department, or for taxes, or for any other indebtedness the payment of which has been assured by the department, from the deceased lessee or the previous lessee. Such payments shall be made out of the loan fund and shall be considered an advance therefrom reimbursable out of payments made by the successor or successors to the tract involved.

The following is a summary of the improvements purchased as of June 30, 1967.

	Lot Number	Date Purchased	Amount
Oahu:			
Nanakuli	147A	6/67	\$ 9,000
	188	5/66	500
Papakolea	49	8/65	1,887
Hawaii:			
Keaukaha	4A	12/64	5,850
	18	8/65	3,100
	29A	12/65	1,660
	194A	7/66	2,000
	251	6/65	4,050
	255	8/65	900
	345	7/65	3,150
			<u>\$32,097</u>

1. Reimbursement of purchase price. As provided in section 209, the amounts paid by the department for improvements on tracts, the leases to which have been terminated, are in the nature of *advances* reimbursable out of payments to be made by successor lessees. Accordingly, in August 1967, the \$9,000 advanced on account of the improvements on lot number 147A in Nanakuli was reimbursed when that tract was leased to a new lessee.

A review of the purchase dates of all other improvements noted in the summary above indicates that it is doubtful that the balance of \$23,097 (\$32,000 - \$9,000) can ever be recovered by the commission. Two factors contribute to our assessment. *First*, the remaining improvements are in run-down conditions, and the department has experienced difficulty finding lessees who will take the tracts involved together with the improvements. *Second*, it is the department's goal to eventually relocate all of the Keaukaha homesteaders to Waiakea; the encroachment of heavy industry into Keaukaha area and the increased jet traffic at the airport make Keaukaha undesirable for residential purposes.

For the reasons noted above, we take exception to the inclusion of \$23,097 as an asset of the home-loan fund. In our opinion, this sum is not recoverable.

2. Renting purchased improvements. The department is renting on a month-to-month basis some of the homes it purchased and for which it has not found successor lessees. In 1961, the State attorney general expressly ruled that the Hawaiian homes commission

act does not authorize the commission to grant a permit to any individual to occupy Hawaiian home premises on a monthly charge basis.³ Thus, although the department considered it prudent to earn revenues from the improvements which would otherwise remain unproductive, we find that such practice is in violation of the Hawaiian homes commission act. We recommend that this practice be discontinued.

3. **Disposition of rentals.** The rents collected from the rental of the improvements purchased by the department are being deposited into and credited to the home-loan fund. (This credit is reflected in Table II under *repayments of principal on loans.*) The department's justification for this practice is that the rentals reduce possible losses which the department may incur by reason of its inability to find lessees willing to reimburse the department for the purchase cost advanced.

We find that the deposit of the rentals into the home-loan fund is in violation of section 213(d) of the Hawaiian homes commission act. The section provides:

... All moneys received by the department from any other source, except moneys received from the Hawaiian Home Administration Account, shall be deposited in a revolving fund to be known as the Hawaiian Home-Operating Fund. . . . 4 (Emphasis added.)

³Attorney General's Opinion No. 61-64.

⁴Section 213(f) of the Hawaiian homes commission act provides that all moneys received from any leasing of lands shall first be credited to the Hawaiian homes-administration account, and then certain excess be transferred to the Hawaiian home-development fund. See chapter 12, *infra*.

As of June 30, 1967, the sum of \$1,665 in rentals had been deposited into the home-loan fund. We recommend that this amount and all subsequent collections of rentals be transferred to the operating fund.

Net Refunds and Adjustments

The statement of changes in cash balances (Table II) shows a net pay out of \$612 due to refunds and adjustments. *Net refunds and adjustments* reflects primarily refunds and adjustments in principal and insurance payments received. A detailed breakdown as to the nature of the refunds and adjustments was not readily available for our inspection. Thus, we are unable to comment on this item.

Loan Fund Balance

The balance sheet (Table I) shows a loan fund balance of \$3,749,817 as of June 30, 1967. We take exception to this figure. In our opinion, the fund balance is short by \$299,190. Our reasons follow.

1. **Erroneous transfer of \$118,190 to operating fund.** Section 213(f) of the Hawaiian homes commission act, as it now appears (and as it appeared at the time of Hawaii's admission into the Union), provides that 25% of the amount of moneys covered into the Hawaiian home-loan fund annually shall be transferred into the Hawaiian home-development fund. Thus, it would seem that of the \$5,000,000 aggregate total of sugar-cane land receipts deposited into the home-loan fund, \$1,250,000 should have been transferred to the development fund, leaving in the home-loan fund the sum of \$3,750,000.

In June 1965, the department found that the home-loan fund exceeded the \$3,750,000 by \$118,190. It assumed that the act requires that the home-loan fund should have no more than \$3,750,000. It further assumed that the \$118,190 represented interests and other receipts and had by mistake been deposited into the home-loan fund, when the act specifically requires that such receipts be deposited into the operating fund. Thus, the department transferred the \$118,190 to the operating fund.

Our examination revealed that both assumptions were incorrect. *First*, we found that the sum of \$118,190 did not, in fact, consist of interests or other receipts. All interests and other receipts had previously been properly deposited into the operating fund as required by the act. *Second*, there were periods in the history of the Hawaiian homes commission act when no transfers were required to be made from the home-loan fund to the development fund. The 25% transfer requirement, therefore, did not apply to the aggregate \$5,000,000. Our review of the records maintained by the department of Hawaiian home lands and the department of accounting and general services disclosed that in fact only \$947,202 in total was required to be transferred and was actually transferred to the development fund.

The loan fund balance as of June 30, 1967 is thus understated by \$118,190. We recommend that this sum be transferred back from the operating fund to the home-loan fund.

2. Shortage of \$181,000. During our examination, we noted a reconciliation of the loan

fund prepared by a former accountant which reflected a shortage in the loan fund of approximately \$181,000. Our inquiry into this matter and questioning of the department's personnel disclosed that this sum probably represents loan fund moneys used to pay for the department's administrative expenses in prior years (estimated to be prior to 1949). The use of loan fund moneys for such purposes is, of course, contrary to the provisions of the Hawaiian homes commission act. We were unable, however, to verify the cause of the shortage, since necessary records (records dating prior to 1955) are unavailable. These records have been disposed of in accordance with the State comptroller's *general records schedule*, which prescribes the destruction of old records.

Opinion on Financial Statements

Except as otherwise noted in this chapter, in our opinion the balance sheet (Table I) fairly presents the assets of the loan fund as of June 30, 1967, and the statement of changes in cash balances (Table II) fairly represents the cash flow for the fiscal period July 1, 1966 to June 30, 1967.

Chapter 5

ADDITIONAL RECEIPTS-LOAN FUND PORTION

Act 4, SLH 1965, established a special revolving account known as *additional receipts-loan fund portion*. The purpose of this account is to provide additional moneys (over and

above the amounts contained in the home-loan fund) for loans to native Hawaiians for the purchase, erection or improvement of dwellings.

Act 4 provides that the account is to be funded by depositing into an account called *additional receipts*, 30% of the State receipts derived from the leasing of cultivated sugarcane lands and from water licenses, until the aggregate amount of the moneys deposited into the account equals \$2,500,000. Eighty-five percent of the annual additional receipts is to be transferred to the Hawaiian home-development fund. (The amounts so transferred are called *additional receipts-development fund portion*. Fifteen percent of the annual additional receipts is to be retained in the account as *additional receipts-loan fund portion*.)

This additional receipts-loan fund portion account differs materially from the Hawaiian home-loan fund in several respects.

1. Moneys in the additional receipts-loan fund portion account are available for loans to purchase, erect or improve dwellings only; they are not available for use in ranching or farming operations as is the case with the home-loan fund.

2. Moneys in the additional receipts-loan fund portion account are available for loans both to Hawaiians who *are* lessees of Hawaiian home lands and to Hawaiians who *are not* lessees of Hawaiian home lands. Moneys in the home loan fund, on the other hand, must be used for dwellings and improvements on Hawaiian home lands.

3. The department may borrow money from private financial institutions and place the

borrowed money into the additional receipts-loan fund portion, or it may guarantee loans made by private financial institutions directly to Hawaiians. This is not possible with respect to the home-loan fund.

4. Not only the principal, but also the interest on loans made from the additional receipts-loan fund portion are to be covered into the additional receipts-loan fund portion account. In the case of the home-loan fund, interests from loans made from the fund are covered into the Hawaiian homes-operating fund.

5. Where the department borrows money from private financial institutions to deposit into the additional receipts-loan fund portion account, or where it guarantees loans made by private financial institutions directly to Hawaiians, the difference between the interest rates charged by the private financial institutions and the interest rates charged by the commission on loans made by it to Hawaiians (2-1/2%) is payable from the additional receipts-loan fund portion account.

6. The additional receipts-loan fund portion minus any amounts used to pay the difference in interest rates, necessary loan processing expenses, etc., is subject to repayment to the State general fund upon appropriate legislative action.

Balance Sheet

As of June 30, 1967, the amount in the additional receipts-loan fund portion account was \$114,700. The balance sheet of the account is shown in Table III.

TABLE III. BALANCE SHEET

Additional Receipts-Loan Fund Portion
June 30, 1967

Cash in State treasury

Balance, July 1, 1966 \$ 57,625

Add:

Thirty percent of State
receipts derived from
leasing cultivated sugar-
cane lands and water
licenses \$280,498

Appropriation from State
general fund, Act 8, section
2, SLH 1966 100,000 \$380,498

Deduct:

Investment in time certif-
icate of deposit 100,000

Eighty-five percent of annual
additional receipts transferred
to *additional receipts-*
development fund portion 323,423 423,423 [42,925]

Balance, June 30, 1967 14,700

Investment in time certificate
of deposit 100,000

Total assets and account balance \$114,700

Our findings and comments on the specific items noted in the balance sheet follow.

Balance, July 1, 1966

At the beginning of the fiscal year, there was a balance of \$57,625 in the additional receipts-loan fund portion account. This sum represents 15% of all moneys received by the account during fiscal year July 1, 1965 to June 30, 1966, including the sum of \$100,000 appropriated by the legislature to the account by Act 99, SLH 1965.

Additions to Account

During fiscal year July 1, 1966 to June 30, 1967, the total sum of \$380,498 was received as additional receipts. Thirty percent of the State receipts derived from the leasing of sugar-cane lands and water licenses accounted for \$280,498. An additional \$100,000 was appropriated by the legislature by Act 8, SLH 1966.

Deductions from Account

As required by Act 4, SLH 1965, \$323,423, being 85% of the total additional receipts, was transferred to the additional receipts-development fund portion. One hundred thousand dollars was invested in a time certificate of deposit. Thus, at the close of the fiscal year, there was \$14,700 in cash and \$100,000 in time certificate of deposit.

Agreement with Retirement System

As of June 30, 1967, no loan had been made from the additional receipts-loan fund portion account. However, in August 1966,

the department entered into a letter agreement with the employees' retirement system of the State of Hawaii for the purpose of borrowing funds from the system to be deposited into the additional receipts-loan fund portion account, as authorized by Act 4, SLH 1965.

Under the agreement, the department may borrow, within a period of two years from the date of the agreement, such sums of money as it may require in multiples of \$1,000. The aggregate total which the department may borrow is \$1,000,000. Each time a sum is borrowed, the department is to issue a promissory note, payable to the order of the retirement system. Each note is payable in equal monthly installments, the first installment being due and payable on the fifth anniversary after the issuance of the note. Interest at the rate of 5% per annum on the unpaid principal balance is payable semi-annually after the date of the note. The note is payable in full within 30 years after its issuance. Prepayment without penalty is authorized after the fifth anniversary of the note.

The agreement further provides that each note is to be secured by two-thirds of the additional receipts-loan fund portion for the next ensuing ten years from the date of issuance of the note, provided that the total security pledged shall not exceed 25% of the total amount borrowed and remaining outstanding at any time.

Based on its projection of the additional receipts-loan fund portion for the next ten years, the department felt during fiscal year 1966-1967, that the maximum amount it could borrow from the retirement system

would be \$375,000. This meant that to comply with the letter agreement, the department needed to have at least \$93,750 in the additional receipts-loan fund portion account which could be pledged. Accordingly, during fiscal year 1966-1967, the department chose not to make any loans from the fund until it had accumulated the sum of \$93,750.

As of the close of fiscal year 1966-1967, the fund had in fact accumulated \$114,700. We are informed that subsequent to June 30, 1967, the department has made some loans from this account, without resorting to borrowing under its agreement with the retirement system.

Opinion on Financial Statement

In our opinion, the balance sheet shown in Table III presents fairly the assets of the additional receipts-loan fund portion, as of June 30, 1967.

Chapter 6

ANAHOLA-KEKAHA LOAN FUND

The Anahola-Kekaha loan fund was established as a result of the provisions of the capital improvements appropriations acts of 1963, 1964 and 1965. The acts and the sources of funding authorized by the acts are as follows:

Act 201, SLH 1963		
Bond fund	\$58,775	
Special fund	<u>5,225</u>	\$ 64,000
Act 52, SLH 1964		
Bond fund		20,000
Act 195, SLH 1965		
General fund	32,000	
Special fund	<u>5,500</u>	<u>37,500</u>
		<u>\$121,500</u>

Each of the acts expressly provides that the appropriated amounts are to be expended by the department of Hawaiian home lands for the construction of new homes at Anahola and Kekaha, Kauai, including furniture and fixtures. The special fund referred to in the acts is the Hawaiian home-development fund, since the Hawaiian homes commission act does not permit the use of any of the special funds, except the development fund, for development purposes.

Initially, there was some confusion as to what the legislature intended when it passed the acts—whether the new homes constructed and the furniture and fixtures purchased should be sold, rented or given to eligible lessees. However, in 1965, with the approval of the governor, the department decided not to construct the new homes, but instead to use the appropriated amounts for loans to Kauai homesteaders who in turn would contract for the building of their homes. As a result of this decision, the revolving fund was created. Loans from this fund are made under the same terms and conditions as loans from the Hawaiian home-loan fund.

Balance Sheet

The balance sheet of this account, as of June 30, 1967, is shown in Table IV.

TABLE IV. BALANCE SHEET

**Anahola-Kekaha Loan Fund
June 30, 1967**

Cash in State treasury:		
Balance, July 1, 1966		\$ 62,150
Add:		
Repayment of principal on loans	\$ 2,761	
Refunds and adjustments	151	
	<u>2,912</u>	
Deduct loan disbursements	54,650	[51,738]
Balance, June 30, 1967		10,412
Loans Receivable		<u>111,088</u>
Total assets and fund balance		<u>\$121,500</u>

Loans Receivable

The only activity in this fund during the fiscal year consisted of loans made and repayments received. During the fiscal year, \$54,650 in new loans were disbursed. Net repayments on loans (after adjustments) was \$2,912. At the close of the fiscal year, outstanding loans totaled \$111,088. The \$111,088 represents loans to 12 homesteaders, nine of whom are lessees of Hawaiian home lands in Anahola and three in Kekaha. As in the case of the home-loan fund, interests on loans were deposited into the Hawaiian homes-operating fund.¹

Opinion on Financial Statement

In our opinion, the balance sheet (Table IV) presents fairly the assets of the Anahola-Kekaha loan fund of the department of Hawaiian home lands as of June 30, 1967.

Chapter 7

HAWAIIAN FARM LOAN FUND

The Hawaiian farm loan fund was created by Act 238, SLH 1965, to provide moneys for loans to Hawaiian home lands lessees engaged in farming and pastoral pursuits. The

terms and conditions of loans made from this fund are the same as those for loans from the Hawaiian home-loan fund. It differs from the Hawaiian home-loan fund in that the farm loan fund is only for farming and pastoral purposes, while the home-loan fund is for both residential and farming and ranching.

This account is funded by appropriations by the legislature. Act 238 appropriated an initial amount of \$100,000 from the State general fund.

Balance Sheet

The balance sheet of this farm loan fund as of June 30, 1967 is set forth in Table V.

¹See chapter 11, *infra*.

TABLE V. BALANCE SHEET

Hawaiian Farm Loan Fund
June 30, 1967

Assets

Cash in State treasury (See Table VI):

Unrestricted	\$ 9,903	
Restricted for loans authorized by the commission	<u>20,141</u>	\$ 30,044

Loans receivable:

Oahu	272	
Hawaii	46,061	
Molokai	19,884	
Kauai	<u>3,739</u>	69,956

Appropriation due from State general fund, Act 103, SLH 1967		<u>150,000</u>
Total assets		<u>\$250,000</u>

Fund Balance

Balance, July 1, 1966	\$ 100,000
Plus appropriation from State general fund, Act 103, SLH 1967	150,000
Balance, June 30, 1967	<u>\$250,000</u>

Cash in State Treasury

The balance sheet shows that on June 30, 1967, there was a cash balance of \$30,044, consisting of unrestricted amounts in the sum

of \$9,902 and restricted amounts in the sum of \$20,141. The cash flow during the fiscal year which resulted in this cash balance is shown in Table VI.

TABLE VI. STATEMENT OF CHANGES IN CASH BALANCES

**Hawaiian Farm Loan Fund
Year Ended June 30, 1967**

	Unrestricted	Cash Restricted
Balance, July 1, 1966	\$ 5,600	\$45,427
Add [deduct]:		
Restriction of cash for loan commitments to homesteaders	[13,005]	13,005
Disbursement of loans to homesteaders		[36,000]
Repayment of principal on loans	15,047	
Cancellation of unused loan commitments	2,291	[2,291]
Refunds and adjustments	<u>[30]</u>	<u> </u>
Balance, June 30, 1967	<u>\$ 9,903</u>	<u>\$20,141</u>

Loans Receivable

At the end of the fiscal year, loans outstanding was \$69,956. This sum represents 31 loans. A summary of the loans outstanding as of June 30, 1967, by islands, is noted below. The number in () is the number of new loans made during the fiscal year July 1, 1966 to June 30, 1967.

Island	Loan Amount Outstanding	Number of Loans Outstanding
Oahu	\$ 272	1 (1)
Hawaii	46,061	21 (2)
Molokai	19,884	6 (4)
Kauai	<u>3,739</u>	<u>3 (0)</u>
	<u>\$69,956</u>	<u>31 (7)</u>

As in the case of the home-loan fund, all interests received on loans from the farm loan fund were deposited into the Hawaiian homes-operating fund.¹

Appropriation Act 103, SLH 1967

The legislature appropriated an additional \$150,000 general fund money to the farm loan fund by Act 103, SLH 1967. Thus, the fund balance at June 30, 1967 was \$250,000. All of this amount is properly accounted for in the balance sheet.

Opinion on Financial Statements

In our opinion, the financial statements covering the Hawaiian farm loan fund of the

¹See chapter 11, *infra*.

department of Hawaiian home lands (Tables VI and VII) present fairly the assets of the fund as of June 30, 1967, and the results of the cash transactions during fiscal year July 1, 1966 to June 30, 1967.

Chapter 8

HAWAIIAN HOME DEVELOPMENT FUND

The Hawaiian home-development fund is used, with the prior written approval of the governor, for constructing sanitary sewerage facilities, for constructing roads through and over Hawaiian home lands, and for other nonrevenue producing improvements. Section 213(c) of the Hawaiian homes commission act provides that 25% of the amount of moneys deposited into the Hawaiian home-loan fund shall annually be transferred into the development fund. Such transfer of funds stopped in January 1964, when the home-loan fund reached its statutory maximum.¹ In addition, section 213(f) of the Hawaiian homes commission act provides that any receipts from leases of lands, deposited into the administration account, which are in excess of the legislatively approved budget to cover the department's administration expenses for the fiscal year, shall be transferred into the development fund.² Since transfers from the home-loan fund terminated in January 1964, the

¹See chapter 4, *supra*.

²See chapter 12, *infra*.

development fund's only source of revenue has been the transfers from the administration account.

Balance Sheet

The balance sheet for the development fund, as of June 30, 1967, is shown in Table VII.

TABLE VII. BALANCE SHEET
Hawaiian Home-Development Fund
June 30, 1967

Assets		
Cash in State treasury (See Table VIII):		
Unrestricted	\$66,771	
Restricted for authorized projects	<u>85,220</u>	\$151,991
Investment in time certificate of deposit		50,000
Work in progress:		
Nienie-Puukapa waterline	40,000	
Nanakuli houselot subdivision	24,331	
Waimanalo new subdivision plans	2,500	
Paukukalo houselots, 2nd increment	2,030	
Waimanalo additional 45 houselots	1,813	
Kawanakoa hall, repairs and maintenance	<u>943</u>	<u>71,617</u>
Total assets		<u>\$273,608</u>
Fund Balance		
Balance, July 1, 1966		\$309,129
Add excess of receipts over disbursements and encumbrances transferred from the Hawaiian homes administration account		62,955
Deduct cost of completed projects:		
Nanakuli road improvements	\$97,186	
Kahikinui survey	310	
Kawaihae layout and plans	500	
Others	<u>480</u>	<u>[98,476]</u>
Balance, June 30, 1967		<u>\$273,608</u>

Cash in State Treasury

As shown in Table VII, as of June 30, 1967, the development fund had a balance of \$273,608. Of this, \$71,617 represented work which was in progress at the close of the fiscal

year, \$50,000 represented an investment in a time certificate of deposit, and \$151,991 represented cash on hand. How the fund ended the fiscal year with a cash balance of \$151,991 is shown in Table VIII.

TABLE VIII. STATEMENT OF CHANGES IN CASH BALANCES

**Hawaiian Home Development Fund
Year Ended June 30, 1967**

	Unrestricted	Cash Restricted
Balance, July 1, 1966	\$ 1,429	\$ 97,595
Add [deduct]:		
Investment in time certificate of deposit		[100,000]
Expiration of time certificates of deposit		252,450
Excess of receipts over disbursements and encumbrances, transferred from the Hawaiian home-administration account	62,955	
Cancellation of restricted cash	61,537	[61,537]
Restriction of cash for authorized projects:		
Nanakuli houselot subdivision	[55,000]	55,000
Nanakuli, subdivide lot 81	[275]	275
Moomoni beach facilities	[500]	500
Puu-Oo land exchange	[1,000]	1,000
Keaukaha baseball backstop	[375]	375
Waimanalo, additional 45 houselots	<u>[2,000]</u>	2,000
	59,150	
Disbursements for projects in progress:		
Kawananakoa repairs and maintenance		[943]
Nanakuli houselot subdivision		[24,331]
Nienie-Puukapu waterline		[40,000]
Paukukalo houselots, second increment		[172]
Waimanalo additional 45 houselots		<u>[1,813]</u>
		67,259
Disbursements for completed projects:		
Nanakuli road improvements		<u>[95,179]</u>
Balance, June 30, 1967	<u>\$66,771</u>	<u>\$ 85,220</u>

The term, *restricted cash*, as used in the balance sheet and in the statement of changes in cash balances, means the unexpended balance of the sums authorized for specific projects. On June 30, 1967, the restricted cash totaled \$85,220. Included in this is the sum of \$59,150, the amount of new projects authorized during the fiscal year (see Table VIII for details).

Investment in Time Certificate of Deposit

The \$50,000 invested in a time certificate of deposit is, in addition to the restricted cash balance of \$85,220, an unexpended balance for projects authorized.

Work—In Progress

The term, *work—in progress*, noted in Table VII, denotes projects authorized but not completed as of June 30, 1967. The dollar amounts opposite the projects listed in Table VII are cumulative totals of amounts already expended on the projects as of June 30, 1967. They include amounts expended in years prior to the fiscal year ending June 30, 1967, as well as the amounts expended during the fiscal year.

Cost of Completed Projects

The item noted as *cost of completed projects* under *fund balance* in Table VII, denotes the total cumulative costs of projects completed in fiscal year 1966-1967. It includes all amounts expended prior to and during the fiscal year.

Opinion on Financial Statements

In our opinion, the balance sheet (Table VII) and the statement of changes in cash

balances (Table VIII) fairly present the assets of the development fund as of June 30, 1967 and the results of the cash transactions in the development fund for the year ending June 30, 1967.

Chapter 9

ADDITIONAL RECEIPTS-DEVELOPMENT FUND PORTION

As noted earlier in this report,¹ Act 4, SLH 1965, provides that 85% of the moneys deposited into the additional receipts-loan fund portion account shall be transferred into the additional receipts-development fund portion. Act 4 further provides (a) that 15% of the moneys in the additional receipts-development fund portion shall be used, with the prior written approval of the governor, for the construction of sanitary sewage facilities, for the construction of roads through and over Hawaiian home lands and for other nonrevenue producing improvements; and (b) that the remaining 85% shall be segregated into a special account which may be drawn upon from time to time by the department of education, with prior written approval by the governor, for such educational projects as shall be developed and directed by the department of education to improve the education of children of lessees, primarily at the pre-school and elementary grade levels.

¹See chapter 5, *supra*.

Balance Sheet

Table IX contains the balance sheet for the

additional receipts-development fund portion,
as of June 30, 1967.

TABLE IX. BALANCE SHEET

Additional Receipts-Development Fund Portion

June 30, 1967

Cash in State treasury:

Balance, July 1, 1966 \$ 48,982

Add eighty-five percent of annual
additional receipts transferred from
Additional Receipts-Loan Fund
Portion 323,423

Deduct:

Investment in time certificates
of deposit \$ 90,000

Eighty-five percent of annual
additional receipts transferred
to Additional Receipts-Development
Fund Portion for Educational
Projects 274,910 [364,910]

Balance, June 30, 1967 7,495

Investment in time certificates of deposit 90,000

Total assets and fund balance \$ 97,495

As noted in Table IX, there was \$48,982 in the fund on July 1, 1966. During the fiscal year, the sum of \$323,423 was transferred from the additional receipts-loan fund portion.² As provided in Act 4, the sum of \$274,910 was transferred into a special account for educational projects. At the close of the fiscal year, there was a fund balance of \$97,495, consisting of \$7,495 in cash and \$90,000 in time certificate of deposit.

Opinion on Balance Sheet

In our opinion, the balance sheet shown in Table IX presents fairly the assets of the additional receipts-development fund portion as of June 30, 1967.

Chapter 10

ADDITIONAL RECEIPTS-DEVELOPMENT FUND PORTION FOR EDUCATIONAL PROJECTS

As noted in the previous chapter,¹ Act 4, SLH 1965, directs that 85% of the moneys deposited into the additional receipts-development fund portion should be set aside in a special account. The moneys in this special account are to be withdrawn by the department of education, with the prior approval of the governor, to carry on educational projects developed by the department of education, after consultation with the university of Hawaii

²See Table III, *supra*.

¹See chapter 9, *supra*.

and the department of Hawaiian home lands. The educational projects are to be those for the benefit of Hawaiian home lessees, particularly at the pre-school and elementary grade levels.

Balance Sheet

The balance sheet for this special account, as of June 30, 1967, is shown in Table X.

TABLE X
ADDITIONAL RECEIPTS-DEVELOPMENT FUND
PORTION FOR EDUCATIONAL PROJECTS

Balance Sheet June 30, 1967	
Cash in State treasury and account balance:	
Balance, July 1, 1966	\$ 27,561
Add eighty-five percent of annual additional receipts transferred from Additional Receipts-Development Fund Portion	274,910
Deduct Transfer to Department of Education for development of educational projects	<u>[270,000]</u>
Balance, June 30, 1967	<u>\$ 32,471</u>

As noted in the balance sheet, there was a cash balance of \$27,561 in the special account at the beginning of the fiscal year. During the fiscal year, the sum of \$274,901² was deposited into the special account, and the sum of \$270,000 was transferred to the department of education for the development of educational projects. The fund balance at the close of the fiscal year was \$32,471.

Opinion on Financial Statement

In our opinion, the balance sheet, as shown in Table X, presents fairly the asset of the development fund portion for educational projects, as of June 30, 1967.

Chapter 11

OPERATING FUND

Section 213(d) of the Hawaiian homes commission act provides that all moneys received, other than lease rentals from Hawaiian home lands not used for homesteading purposes,¹ shall be deposited into a revolving

²See Table IX, *supra*.

¹Lease rentals from Hawaiian home lands not used for homesteading are deposited into the Hawaiian home-administration account per section 213(f) of the Hawaiian homes commission act. See chapter 12, *infra*.

fund called the Hawaiian home-operating fund. Thus, among the receipts deposited into the operating fund are pasture fees, license fee and water charges. The section further provides that moneys in the fund may be supplemented by other funds appropriated by the legislature. It also permits the transfer of moneys from the home-loan fund on a loan basis to be repaid to the home-loan fund in not more than ten annual installments, provided that the aggregate amount of such transfers outstanding at any one time is not more than \$500,000.

The moneys in the operating fund are used for the following purposes: (1) for the construction and reconstruction of revenue producing improvements and the acquisition of real property and interests therein, such as water rights; (2) for payment into the treasury of the State of such amounts as are necessary to meet payments of principal and interest on bonds issued for the construction of such revenue producing improvements; (3) for the operation and maintenance of the improvements; and (4) for the purchase of water or other utilities, goods, commodities, supplies, or equipment and for services, to be resold, rented, or furnished on a charge basis to occupants of Hawaiian home lands.

Balance Sheet

The balance sheet of the operating fund as of June 30, 1967, is shown in Table XI.

TABLE XI. BALANCE SHEET

Operating Fund
June 30, 1967

Assets			
Cash in State treasury:			
Restricted for:			
Leasing cost	\$ 9,797		
Authorized projects	169,413		
Unrestricted	<u>54,363</u>		\$233,573
Investment in time certificate of deposit			150,000
Receivables from:			
Hilo Electric Company, Ltd.	30,485		
Board of Water Supply:			
County of Hawaii	9,835		
County of Kauai	9,432		
Homesteaders	<u>28,084</u>		77,836
Reimbursable leasing costs			148,701
Work in progress:			
Kaei Hana II, Kawaihae industrial subdivision			<u>16,587</u>
Total assets			<u>\$626,697</u>
Fund Balance			
Balance, July 1, 1967			\$458,778
Add:			
Excess of revenue over expenditures (Table XII)	\$ 38,497		
Cost of land improvements reinstated as reimbursable from lessees	<u>136,104</u>	\$174,601	
Deduct:			
Purchase of equipment	4,882		
Cost of completed project	<u>1,800</u>	<u>6,682</u>	\$167,919
Balance, June 30, 1967			<u>\$626,697</u>

As noted in the balance sheet, the fund balance of the operating fund as of June 30, 1967 was \$626,697. Our findings and recommendations with respect to the fund balance and the items noted in the balance sheet follow.

Cash in State Treasury

As of June 30, 1967, the operating fund had two classes of cash totaling \$233,573—one class called *restricted*, and the other called *unrestricted*. Restricted cash represents the amounts earmarked or set aside for specific purposes or specific projects. Unrestricted cash represents money which is uncommitted and available for use.

As of June 30, 1967, \$9,797 was earmarked to defray leasing costs, such as cost of appraisals, publication of notices, and preparation of lease documents. The sum of \$169,413 was set aside for projects which had previously been authorized, to-wit: the development of parcels in the Kawaihae and Waiakea-Panaewa areas on the island of Hawaii for industrial uses.

Receivables

1. **From utility companies.** The balance sheet notes that on June 30, 1967, the sum of \$30,485 was receivable from the Hilo Electric Company, Ltd.; \$9,835 from the Hawaii county board of water supply; and \$9,432 from the Kauai county board of water supply. These sums represent the unpaid balances of advances made by the department to the utility companies for the construction by them of utility lines on Hawaiian home lands.

The agreements between the department and the utility companies provide that the department initially pay for the installation of the utility lines, but that the utility companies will refund the paid amounts over a period of a specified number of years. The refund is based on a percentage of the revenues collected by the utility companies on account of the lines installed. This means that the total amount which will be refunded the department will depend on the amount of revenues collected by the utility companies over the specified number of years. Thus, the department may not necessarily receive all of the amounts noted as receivables in the balance sheet.

2. **From homesteaders.** On June 30, 1967, there was due from homesteaders, the total sum of \$28,084. This amount represents charges for water, pasture use and other services rendered by the department to homesteaders. Our review of the department's records indicates that some of the charges had been outstanding for some time. It appears that the department is lax in its handling of these delinquent accounts. Except with respect to water charges, the department does not maintain a list of delinquent accounts.

We recommend that the department exert control over delinquent accounts, by establishing procedures which would require a preparation of a list of delinquencies on a monthly basis and which would prescribe the steps to be taken to prevent debts from remaining outstanding for long periods of time.

Reimbursable Leasing Costs

The balance sheet notes as an asset of the department the sum of \$148,701 in reimbursable leasing costs. *Reimbursable leasing costs* are costs which are incurred in leasing land (for other than homesteading purposes) and which are advanced by the department and are to be reimbursed by the lessee.

1. **Development costs of Kaei Hana I industrial subdivision.** Included in the \$148,701 is the sum of \$136,104, which represents the costs incurred in developing the Kaei Hana I industrial subdivision. We take exception to the inclusion of this \$136,104 as *reimbursable leasing costs*.

Construction and development costs of any project are not costs reimbursable by lessees. In addition to lease rent, a lessee is responsible for only those costs directly connected with the leasing process, such as the costs of appraisal, publication notices and lease documents. We note that in prior years, the department consistently and properly excluded construction and development costs from the amounts to be reimbursed by lessees.

Thus, the construction cost of \$136,104 is not an asset of the operating fund, and the fund balance is accordingly overstated by that amount.

2. **Rents from Kaei Hana I industrial subdivision.** As a result of the department's treatment of the construction costs incurred in the development of Kaei Hana I industrial subdivision as reimbursable items, all rents collected from lessees of this subdivision were, in fiscal year 1966 to 1967, and are currently being deposited into the operating fund and

used to reduce the balance of the reimbursable leasing costs. The deposit and use of the lease rentals in this fashion violate the provisions of section 213(f) of the Hawaiian homes commission act. The act states:

... The entire receipts derived from any leasing of the available lands defined in section 204 shall be deposited into the Hawaiian home-administration account

... any amount of money in said account in excess of the amount approved by the legislature for the [fiscal period] or so made available shall be transferred to the Hawaiian home-development fund

Under section 213(f), the lease rents from the Kaei Hana I industrial subdivision should have been deposited into the administration account. Thus, we recommend that all rents from the Kaei Hana I industrial subdivision collected since June 30, 1967 be transferred from the operating fund to the administration account. With respect to the rents collected prior to June 30, 1967, which amounted to approximately \$1,000, we recommend that they be transferred directly to the Hawaiian home-development fund, since, under section 213(f), the administration account is closed out to the development fund at the end of each fiscal year.²

Work in Progress

The Kaei Hana II Kawaihae industrial subdivision was in the process of development

²See chapter 12, *infra*.

as of the close of fiscal year June 30, 1967. The figure \$16,587, noted in the balance sheet (Table XI), is the cumulative total of the cost of developing the subdivision as of the end of the fiscal year.

Excess of Revenue over Expenditures

The balance sheet notes, under the category *fund balance*, the sum of \$38,497 as the excess of revenue over expenditures during the fiscal year. A detailed listing of the revenues collected and the expenditures made during the fiscal year is contained in Table XII.

TABLE XII. STATEMENT OF REVENUE AND EXPENDITURES

Operating Fund				
Year Ended June 30, 1967				
		Actual	Budget	Actual Over [Under]
REVENUE:				
Interest on loans		\$ 81,847	\$ 90,000	\$ [8,153]
Interest on bank deposits		27,453	17,000	10,453
Water charges	\$20,447			
Pasture fees	18,102			
Rents	5,123			
Miscellaneous services	3,612			
Equipment rentals	585			
Cattle hauling	388			
		<u>48,257</u>	<u>55,000</u>	<u>[6,743]</u>
Total Revenue		<u>157,557</u>	<u>162,000</u>	<u>[4,443]</u>
EXPENDITURES:				
Salaries	65,385			
Contributions to employee benefits	8,610	73,995	73,200	795
Materials and supplies	14,579			
Utilities	14,415			
Rentals	5,125			
Repairs and maintenance	4,780			
Workmen's compensation	3,957			
Miscellaneous current expenses	883			
Freight and delivery	536			
Communication	409			
Engineering and architectural fees	381			
		<u>45,065</u>	<u>45,000</u>	<u>65</u>
Total expenditures		<u>119,060</u>	<u>118,200</u>	<u>860</u>
Excess of revenue over expenditures		<u>\$ 38,497</u>	<u>\$ 43,800</u>	<u>\$ [5,303]</u>

Several items included in Table XII deserve comment.

1. **Revenue: interests on loans.** The sum of \$81,847 was received as interests on account of loans made from the Hawaiian home-loan fund, the Hawaiian farm loan fund and the Anahola-Kekaha loan fund. Section 213(d) of the Hawaiian homes commission act provides that moneys from all sources (other than from leasing of available lands) shall be deposited into the operating fund. Not deposited into the operating fund, however, are interests collected on account of loans made from the additional receipts-loan fund portion. Interests on loans made from the additional receipts-loan fund portion are by Act 4, SLH 1965, required to be deposited into the additional receipts-loan fund portion account.

2. **Revenue: interests on bank deposits.** The sum of \$27,453 was received as interests on account of investments in time certificates of deposit of moneys belonging to the Hawaiian home-loan fund, additional receipts-loan fund portion account, development fund, additional receipts-development fund portion account, and operating fund.³

Ten thousand four hundred and fifty-three dollars more was received in interests on bank deposits than was anticipated in the budget.

³Unlike interests received on loans, Act 4, SLH 1965, does not require the deposit into the additional receipts-loan fund portion account of interests received on investments of the account's moneys. Thus, under the general provision of section 213(d) of the Hawaiian homes commission act, which requires deposit of moneys from all sources into the operating account, interests received on investments of the moneys of the additional receipts-loan fund portion are required to be placed into the operating fund.

The difference may be explained thus: (1) some of the \$27,453 (actual receipts) had accrued prior to, but was not received until after July 1, 1966, and had not thus been considered in the budget; (2) moneys of the various funds during fiscal year 1966 to 1967, had been kept in time certificates of deposit for periods longer than had been anticipated, because of the slowness with which projects funded by the various funds actually got off the ground.

3. **Revenue: charges, fees.** The amounts noted in the statement of revenue and expenditures (Table XII) for water charges, pasture fees, and miscellaneous services reflect the collection of charges which section 213(d) of the Hawaiian homes commission act permits to be assessed the homesteaders.

Rents of \$5,123 reflect collection of the one dollar per year lease rentals charged the 1,800 homesteaders, the rentals charged licensees of lots which are used for garages, service stations, markets, stores, etc., situated in homestead areas,⁴ and the rentals collected from two cottages which are from time to time rented out to workers, on a temporary basis while performing their jobs.

4. **Expenditures: salaries and contributions to employee benefits.** Among the expenditures of the operating fund during the fiscal year were payments made as salaries (\$65,385) and

⁴Section 207(c)(1)(B), Hawaiian homes commission act, provides that the department may grant licenses for lots within a district in which lands are leased to Hawaiian homesteaders to theaters, garages, service stations, markets stores, and other mercantile establishments (all of which shall be owned by lessees of the department or by organizations formed and controlled by said lessees).

as the fund's contribution toward employee benefits (\$8,610).

There are 11 employees (eight on Molokai and three on Hawaii) who are paid from the operating fund. These employees have been hired to maintain the domestic water system on Molokai and to render services to homesteaders on Molokai and Hawaii. Section 213 (d), Hawaiian homes commission act, provides that maintenance costs of the revenue producing improvements may be paid from the operating fund.

The item, *contributions to employee benefits* of \$8,610, appears on the statement of revenue and expenditures, because during fiscal year July 1, 1966 to June 30, 1967, all special funds were charged for contributions to employee benefits for all employees paid from the special funds.

5. Expenditures: workmen's compensation.

During the fiscal year, the operating fund paid out the sum of \$3,957 as workmen's compensation, to pay medical expenses incurred by an employee who was injured on the job. As noted above, during the fiscal year, each special fund was required to pay workmen's compensation of any of its employees who incurred injury on the job. Since October 15, 1967, all workmen's compensation claims and unemployment compensation benefit payments are no longer charged to the special or federal funds but to the State's central account maintained by the department of accounting and general services.⁵

⁵Letter, dated October 4, 1967 from the department of accounting and general services to the department of Hawaiian home lands.

In this connection, we noted in our examination that one employee who was injured on the job received his *full* salary during the period of his temporary, total disability and absence from work. It would appear that the department's records should show the payment made to the employee as either payment made under the State's workmen's compensation law or as a charge-off against the employee's sick leave accumulation. However, a check of the records failed to reveal that the employee ever filed a claim under the workmen's compensation statute or that the payment made to him was charged against his sick leave accumulation. It would further appear that if the payment made to the employee is considered payment under the workmen's compensation law, the employee was overpaid. The State's workmen's compensation law (as it existed during the fiscal year 1966 to 1967 and as it now exists) provides that an employee injured on the job may be paid during the period of his temporary, total disability, but not including the first two days, a weekly benefit at the rate of 66-2/3% of his average weekly wages, but no more than \$112.50 nor less than \$18 a week.⁶ No statutory authority existed during the fiscal year to permit an employee injured on the job to take the benefits of both the workmen's compensation law and the sick leave statute.⁷

⁶Section 97-30(b), RLH 1955.

⁷At the 1967 session, the State legislature enacted Act 88, SLH 1967. Act 88 provides that where a public employee is eligible for workmen's compensation benefits, he shall be paid the difference between his regular salary and the

We recommend that the records be clarified by either showing the payments made to the employee as payment of benefits under the workmen's compensation law or as a charge against the employee's sick leave accumulation, and that necessary adjustment be made for any moneys received by the employee which is in excess of what he was legally entitled to receive.

6. **Expenditures-others.** The remainder of the expenditures noted in the statement of revenue and expenditures (Table XII) relate mainly to the cost of maintaining the domestic water system on the island of Molokai, which was constructed when homesteading first began on that island. It also includes expenditures for the operation of community pastures and providing heavy equipment services to homesteaders on Molokai and Hawaii.

7. **Cost of services provided the homesteaders.** It is readily apparent from the statement of revenue and expenditures (Table XII) that during fiscal year July 1, 1966 to June 30, 1967, the income from services rendered to homesteaders (\$43,134) (\$48,257 less rents of \$5,123), was far less than the expenses incurred by the department in rendering those services (\$119,060). In the light of the intent of the Hawaiian homes commission act, perhaps the charges for services

temporary disability compensation, in addition to the temporary disability compensation he receives as workmen's compensation benefits; this difference, however, is to be charged against the employee's accumulated sick leave allowance. Under this act, the employee may receive 66-2/3% of his full salary under the workmen's compensation law, and the remaining 33-1/3%, provided that this 33-1/3% is charged off against his sick leave accumulation. This was not legally possible before the enactment of Act 88.

rendered need not equal the cost of providing those services. We believe, however, that the charges should be reasonable, and should recoup as much of the cost to the department in rendering the services. Our examination revealed that the rates charges for the various services were last adjusted on December 15, 1961.

We recommend that the rates charged for the services rendered by the department to the homesteaders be reviewed at least annually and that the rates be adjusted to recoup as much of the cost to the department in rendering such services as the intent of the Hawaiian homes commission act permits.

Cost of Land Improvements Reinstated As Reimbursable from Lessees

In the balance sheet (Table XI), under the heading *fund balance*, the sum of \$136,104 is noted as *cost of land improvements reinstated as reimbursable from lessees*. This \$136,104 is included in the sum of \$148,701 noted as receivable, *reimbursable leasing costs, under assets*. This item was discussed earlier in this chapter.⁸ The amount does not belong in the balance sheet. It was not reflected in the balance sheet of June 30, 1966, but was *reinstated* in the June 30, 1967 balance sheet, since the department decided during the fiscal year to seek reimbursement of the development costs of the Kaei Hana I industrial subdivision from lessees of the subdivision.

⁸See page 33, *supra*.

Deductions

The balance sheet notes as deductions, the purchase of equipment (\$4,882) and the cost of completed projects (\$1,800). *Completed project* denotes that project which was finished during the fiscal year, and the sum \$1,800 represents the total cumulative cost of that project.

Fund Balance

In addition to the exception taken earlier in this chapter regarding the operating fund balance of \$626,697, we note here that further adjustments to the balance are required as explained in chapter 4, Hawaiian home-loan fund.⁹

Opinion on Financial Statements

In our opinion, except as otherwise noted in this chapter and in chapter 4, the financial statements of the operating fund fairly present the assets of the fund and the results of revenue collected and expenditures made on account of the fund for the fiscal year July 1, 1966 to June 30, 1967.

⁹In chapter 4, on page 14, *supra*, we recommended that certain rentals in the sum of \$1,665, collected prior to June 30, 1967, and rentals collected subsequent to that date be transferred from the Hawaiian home-loan fund to the operating fund. In the same chapter, on page 15, *supra*, we recommended that the sum of \$118,190 which was erroneously deposited into the operating fund be transferred to the home-loan fund.

Chapter 12

ADMINISTRATION ACCOUNT

The administration account is a special account set up by section 213(f) of the Hawaiian homes commission act. The section provides that the entire receipts from any leasing of available lands¹ shall be deposited into this account. The moneys are to be expended by the department for salaries and all other administrative expenses of the department, excluding capital improvements.

Section 213(f) further requires that the Hawaiian homes commission secure the prior approval of the State legislature on the total amount which may be expended from the administration account during a fiscal year. It provides that in each fiscal year, the excess of the receipts deposited into the administration account, over the amount approved by the legislature, shall be transferred to the Hawaiian home-development fund. Such transfer is to be made immediately after the amount of money deposited into the administration account equals the amount approved by the legislature.

Statement of Revenue and Expenditures

For fiscal year July 1, 1966 to June 30, 1967, the State legislature, by Act 8, SLH 1966, approved the expenditure of \$297,642, or so much thereof as shall be sufficient to

¹*Available lands* is defined in section 203, Hawaiian homes commission act, as all public lands described in the section, excluding (a) all lands within any forest reservation; (b) all cultivated sugar-cane lands; and (c) all public lands held under a certificate of occupation, homestead lease, right of purchase lease, or special homestead agreement.

accomplish the purpose. The expenditures incurred and the revenue earned by the administration account during the fiscal year are

shown in the statement of revenue and expenditures, Table XIII.

TABLE XIII. STATEMENT OF REVENUES AND EXPENDITURES
Administration Account
Year Ended June 30, 1967

	Actual	Budget	Actual Over [Under]
REVENUE:			
Rentals of available lands under the control of the Dept. of Land and Natural Resources	\$237,170		
Leasing and licensing of available lands	90,748		
Permissive use of available lands	17,818		
Sale of moss rock on available lands	6,828		
Total revenue	<u>352,564</u>	<u>\$298,877</u>	<u>\$53,687</u>
EXPENDITURES:			
Salaries	204,265	233,926	[29,661]
Contribution to employee benefits	24,273	25,681	[1,408]
State staff agencies assessment	12,933	14,174	[1,241]
Materials and supplies	5,866	4,150	1,716
Travel and subsistence	6,912	7,127	[215]
Settlement of civil suit	4,825	—	4,825
Repairs and maintenance	2,917	5,400	[2,483]
Communication	2,094	2,500	[406]
Printing and advertising	1,718	1,100	618
Engineering and architectural fees	1,650	—	1,650
Miscellaneous current expenses	1,552	1,785	[233]
Utilities	1,458	950	508
Equipment	557	569	[12]
Freight and delivery	675	100	575
Rentals	258	180	78
Total expenditures	<u>271,953</u>	<u>297,642</u>	<u>[25,689]</u>
Excess of revenue over expenditures	<u>\$ 80,611</u>	<u>\$ 1,235</u>	<u>\$79,376</u>

It should be noted that the statement of revenue and expenditures is presented on the *accrual* rather than on the *cash*, basis—that is, all revenues earned, although not yet received, and all liabilities incurred, although not yet paid, are included in the statement. This accrual method enables the department to determine the exact portion of all receipts attributable to these activities occurring during the fiscal year which should be transferred to the development fund pursuant to section 213(f) of the Hawaiian homes commission act.

1. Revenue. a. Rentals from leases. The bulk of the revenue of the administration account was derived from lease rentals from lands not used for homesteading. These rentals included rentals from non-homestead leases such as the leases of lots in industrial subdivisions developed by the department.

Prior to the enactment of Act 271, SLH 1965, the department of Hawaiian home lands had no authority to lease or grant licenses to its lands, except for the purposes expressly provided in the Hawaiian homes commission act. The act, however, permitted the department of Hawaiian home lands to transfer its lands not needed for the purposes of the act to the department of land and natural resources for management as any other public land, including the leasing of the lands for purposes not permitted by the Hawaiian homes commission act. Over the years, the department of Hawaiian home lands transferred several tracts of land to the department of land and natural resources for management.

Act 271 still permits the department of Hawaiian home lands to transfer lands not needed

for the purposes of the act to the department of land and natural resources. However, it now permits the department of Hawaiian home lands itself to lease or grant licenses to lands not needed for the purposes of the act in the same manner and under the same terms and conditions as those governing the leasing of public lands by the department of land and natural resources. As a result, some lands controlled by the department of land and natural resources have been transferred back to the department of Hawaiian home lands as the leases, which had been executed in the department of land and natural resources and which were in force at the time of the enactment of Act 271, expired.

During the fiscal year 1966 to 1967, lease rentals from lands still under the control and management of the department of land and natural resources totaled \$237,170, and lease rentals from lands controlled and managed by the department of Hawaiian home lands totaled \$90,748.

b. Rentals from permissive uses of lands. In addition to the lease rentals, the department collected \$17,818 from individuals to whom the commission granted revocable permits of occupancy. A summary of the permits of occupancy and the reasons of the department for granting them are noted in exhibit 1 attached at the end of this chapter. As noted in the department's explanations, the granting of the permits, indeed, enabled the department to derive revenue which it would not otherwise have received.

While the department may have thought it to be in its best interest to grant the permits,

the Hawaiian homes commission act does not authorize the department to do so. In June 1961, the State attorney general issued an opinion in which he stated that the authority of the department to issue licenses and leases are clearly prescribed and limited in section 207 of the Hawaiian homes commission act, and that the department's authority does not extend to the granting of licenses, on a monthly charge basis, to any individual to occupy Hawaiian home lands.²

In 1965, the State legislature enacted Act 271, SLH 1965, which amended section 204 of the Hawaiian homes commission act. As amended, section 204 provides:

In the management of any retained available lands not required for leasing under section 207(a), the department may dispose of such lands by lease or license to the general public, including native Hawaiians, on the same terms, conditions, restrictions and uses applicable to the disposition of public lands as provided in chapter 103A; . . .

In November 1965, the State attorney general issued another opinion. The opinion states that Act 271, SLH 1965, does not modify the attorney general's earlier opinion of 1961, and that the department does not have the authority to issue permits.³ The opinion cites the following facts.

² Attorney general's opinion 61-64.

³ Attorney general's memorandum, dated November 30, 1965, to James C. Clarke, Planning Coordinator, department of Hawaiian home lands.

Act 271, SLH 1965, was introduced as House Bill No. 557. House Draft 2 of H.B. 557 deleted the proposal in House Draft 1 which would have authorized the department to issue revocable permits. The reasons for the deletion are stated in Standing Committee Report No. 707, House Journal 1965, as follows:

. . . Your Committee has also deleted the words revocable permit and or otherwise from the power to dispose of such lands by lease, license, revocable permit or otherwise. . . . Your Committee finds that the power to lease and license is sufficient to accomplish the purpose of the bill. . . .

Thus, the department of Hawaiian home lands did not have, during the fiscal year under examination, and does not now have any authority to grant permits. We recommend that the department terminate as quickly as possible its practice of granting revocable permits. If the department believes that it is in the best interest of the department to grant revocable permits, we recommend that the department seek legislation authorizing the department to do so.

c. Receipts from sale of moss rock. The statement of revenue and expenditures includes the sum of \$6,828 as receipts from the sale of moss rock on available lands. This sum was collected as a result of the licenses which the department granted for the removal of moss rock. Section 204 of the Hawaiian homes commission act, as amended by Act 271, SLH 1965, authorizes the department to

issue such licenses on the same terms, conditions, restrictions and uses as provided in chapter 103A, relating to public lands. Section 1 of chapter 103A defines *land license* as a *privilege granted to enter land for certain special purpose such as the removal of timber, soil, sand, gravel, stone, hapuu and plants . . .*

2. **Expenses.** The statement of revenue and expenses of the administration account shows that during the fiscal year, accrued expenses totaled \$271,953. Included in this figure are employees' salaries and benefit contributions, materials, supplies, travel, and other administrative expenses of the department.

The major expense was, of course, employees' salaries. Act 8, SLH 1966, in which the legislature approved the sum of \$297,642 as the limit of expenditures, directed that no more than 28 employees could be hired and paid for from the administration account during the fiscal year 1966 to 1967. Included in the 28 were the chairman of the commission, 18 positions on Oahu, six positions on Hawaii, two positions on Molokai and one position each on Kauai and Maui. During the fiscal year, the department experienced vacancies in four authorized positions. The four vacancies explain the difference of \$29,661 between the actual salary expenses and the budgeted salary expenses (see Table XIII).

We are informed that of the four vacancies, the positions of fiscal officer and tenant services assistant will be left vacant pending

the outcome of a management audit which will result in a reorganization of the department's personnel structure. This audit is being conducted by the management services division of the department of budget and finance and is expected to be completed in January 1968. Of the remaining two vacancies, the account clerk 1 position was filled in May 1967, and the building maintenanceman position was deleted by the legislature in the 1967 session.

3. **Excess of revenue over expenses.** The excess of earned revenue over accrued expenses for fiscal year 1966 to 1967 was \$80,611. This was \$79,376 more than the \$1,235 which had been estimated. This large difference is attributable in part to an underestimation of the rental receipts and in part to the vacancy in four employee positions.

Account Balance

The balance of the administration account as of June 30, 1967 is shown in Table XIV.

Table XIV reflects the transfer of \$62,955 to the development fund, accounts receivable of \$21,939, and encumbrances payable of \$2,087. These items deserve a brief comment.

As noted earlier, section 213(f) of the Hawaiian homes commission act provides that in each fiscal year, all receipts deposited into the administration account in excess of the budget approved by the legislature shall be transferred to the development fund. The

TABLE XIV
DEPARTMENT OF HAWAIIAN HOME LANDS
ADMINISTRATION ACCOUNT

Statement of Changes in Account Balance
Year Ended June 30, 1967

Balance, July 1, 1966		\$ 3,275
Add:		
Excess of revenue over expenses (Table XIII)	\$80,611	
Refund of prior year expenses and transfer in of accrued vacation	1,008	
	81,619	
Deduct transfer to development fund	62,955	18,664
Balance, June 30, 1967		\$21,939
Represented by:		
Cash in State treasury		2,087
Accounts receivable		21,939
Encumbrances payable		[2,087]
		\$21,939

statement of revenue and expenses (Table XIII) shows an excess of receipts over expenditures of \$80,611. The department, however, actually transferred \$62,955. The entire \$80,611 had not been transferred as of June 30, 1967 because not all of the excess amount, although *earned*, had been *received*. Table XIV shows that the amount earned during the fiscal year, \$21,939, had not been received as of June 30, 1967. In addition, \$2,087 worth of liability incurred in the year had not been

paid as of June 30, 1967. Upon the receipt of the \$21,939, and the payment of the \$2,087, it is expected that the department will transfer the remainder of the excess to the development fund.

Opinion on Financial Statements

In our opinion, the financial statements relating to the administration account present fairly the results of the department's administrative operations for the year July 1, 1966 to June 30, 1967.

DEPARTMENT OF HAWAIIAN HOME LANDS
Schedule of Permissive Use of Available Lands
Year Ended June 30, 1967

<i>User's Name</i>	<i>Area</i>	<i>Terms</i>	<i>Revenue Earned</i>	<i>Department's Explanation on Paragraph Numbered</i>
Clifford Freitas	Waianae	\$ 150/month	\$ 1,800	1
Antone Ruis	Waianae	150/month	1,800	1
Sung's Dairy, Inc.	Lualualei	50/month	50	2
James W. Glover, Ltd.	Lualualei	500/year	583	3
Hilo Salvage Co.	Panaewa	175/month	700	4
John Pekelo, Sr.	Waimanu	10/month	120	5
Ulupalakua Ranch, Inc.	Kahikinui	16,200/year	1,350	6
Fred Teixeira	Waimanalo	100 semi-annually	200	7
Parker Ranch	Kamuela	11,315.16 annually	11,315	8
Bay City Motors	Hilo	25/month	25	9
Ernest Kaohimaunu	Waimanalo	10/year	10	10
Prior year adjustment			[135]	
			<u>\$17,818</u>	

1. These lands were originally under land leases from the department of land and natural resources. Control over these lands was subsequently transferred to the department of Hawaiian home lands. The individuals concerned have been using the area for dairy operations. The leases have expired but the individuals are being permitted to use the land on a monthly rental basis until the department conducts a new auction. The auction is being withheld because the department is unable to find others interested in the land.

2. Sung's Dairy, Inc., was permitted to use the land when it was under the control of the department of land and natural resources. It has continued to use the land after control was transferred to the department of Hawaiian home lands. Permission was revoked in July 1966, and the land was subsequently leased for 25 years effective January 1, 1967 as a result of a public auction.

3. James W. Glover, Ltd., has been permitted to use this area for temporary storage of construction equipment and materials for the duration of a contract with the State on a flood control project in Maile.

4. Hilo Salvage Company was permitted to use this area for temporary storage of scrap materials. Permission was subsequently revoked and the land was leased at a public auction effective September 1, 1966.

5. John Pekelo, Sr., is about 72 years old and has permission to use this land area. This land is located on the Hamakua coast on Hawaii, and is, for all practical purposes, inaccessible.

6. This land was transferred by the department of land and natural resources to the department of Hawaiian home lands, Ulupalakua Ranch, Inc., who occupied the land subsequent to its transfer, was given 2 year to vacate the premises. Land was subsequently leased to Maui Factors effective April 1, 1967, upon public auction.

7. Fred Teixeira was granted permission to graze cattle on this land which is located on the hillside of Waimanalo. The department has no immediate use for this marginal land.

8. Parker Ranch is permitted to utilize approximately 2,200 acres for grazing cattle in exchange for \$11,315 per annum and supplying water to homestead ranchers in the adjacent area. This agreement is to be terminated when a water line, which is presently under construction, is completed.

9. Bay City Motors is permitted to use vacant lots adjacent to its leased lot for storage of automobiles. This permission is to be terminated when the department finds it feasible to auction these vacant lots.

10. Ernest Kaohimaunu is permitted to use the unexcavated portion of the Waimanalo quarry for raising calves. He is to vacate the premises when the quarry operation reaches the area he is using.

Chapter 13

OTHER ACCOUNTS

In addition to the funds described in the preceding chapters, the department of Hawaiian home lands maintains other miscellaneous accounts. This chapter describes these other accounts.

Petty Cash Fund

The department maintains a petty cash fund of \$325, which was advanced by the State general fund. The moneys in this fund are used to give change, where necessary, when loan payments are made by homesteaders and for minor expenses such as lunch per diem for commissioners, postage due, etc. The moneys in this account are reimbursed from time to time from the appropriate funds.

Temporary Deposits

The State comptroller has set up an account for the temporary deposit of moneys left with the department of Hawaiian home lands. The moneys are disbursed for the specific purposes for which they have been deposited as soon as the propriety of the disbursements are determined.

As of June 30, 1967, there were temporary deposits of \$56,042. Included in this amount were deposits made by homesteaders for the difference between the loan amounts and the

cost of new home construction, deposits made at the time of public auction by lessees of available lands in an amount equal to 25% of the lease rental to cover leasing costs, and moneys received from the State and federal governments for damages and cost of relocation of homesteaders displaced at Keaukaha due to the construction of jet runway at Hilo airport.

Bond Fund Appropriations

During the course of years, the State legislature authorized the floating of State bonds for construction by the department of Hawaiian home lands of certain capital improvements. The following is a summary of the State bond fund moneys as of June 30, 1967.

	PROJECTS			
	Nanakuli Houselot Subdivision	Panaewa Houselot Subdivision	Waimanalo Sewer Lines	Nanakuli Road Improvements
Law	Act 38/66	Act 30/62	Act 52/64	Act 201/63 Act 195/65
Appropriation	\$445,000	\$35,000	\$120,000	\$ 53,925 89,000
Allotment	--	35,000	120,000	53,925 89,000
Expended as of June 30, 1967	--	34,754	88,029	142,925
Balance of allot- ment unexpended at June 30, 1967	--	246	31,971	--
Status of project at June 30, 1967	Planning	Completed	Completed	Completed
Date completed	--	3/24/65	3/22/66	11/15/66

Construction of the Nanakuli houselot subdivision is expected to begin sometime after the bid opening on December 28, 1967.

As shown in the summary, the Panaewa houselot subdivision and the Waimanalo sewer lines projects were completed a few years ago with unexpended allotment balances of \$246 and \$31,971, respectively. These unexpended allotment balances are still carried on the books of the department. We recommend that

the unexpended allotment balances (and future balances as they occur) be reported immediately to the department of planning and economic development for proper disposition.

Property Inventory

The department maintains an inventory of its property in its general ledger control account. In addition, the department receives

a detail listing of its property from the data processing division of the department of accounting and general services. The general ledger control account is kept by categories of property. The detail listing is prepared by specific items of property. Our examination revealed that the cost figures used in the general ledger control account are at variance from the cost figures used in the detail listing. The following is a summary of the inventory cost figures used in the general ledger account and the detail listing.

	<i>General Ledger Control Account</i>	<i>Detail Inventory Listing</i>	<i>Control Over [Under]</i>
<i>Material & supplies</i>	\$ 5,780	\$ 5,780	\$ --
<i>Equipment</i>	158,683	160,728	[2,045]
<i>Structures & permanent improvements to land</i>	3,854,919	2,614,624	1,240,295
<i>Land & interest in land</i>	30,294	30,294	--
<i>Total</i>	<u>\$4,049,676</u>	<u>\$2,811,426</u>	<u>\$1,238,250</u>

As the summary indicates, the total inventory cost as recorded in the general ledger control account is \$1,238,250 more than the inventory cost recorded in the detail inventory listing. *Structures and permanent improvements to land* accounts for practically all of the difference. We are informed that this difference has been on the books for many years. We can only speculate as to the possible reasons for the difference since the old records are no longer available for our examination.

We believe that the detail listing is perhaps far more accurate than the general ledger control account. The latter, it appears, cumulates the total inventory costs as property is acquired, while the former is compiled periodically. Further, the detail listing contains a description of each of the department's property, while the general ledger control account does not.

We recommend that the general ledger control account be adjusted to the detail inventory listing, and that the two kinds of records be hereafter reconciled periodically. We do not believe there would be any significant effect, detrimental to the department's inventory, by making the recommended adjustment.

PART III. SUMMARY

Section 32, chapter 2, Revised Laws of Hawaii 1955, as amended, requires the office of the auditor to conduct post-audits of all transactions and of all books and accounts kept by State departments. Pursuant to this requirement, the office of the auditor examined the books and accounts of the department of Hawaiian home lands and the transactions noted therein for the fiscal period July 1, 1966 to June 30, 1967.

The audit was conducted to determine the legality of the department's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the department's controls to safeguard its assets against loss, waste, fraud and extravagance.

The examination covered the following funds administered by the department of Hawaiian home lands: Hawaiian home-loan fund; additional receipts-loan fund portion; Anahola-Kekaha loan fund; Hawaiian farm loan fund; Hawaiian home-development fund; additional receipts-development fund portion; additional receipts-development fund portion for educational projects; operating fund; administration account; and miscellaneous accounts, including the petty cash fund, temporary deposit account, bond fund appropriations account, and property inventory account.

Except with respect to matters relating to internal control, there were no findings of

significance regarding the following funds: additional receipts-loan fund portion; Anahola-Kekaha loan fund; Hawaiian farm loan fund; Hawaiian home-development fund; additional receipts-development fund portion; and additional receipts-development fund portion for educational projects. Our major findings and recommendations with respect to internal control and the other funds and accounts are summarized below.

Internal Control

A system of internal control is required to insure accuracy and reliability of financial data, to promote operational efficiency, and to assure adherence to laws, policies, rules and regulations. Included in any system of internal control is the principle of *cross-check*—that is, the separation of duties such that no one individual handles all phases of a transaction.

1. **Cash account balances.** The cash account balances maintained by the department of Hawaiian home lands have not been reconciled for more than a year with the cash account balances kept by the department of accounting and general services. Both the department of Hawaiian home lands (as an operating agency) and the department of accounting and general services (as the State's official agency responsible to account for State funds as a whole) are required to maintain accurate records of account. Periodic checks of the

records of one department with the records of the other permit early detection of discrepancies which may exist. Our examination disclosed a discrepancy of \$911 in the June 30, 1967 closing balances noted on the records of the two departments. We recommend that a reasonable attempt be made to ascertain the cause of this discrepancy. We further recommend that hereafter the cash account records of the department of Hawaiian home lands be reconciled with the records of the department of accounting and general services at least quarterly and any differences be promptly investigated.

2. **Petty cash and cash receipts.** Petty cash accounts are maintained at all neighbor island branch offices of the department. Surprise cash counts of the petty cash fund and checks of the prenumbered cash receipt slips by persons other than those handling the cash fund and cash slips are not being done. To insure that the petty cash fund is being used and the cash receipts are being issued for proper purposes, we recommend that periodic, unannounced cash counts and checks of prenumbered cash receipt slips be conducted by a person from the main office in Honolulu.

3. **Financial reports.** Monthly financial reports pertaining to receipts and expenditures of the various accounts are being presented to the members of the commission. However, with respect to the financial reports covering the operating fund and the administration account, the monthly reports reflect only the results of transactions had during the month for which the reports are prepared. We do not believe that financial reports of this nature

are sufficient for the purposes of control by the commission. We recommend as follows.

With respect to the operating fund, the monthly reports should contain a cumulative total of all receipts and of all expenditures from the beginning of the fiscal year to the reporting date. Such information will enable the commission members to readily ascertain the funds available for use.

With respect to the administration account, the monthly reports should contain (a) a cumulative total of all amounts transferred from the administration account to the development fund, (b) a cumulative total of all expenditures made from the fund, and (c) the budget limitations with respect to expenditures. Such information will enable the commission members to ascertain on a monthly basis, whether or not the requirements of the Hawaiian homes commission act regarding transfer of moneys to the development fund and expenditures from the administration account are being adhered to.

Hawaiian Home-Loan Fund

The Hawaiian home-loan fund is used to make loans to Hawaiian home homesteaders for the purpose of constructing dwellings or making improvements thereto and aiding homesteaders in their farming and ranching operations.

1. **Restricted cash for loans authorized by the commission.** Cash which are available for loans are categorized as either *unrestricted* or *restricted*. Moneys are restricted whenever the commission approves a loan application. There is often a time lag between loan approval and construction of the dwelling and disbursement

of the loan amount. During this time period, the approved loan amount is classified as *restricted*.

Our review of the restricted cash as of June 30, 1967 revealed that \$34,000 had been classified as *restricted* for a period of more than a year. It appears that most of all of this amount will probably not be disbursed because of the inability of the homesteader to use the loan for one reason or another or because of an excess of loan amount over actual cost of constructing a dwelling. We recommend that the restricted cash balance be reviewed monthly for unrequired loan commitments and that all unrequired amounts be transferred as quickly as possible to the unrestricted category and be made available for other loans.

2. **Repair loans.** During the fiscal year 1966 to 1967, 119 loans totaling \$30,037 were made for repairs to roof, kitchen, etc. The Hawaiian homes commission act provides that loans should be made for the *erection of dwellings* and other *permanent improvements*. We question the authority of the commission to make loans for repairs. We recommend that the department secure a legal opinion from the attorney general as to whether or not it is authorized to make repair loans.

3. **Delinquencies.** As of June 30, 1967, among the receivables was \$20,726 in monthly installments (on 85 loans) which were overdue for periods of three months or more. The department's practice has been to send four to five monthly reminder notices before issuing a citation to a delinquent homesteader

to appear before the commission. We recommend that the delinquency policy be tightened by shortening the period for the issuance of citations to not more than 90 days.

4. **Improvements purchased.** The Hawaiian homes commission act provides that the department shall purchase the improvements put up by the lessee in the event the lessee dies without eligible heirs or if the lessee surrenders his lease or if his lease is terminated. As of June 30, 1967, the department had purchased the dwellings on 10 tracts, at a total cost of \$32,097. One of the dwellings was later sold to a successor lessee for \$9,000. It is doubtful that the remaining dwellings can be sold to successor lessees of the tracts on which the dwellings are situated since they are in rundown conditions and are on tracts at Keaukaha which are not suitable for residential purposes due to the expansion of Hilo airport. Thus, in our opinion, the sum of \$23,097 should not be included as an asset of the department.

5. **Use of improvements purchased.** Since the department has been unable to find takers to the tracts of land on which the improvements purchased are situated, it has rented out the dwellings on a month-to-month basis. This practice is in violation of the Hawaiian homes commission act, as noted in attorney general's opinion no. 61-64. In addition, the department has deposited the rentals collected into the home-loan fund, when the Hawaiian homes commission act requires that such receipts be deposited into the Hawaiian home-operating fund.

We recommend that the practice of renting out dwellings on a month-to-month basis be terminated, and that all rentals deposited into the home-loan fund be transferred to the operating fund.

6. **Loan fund balance.** The loan fund balance as of June 30, 1967 is understated by \$299,190. The amount of \$118,190 has been erroneously deposited into the operating fund when it properly belongs in the loan fund. In addition, there is a shortage of \$181,000. The source of that shortage is not now ascertainable, since the records of the department preceding 1949 have been disposed of in accordance with State regulations.

Operating Fund

The operating fund consists of moneys from all sources, except lease rentals on lands used for purposes other than homesteading. Included are interests on loans and bank deposits of moneys belonging to all the funds under the control of the department, except interest on loans from the additional receipts-loan fund portion. The moneys are used for the purpose of constructing revenue-producing improvements, retiring bonds floated to construct revenue-producing improvements, and to pay for services and supplies rendered homesteaders on a charge basis.

1. **Receivables from homesteaders.** As of June 30, 1967, there was due from homesteaders the total sum of \$28,084. This amount represents charges for water, pasture use and other services rendered by the department. Some of the charges have been outstanding for some time. The department is lax in its

collection as evidenced by its failure to maintain a current list of outstanding debts, except in case of water charges. We recommend that the department exert control over the delinquent accounts by establishing procedures requiring the preparation of monthly delinquency lists and outlining steps to be taken to prevent debts from remaining outstanding for long periods of time.

2. **Reimbursable leasing costs.** Included as an asset of the department is an item labeled *reimbursable leasing costs*. Included in this entry as of June 30, 1967, is a sum of \$136,104, which represents the costs to the department of developing the Kaei Hana I industrial subdivision. The department is expecting to make up this cost by charging the sum to lessees in the subdivision. We find that this practice is contrary to the provisions of the Hawaiian homes commission act. Development costs are not costs reimbursable by lessees.

3. **Rents from Kaei Hana I industrial subdivision.** The department has deposited into the operating fund, rentals collected from lessees of the Kaei Hana I industrial subdivision. It has used these rentals to reduce the balance of the reimbursable leasing costs incurred by reason of the development of the subdivision. The deposit of these rentals into the operating fund is in violation of the Hawaiian homes commission act, which requires such rentals to be deposited into the administration account. We recommend that all rentals collected after June 30, 1967 be transferred to the administration account, and all such rentals collected prior to July 1, 1967 be transferred to the development fund. The

Hawaiian homes commission act requires that all excess amounts in the operating account be closed out each fiscal year to the development fund.

4. **Payment of workmen's compensation.** During the fiscal year, an employee injured on the job was paid his full salary during the period of his temporary, total disability and absence from work. There is no record of the employee ever having filed for benefits under the workmen's compensation law. Nor is there any record that the payment made to him has been charged off to his sick leave accumulation. Under the applicable statutes in force during the fiscal year, an injured employee could either file for benefits under workmen's compensation or take sick leave, but not both. Under workmen's compensation, however, his temporary, total disability benefits are limited to 66-2/3% of his salary. We recommend that the records be clarified by either showing the payments made to the employee as payment of benefits under workmen's compensation or as a charge against his sick leave accumulation, and that necessary adjustment be made for any money received by him which is in excess of what he was legally entitled to receive.

5. **Costs of services provided homesteaders.** During the fiscal year, receipts from charges to homesteaders for services rendered by the department was \$43,134, and the costs to the department in rendering those services was \$119,060. While, perhaps, under the Hawaiian homes commission act, the rates at which services rendered by the department to homesteaders need not be such as to recoup all costs

to the department, we believe that the rates should bear some reasonable relationship to actual costs. We recommend that the rates charged for services be reviewed at least annually and that they be adjusted to recoup as much of the costs to the department in rendering such services as the intent of the Hawaiian homes commission act permits.

Administration Account

All receipts from leasing of available lands are deposited into the administration account from which the administrative expenses of the department are paid. The Hawaiian homes commission act provides that the commission shall secure legislative approval as to the amount it may spend for administrative expenses during a fiscal year and that the excess of revenue over the approved expenses for that fiscal year shall be transferred to the development fund.

Our examination of the account revealed that the department is granting revocable permits to individuals to occupy and use certain available lands. In the attorney general's opinion (opinion no. 61-64), the department of Hawaiian home lands does not have authority to grant revocable permits for the occupancy of its lands. We recommend that the department terminate as quickly as possible its practice of granting revocable permits. If the department believes that it is in the best interest of the department to grant revocable permits to lands which would otherwise remain idle, we recommend that the department seek legislation authorizing the department to grant such permits.

Other Accounts

In addition to the several special funds, the department of Hawaiian home lands administers other miscellaneous accounts. They are the petty cash fund, temporary deposit account, bond fund account and the property inventory account. Our findings and recommendations in this summary are limited to the latter two accounts.

1. **Bond fund appropriations.** The State legislature in the past authorized the floating of bonds for certain non-revenue-producing improvements. The bond moneys were expended by the department of Hawaiian home lands. As of June 30, 1967, there was a total of \$32,217 in unused amounts for two projects which were completed on March 24, 1965 and March 22, 1966. We recommend that these unexpended allotment balances (and future balances as they occur) be reported immediately to the department of planning and economic development for proper disposition.

2. **Property inventory.** The department maintains two inventory accounts. One of these is the general ledger control account, which cumulates by categories the property acquired by the department. The other is a detail listing which lists each specific item of property under the control and management of the department. The cost figures noted on these two accounts do not agree. The general ledger control account shows property in the amount of \$4,049,676, while the detail listing shows property in the amount of \$2,811,426. We believe that the detail listing is more accurate of the two. We recommend that the

general ledger control account figure be adjusted to the one appearing on the detail listing, and that hereafter, the two accounts be reconciled periodically.

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PART IV

APPENDICES

MEMORANDUM OF COMMENTS OF AFFECTED AGENCY

This financial report of the department of Hawaiian home lands was completed in January 1968. On February 6, 1968, we distributed a copy of the report to the department of Hawaiian home lands, via a transmittal letter, a copy of which is attached as Attachment No. 1. The department was requested to submit to us its comments, if any, no later than February 14, 1968.

The department of Hawaiian home lands submitted its response on February 14, 1968. (See Attachment No. 2.) The department of Hawaiian home lands agrees with the recommendations contained in our report and has indicated that it is implementing or will implement the changes recommended, except the following.

Erroneous Transfer of \$118,190 to Operating Fund

In our report we noted that \$118,190 was erroneously transferred from the home-loan fund to the operating fund, and recommended that this sum be returned to the loan fund. The department of Hawaiian home lands responded to this recommendation thus:

This specific transfer was made after consultation and on the advice of the Department of Accounting and General Services by memo dated November 5, 1964. We will be happy to accept the recommendation of the audit report that this amount be transferred from the operating fund back to the home-loan fund. Before doing so, however, we feel that this matter should be reconciled between the Legislative Auditor and the Department of Accounting and General Services to the satisfaction of both.

The department then stated, *Action on this specific item is being withheld until the matter is reconciled as suggested above.*

Our Comments:

The department of accounting and general services' memo, dated November 5, 1964, did not advise the department of Hawaiian home lands to make the specific transfer in question. The memo simply gave general advice in making proper adjustments and recommended several approaches in disposing of any excess in the loan fund. Further, the memo's recommendations were based on the assumption that the home-loan fund should have no more than \$3,750,000. As stated and explained in our report, this assumption was incorrect. We stated clearly our position on this matter, and we feel that the department of Hawaiian home lands should initiate the transfer in question. If the department of accounting and general services disapproves of this transfer, we will be happy to discuss this matter with the department.



CLINTON T. TANIMURA
AUDITOR

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
IOLANI PALACE
HONOLULU, HAWAII 96813

February 6, 1968

Mr. Abraham Piianaia
Commission Chairman
Department of Hawaiian
Home Lands
530 Halekauwila Street
Honolulu, Hawaii

Dear Mr. Piianaia:

Enclosed is a copy of our preliminary report on the audit of the accounting records of your department for the fiscal year ended June 30, 1967. The term, *preliminary*, indicates that the report has not been released for general distribution. However, copies of this report have been submitted to the Administrative Director of the State, the Speaker of the State House of Representatives, and the President of the State Senate.

The report contains a number of recommendations. I would appreciate receiving your written comments on them, 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 February 14, 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 February 9, 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.

We are deeply thankful for the help and cooperation extended by your staff to our auditors.

Sincerely yours,


Clinton T. Tanimura
Auditor

PROJECT OFFICES

WAIMEA OFFICE
P. O. BOX 125
KAHUELA, HAWAII

KEAUKAHA OFFICE
P. O. BOX 833
HILO, HAWAII



STATE OF HAWAII
DEPARTMENT OF HAWAIIAN HOME LANDS
P. O. BOX 1879
HONOLULU, HAWAII 96805

February 12, 1968

ATTACHMENT NO. 2

RECEIVED

FEB 14 1968

OFFICE OF THE AUDITOR
TIME _____

PROJECT OFFICES

MAUI OFFICE
P. O. BOX 22
KAHOOLA, MAUI

MOLOKAI OFFICE
P. O. BOX 198
MOOLEHUA, MOLOKAI

KAUAI OFFICE
P. O. BOX 332
LIHUE, KAUAI

Mr. Clinton T. Tanimura
Legislative Auditor
State of Hawaii
Schuman Building Annex
Honolulu, Hawaii

Dear Mr. Tanimura:

Your February 1968 preliminary Financial Audit of the Department of Hawaiian Home Lands For The Fiscal Year Ended June 30, 1967, reached me on February 6, 1968. Since that time, I have gone over it several times and have discussed it with our accountant, paragraph by paragraph.

As a result of the foregoing, I am submitting the enclosed report which includes comments on each area in which you have made recommendations. Should any of my comments be unacceptable or hazy, please feel free to let me know so we may be able to discuss the matter to our mutual satisfaction.

In closing, may I state that the field auditors who spent many weeks going over our books and other records, Mr. Donald Asao and Mr. Wallace Rezendes, conducted themselves as gentlemen throughout the entire period they were with us and were well received by our staff. This speaks well for your organization and, certainly, you are to be congratulated.

Respectfully,


A. K. PII'ANAIA, Chairman
Hawaiian Homes Commission

Enclosure

COMMENTS

ON THE FEBRUARY 1968 PRELIMINARY FINANCIAL AUDIT OF
THE STATE DEPARTMENT OF HAWAIIAN HOME LANDS FOR THE
FISCAL YEAR ENDED JUNE 30, 1967, BY THE LEGISLATIVE
AUDITOR OF THE STATE OF HAWAII

Submitted by

A. K. Piianaia, Chairman
Hawaiian Homes Commission
Department of Hawaiian Home Lands

February 12, 1968

PREFACE

The February 1968 preliminary FINANCIAL AUDIT OF THE STATE DEPARTMENT OF HAWAIIAN HOME LANDS FOR THE FISCAL YEAR ENDED JUNE 30, 1967, as prepared and submitted by the Legislative Auditor of the State of Hawaii, Mr. Clinton T. Tanimura, was received by the Department of Hawaiian Home Lands on February 6, 1968.

In his letter of transmittal, Mr. Tanimura indicates that the audit report contains a number of recommendations; that he would appreciate receiving written comments on the said recommendations, including specific actions taken, or intended to be taken, in respect to each recommendation. The deadline set for the submission of comments is February 14, 1968.

Having gone over the audit report several times, by myself as well as with the Department's accountant, and having studied each finding and recommendation carefully, the comments contained in this report are made with the knowledge that the ultimate desire is the attaining and maintaining of sound and effective financial management in the operation and administration of the government of the State of Hawaii by both its Legislative and Executive branches.

Should there be any questions in respect to the comments made in this report, feel free to raise them and to contact us. The comments in this report are made on a page-by-page basis in respect to the Legislative Auditor's preliminary audit.

Legislative Auditor's Note

Please disregard page numbers noted in the department's "Comments." They refer to the page numbers of our preliminary draft report.

COMMENTS

Pages 1 to 6: No comments necessary.

INTERNAL CONTROL

Pages 7 to 8: Item: RECONCILIATION OF CASH ACCOUNT BALANCES

In discussing this specific item with our accountant, I am convinced that the net overage of \$911 is due to our failure to reconcile our records with those of the Department of Accounting and General Services on a more frequent basis.

SPECIFIC ACTION TAKEN: Our accountant is now making a thorough check of our records to locate this discrepancy and will be working with the Department of Accounting and General Services to reconcile the discrepancy when it is located.

In addition to the above, I have instructed our accountant to set up forthwith a mutually agreeable schedule for monthly reconciliation of our financial records so as to ascertain and correct discrepancies as early as possible if such discrepancies do exist, thereby reducing or eliminating errors of this nature in the future.

Pages 8 to 9: Item: COUNT OF PETTY CASH AND CASH RECEIPTS

Under this item it is recommended that periodic, unannounced cash counts of cash and cash collections and checks of prenumbered cash receipt slips be made at all neighbor island branch offices as a measure of internal control. At the present time, this is not being done.

SPECIFIC ACTION TAKEN: As recommended, I have instructed our accountant to make unannounced visits to our neighbor island branch offices for the purpose as stated above. These shall be on a quarterly basis (once every three months), at different times and in such a manner as to be not only unannounced by unexpected as well. Any discrepancies discovered by such visits shall be reported immediately and a complete statement of facts submitted.

Pages 9 to 10: Item: FINANCIAL REPORTS

This item is further subdivided to cover monthly reports on: (1) Operating fund; and (2) Administration account. In each case, however, it is recommended that the monthly financial reports submitted to the Hawaiian Homes Commission be continued as they are except that

cumulative total receipts and expenditures be included so as to provide the Commission with information as to the total balance in the operating fund available for use, and the total of amounts received in the administration account as well as all transfers to the development fund.

SPECIFIC ACTION TAKEN: As recommended, I have instructed our accountant to prepare our monthly financial reports as recommended for the operating fund and for the administration account. This, I am assured, will begin with the monthly reports for the month of March, 1968.

Pages 11 to 14: No comments necessary.

Page 15: Item: Restricted cash.

The matter of restricted cash is historical with the Department. Once a loan has been approved, it may be months before the loan is actually used for one or more reasons. There is, I agree, no reason for any loan not to be used within one year as in the case with the \$24,000 mentioned in the audit report.

SPECIFIC ACTION TAKEN: All approved loans restricted for over 12 months will be cancelled

forthwith. Hereafter, all loans not used after 90 days will be reviewed and if such loans can not be used within the next 30 days, they will be cancelled. This will release restricted cash for further use in the homesteading program.

Pages 16 to 17:

Item: Repair loans.

Since the beginning of the Hawaiian Homes program loans for repairs to homes have been treated on the same basis as loans for improvements. Inasmuch as most homes in the homesteading program are amortized through loans by the Department, it has been the feeling of the Commission that so long as a balance remains outstanding to the Department on a home loan, it is good business to keep the home in good repair, and in this way protect its investment.

SPECIFIC ACTION TAKEN: An opinion of the Attorney General will be requested to clear this matter. When received, a copy of the opinion will be forwarded to the Legislative Auditor.

Pages 17 to 18:

Item: Delinquencies.

Four years ago delinquency on loan repayments stood at about 20%. Over the past four years, we have worked at this until now the delinquency is less than 1%, and has been so for

over two years. This has been an area quite touchy with the Commission and in several cases cancellation of leases has resulted. The problem in such cases, however, is that these families who lose their homesteads become welfare cases and the burden of assisting them is only shifted by our Department to the Department of Social Services.

SPECIFIC ACTION TAKEN: We will accept on a trial basis the recommendation of the audit report and cite delinquents after 90 days. If this works out we will adopt the 90 day delinquent citation system. If not, we shall seek other means of meeting this specific problem.

Pages 19 to 20: Item: Reimbursement of purchase price.

The audit report gives the Department and the Commission an excellent reason for making use of Section 215(3) which states, in part: "... the department may, if it deems advisable and for the best interests of the lessees, write-off and cancel, wholly or in part, the contract of loan of the deceased lessee, or previous lessee, as the case may be, where such loans are delinquent and deemed uncollectible."

SPECIFIC ACTION TAKEN: We shall take cognizance of the audit report's opinion and exclude \$23,097 as an asset of the home-loan fund.

Page 20: Item: Renting purchased improvements.

This practice is now going on only at Keaukaha, Hawaii. The practice is, as indicated in the audit report, not permitted by the Hawaiian Homes Commission Act.

SPECIFIC ACTION TAKEN: The Department will propose legislation to make this practice legal under the Act. If this cannot be legalized the practice will be discontinued. In any event, there will not be any further renting of purchased homes and those now being rented will be phased out.

Pages 20 to 21: Item: Disposition of rentals.

The audit report is concise and clear in respect to this item.

SPECIFIC ACTION TAKEN: The recommendation that revenues from rentals be transferred and deposited in the Hawaiian Home-Operating Fund will become effective immediately.

Pages 21 to 22: Item: Erroneous transfer of \$118,190 to operating fund.

This specific transfer was made after consultation and on the advice of the Department of Accounting and General Services by memo dated November 5, 1964. We will be happy to accept the recommendation of the audit report that this amount be transferred from the operating fund back to the home-loan fund. Before doing so, however, we feel that this matter should be reconciled between the Legislative Auditor and the Department of Accounting and General Services to the satisfaction of both.

SPECIFIC ACTION TAKEN: Action on this specific item is being withheld until the matter is reconciled as suggested above.

Pages 22 to 23: Item: Shortage of \$181,000.

This is an interesting phase of the financial history of the Department. The answer to the shortage came to light several years ago in a Senate Ways and Means Committee hearing when Senator Julian Yates made a statement to the effect that while he was Executive Secretary of the Hawaiian Homes Commission, the Territorial Legislature at times did not provide enough money to operate the Department. To make ends meet and

keep the program going, over the years, he simply used funds in the home-loan fund to meet the costs of operation and administrative expenses.

SPECIFIC ACTION TAKEN: None.

Pages 24 to 46: No comments necessary.

Page 47: Item: From homesteaders.

The audit report indicates that an outstanding amount of \$28,064 representing charges for water, pasture use and other services rendered by the Department to homesteaders, is due the Department. The audit report recommends more stringent control over such delinquent accounts.

SPECIFIC ACTION TAKEN: The recommendation will be followed and procedures established to prevent charges for services from remaining outstanding for long periods of time, including the preparation of a list of delinquencies.

Page 47: Item: REIMBURSABLE LEASING COSTS

The question that arises in this item is: Inasmuch as construction and development costs of prior years were for the development of lands for leasing to homesteaders only, hence, for non-revenue producing improvements, whereas,

the development costs here were for revenue-producing improvements, why should this fund not be reimbursed?

SPECIFIC ACTION TAKEN: None as yet. We want to discuss this with Counsel, then proceed from there. You will be posted on this matter.

Page

48:

Item: Rents from Kaei Hana I industrial subdivision.

In respect to this item the audit report indicates that the revenues collected from this industrial subdivision should be deposited into the administration account, not to the operating fund as is being done now. This would also mean that operating funds once used for construction of revenue producing projects would be unavailable again except by way of home-development fund where it may be used for non-revenue producing projects.

SPECIFIC ACTION TAKEN: None as yet. We want to discuss this with Counsel; You will be posted on this matter. (Legislation may be sought which will permit return of the revenues obtained through this operating fund to the said operating fund for further use in generating revenue producing projects).

Pages 49 to 52: No comment necessary.

Pages 53 to 54: Item: Expenditures: workmen's compensation.

This matter of one of our employees receiving full salary while absent from work during a period of temporary, total disability will be checked thoroughly so as to straighten out this situation, as well as to prevent repetition of similar cases in the future.

SPECIFIC ACTION TAKEN: This specific item is being looked into and will be corrected as soon as possible and the records clarified.

Pages 54 to 55: Item: Cost of services provided the homesteaders.

This is a problem with historic roots in the formative years of the Hawaiian Homes program. Many areas opened to homesteading had no utilities, domestic water, and other items needed for land occupancy. Rates were set for services, changed from time to time, but never set high enough to meet the cost of providing such services. This has been especially true of the domestic water system on Molokai. The House Committee of Congress to which the bill creating the Hawaiian Homes Commission was referred, recommended, among other things, that accessible water in adequate amounts must be provided for all tracts.

SPECIFIC ACTION TAKEN: The audit report's recommendation is acceptable. A real effort will be made to bring charges for service in line with cost of such service.

Page 55: Item: COST OF LAND IMPROVEMENTS REINSTATED AS REIMBURSABLE FROM LESSEES

This item has been covered in comments, reference pages 47 to 48.

Pages 56 to 59: No comments necessary.

Pages 60 to 61: Item: Rentals from permissive uses of lands.

The practice of granting permissive use of land can be an important contribution to our program. However, since the Department is now not authorized to grant permissive use of its land, it would be prudent to seek legislation to permit such permissive use as recommended in the audit report.

SPECIFIC ACTION TAKEN: The practice of granting revocable permits will be discontinued forthwith. In the meantime, we shall plan to seek legislation to make this practice legal.

Pages 62 to 68: No comment necessary.

Pages 69 to 70: Item: BOND FUND APPROPRIATIONS

The audit report is clear in respect to this specific item.

SPECIFIC ACTION TAKEN: Unexpended allotment balances are being reported to the Department of Planning and Economic Development forthwith for proper disposition.

Pages 71 to 72: Item: PROPERTY INVENTORY

The audit report's recommendation that the general ledger control account be adjusted to the detail inventory listing with periodic reconciliation of both will be followed.

SPECIFIC ACTION TAKEN: As soon as staff is available for this job, it will be done.

Page 73: No comment necessary.

Page 74: Item: Cash account balances.

This is presented clearly in the audit report and needs no further comment.

SPECIFIC ACTION TAKEN: Our Accountant has been instructed to locate this discrepancy as soon as possible and to reconcile records with the Department of Accounting and General Services on a monthly basis. (See comments for pages 7 to 8).

Pages 75 to 80: Most items on these pages have been covered. No further comment necessary.

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