

AUDIT REPORT
NO. 71-3
MARCH 1971

AUDIT
OF THE
STATE VENDOR
PAYMENT PROCESS

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 7, 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
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FOREWORD

This audit report is the result of our examination of the vendor payment process of the State. The audit was conducted pursuant to a request by the presiding officers of both houses of the State legislature who expressed concern over the slow payment to vendors by State agencies.

Our audit focused on the activities and processes of four departments—department of accounting and general services, university of Hawaii, department of education and the department of health. In general, we found that the payment process is unnecessarily slow and that significant improvements can be made if the recommendations contained in this report are adopted.

As has always been our practice, we requested the agencies affected by our examination to submit in writing their comments on our findings and recommendations and to indicate what action they have taken or intend to take on our recommendations. The responses of the agencies are appended in Part III, Responses of Affected Agencies.

I wish to acknowledge the fine cooperation and assistance extended to my staff by the departments' personnel.

Clinton T. Tanimura
Legislative Auditor

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**PART I
INTRODUCTION AND SOME BACKGROUND**

Chapter 1

INTRODUCTION

The President of the Senate and the Speaker of the House of Representatives, Fifth State Legislature, have expressed their concern over the continuing failure of State agencies to pay for goods delivered and services rendered within the 60 days required by section 103-10 of the Hawaii Revised Statutes and have requested this office, by joint letter, to conduct an inquiry into this late payment problem. This is a report on that examination.

Objectives of the Audit

The objectives of the audit were:

1. To determine the expeditiousness and efficiency of the State's vendor payment processes.
2. To recommend actions as appropriate to correct any inefficiencies and delays experienced in the current payment processes.

Scope of the Audit

The payment processes, subject to examination, included that process which is generally applicable to all agencies, and those processes unique to individual agencies.

In addition to the foregoing, petty cash funds used by the departments to pay for goods and services were examined.

The audit focused on the activities, records and documents involved in payment of vendors and the sequential flow of the payment process at the department of accounting and general services, the university of Hawaii, the department of education, and the department of health for the 1969-1970 fiscal year and the 1970-1971 fiscal year now in progress.

Organization of the Report

This report is organized into two parts as follows:

Part I (chapters 1 and 2) – Introduction and Background.

Part II (chapters 3 to 7) – Findings and Recommendations.

Definition of Terms

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

Average means the median or midpoint of a sample.

DAGS means the department of accounting and general services.

DOH means the department of health.

DOE means the department of education.

Payment process means that phase of the procurement process which occurs from the receipt of a vendor's invoice or the receipt of goods or services to the payment for such goods or services.

Procurement process means the flow of sequential activities which occurs from the making of a decision to acquire goods or services to the payment for such goods or services as may be acquired.

Purchase order means a document containing appropriate authorization to purchase that is sent to the vendor instructing him to make delivery.

Receiving report means a document acknowledging the receipt or delivery of goods. It contains information such as the date, quantity and items delivered.

Requisition means a document that a user uses to make a request for purchase.

State means the State of Hawaii.

Summary warrant voucher (SWV) means a document authorizing the State comptroller to make payment on the claims listed thereon.

UH or *university* means the university of Hawaii.

Vendor's invoice means a document prepared by the vendor which contains a statement of the goods sold or services rendered and represents the vendor's claim for payment.

Warrant means an order drawn by the State comptroller upon the State treasury directing the State director of finance to pay the amount specified thereon to the person named or to bearer.

Chapter 2

SOME BACKGROUND

The ombudsman of the State of Hawaii issued a report in January 1970 which summarized the activities of his office for the six-month period ended December 31, 1969. In his report, the ombudsman cited as a continuous and annoying problem the long delays experienced by vendors in being paid for goods sold and services rendered to the State. Some

complained of not being paid for periods up to six months. The ombudsman suggested that the problem of late payments be referred to the legislative auditor for an overall study.

The problem seems to be one of long standing. Findings similar to those of the ombudsman led to the enactment of section 103-10, HRS (Act 292, SLH 1967). This statute was enacted as a result of a legislative finding that a substantial number of contractors

selling goods and services to the State and county governments were frequently waiting 90 to 120 days or more to receive payment. The purpose of the legislation was to require prompt payment on government contracts. Briefly, section 103-10, HRS, provides that vendors be paid no later than 60 calendar days following receipt of a statement. If the vendor does not receive payment within the 60-day period, he is entitled to interest on the amount unpaid at the rate of ½% per month.

PART II
FINDINGS AND RECOMMENDATIONS

Chapter 3

SUMMARY OF FINDINGS

The procurement process for the State involves two organizational units—first, the department where the activities of ordering and receiving the goods or services take place; and second, the department of accounting and general services where the claims for payment are subject to audit and where the warrants are prepared and mailed to the vendor. A flow chart of the general procurement process is presented in figure 3.1.

The process begins when the decision to acquire goods is made. The department issues a purchase order for goods to a vendor and upon delivery, prepares a receiving report. The vendor in turn sends an invoice to the department which is matched with a copy of the purchase order and the receiving report. The department then prepares and sends a summary warrant voucher to DAGS where it is subject to audit. The warrants are subsequently issued and mailed to the vendor.

State Average Payment Time

Though the general procurement process begins when the decision is made to acquire goods, the payment process actually begins at delivery or at the receipt of the vendor's invoice by the department. The overall payment process therefore is the elapsed time between the receipt of goods or invoice to the date when a warrant is issued to the vendor. Figure 3.2 presents our measurement of this payment process.

Our sampling of the purchase transactions of the State for fiscal year 1969–1970 showed an average process time of 49 days with approximately 30% of our sample taking more than 60 days to process. By applying 30% to the approximate number of purchase orders (300,000) issued by the State for FY 1969–1970, we arrive at an estimated 90,000 purchase orders which were not paid within the 60-day statutory requirement provided in section 103–10, HRS.

Although the statute requires the State to pay interest at the rate of ½% per month on amounts to vendors unpaid after 60 days, we understand that very few payments of interest have actually been made since the enactment of the statute.

Figure 3.1
THE GENERAL PROCUREMENT PROCESS

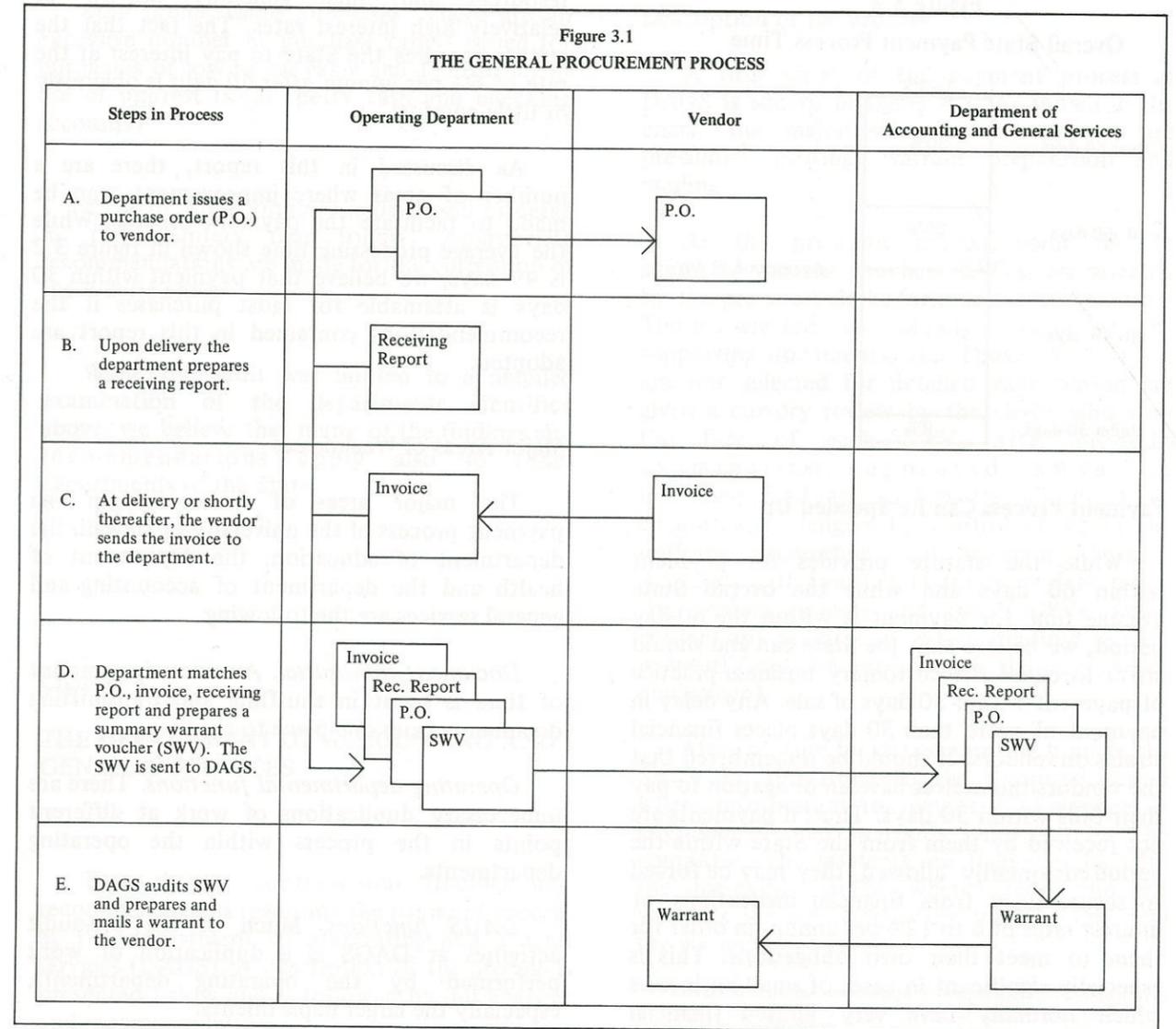
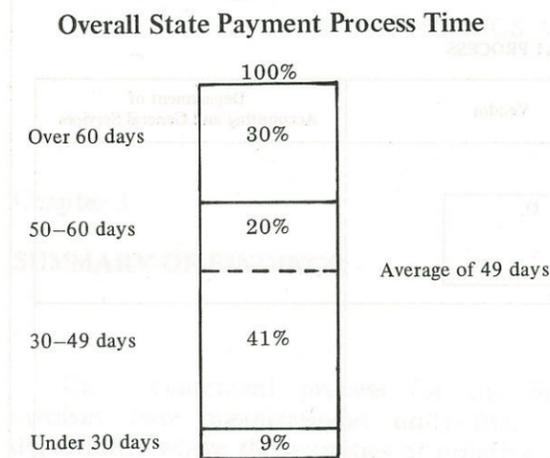


Figure 3.2



Payment Process Can Be Speeded Up

While the statute provides for payment within 60 days and while the overall State average time for payment is within the 60-day period, we believe that the State can and should strive to equal the customary business practice of payment within 30 days of sale. Any delay in payment of more than 30 days places financial strains on vendors. It should be remembered that the vendors themselves have an obligation to pay their bills within 30 days. Thus, if payments are not received by them from the State within the period customarily allowed, they may be forced to secure loans from financial institutions at interest rates of 8 to 12% per annum in order for them to meet their own obligations. This is especially significant in cases of small businesses which normally have very limited financial

resources and must generally borrow at relatively high interest rates. The fact that the statute requires the State to pay interest at the rate of 6% per annum after 60 days is obviously of little comfort.

As discussed in this report, there are a number of areas where improvements can be made to facilitate the payment process. While the average processing time shown in figure 3.2 is 49 days, we believe that payment within 30 days is attainable for most purchases if the recommendations contained in this report are adopted.

Major Areas of Weaknesses

The major areas of weaknesses in the payment process of the university of Hawaii, the department of education, the department of health and the department of accounting and general services are the following:

Document transmittal. An excessive amount of time is spent in shuffling and transmitting documents from one place to another.

Operating departmental functions. There are unnecessary duplications of work at different points in the process within the operating departments.

DAGS functions. Much of the pre-audit activities at DAGS is a duplication of work performed by the operating departments, especially the larger departments.

Low dollar value purchases. There are an excessive number of purchase orders issued for purchases of low dollar value and an insufficient use of imprest funds (petty cash and checking accounts).

Each of these findings is discussed in detail in the chapters that follow. Appropriate recommendations are made for the correction of these deficiencies.

While the audit was limited to a detailed examination of the departments identified above, we believe that many of the findings and recommendations apply also to other departments of the State.

Chapter 4

THE DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

This chapter contains our findings and recommendations regarding the payment process at the department of accounting and general services (DAGS). A description of the process is presented below and is followed by our analysis and recommendations.

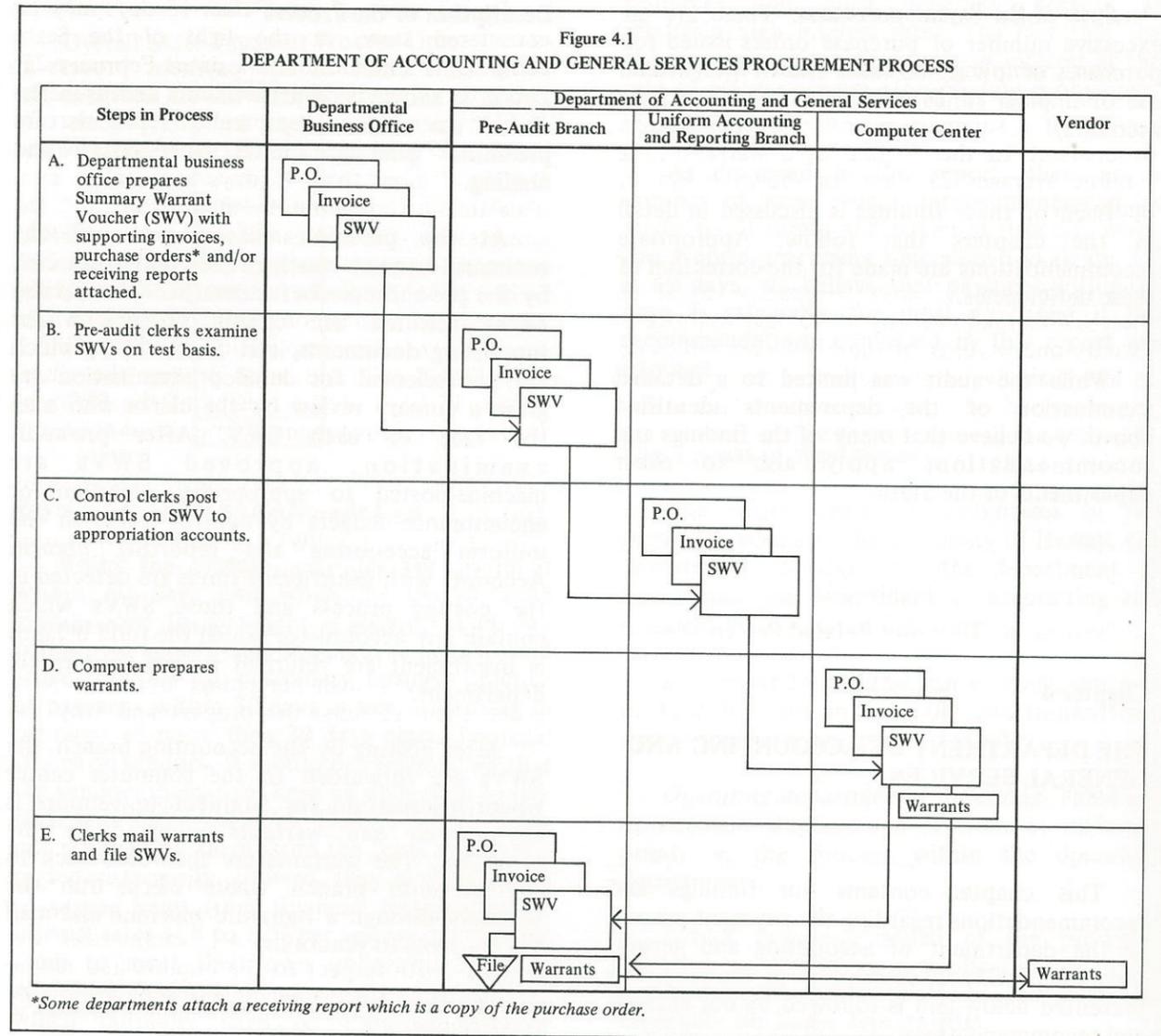
Description of the Process

A flow chart of the payment process at DAGS is shown in figure 4.1. As shown in the chart, the major steps in the process are pre-audit¹ posting, warrant preparation and mailing.

At the pre-audit branch, some of the summary warrant vouchers (SWVs) are selected by the pre-audit clerks for detailed examination. Those selected are closely scrutinized for supporting documents, etc. Those SWVs which are not selected for detailed examination are given a cursory review by the clerks who scan the face of each SWV. After pre-audit examination, approved SWVs are machine-posted to appropriate allotment or encumbrance ledgers by control clerks in the uniform accounting and reporting branch. Accounts with insufficient funds are detected in the posting process and those SWVs which contain any account for which the fund balance is insufficient are returned to the appropriate department.

After posting by the accounting branch, the SWVs are forwarded to the computer center where information for payment to vendors is keypunched and warrants prepared by the computer. The warrants are then sent back to the pre-audit branch where clerks run the warrants through a signature machine and mail the warrants to vendors.

¹DAGS is required by section 26-6, HRS, to pre-audit and post audit the financial accounts of all State departments to determine the legality of expenditures.

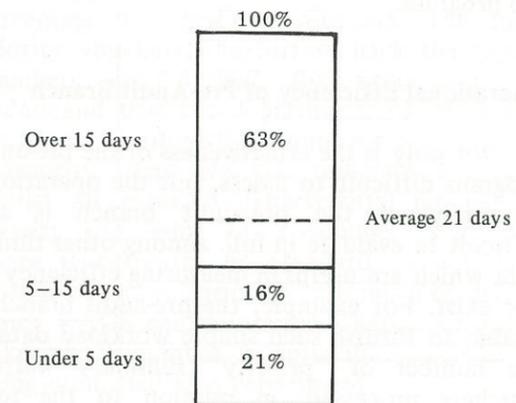


Analysis of the Payment Process

Our sampling revealed that the overall process time at DAGS, measured from the receipt of a summary warrant voucher from a department to the mailing of a warrant to a vendor, averages 21 days, as shown below in figure 4.2.

As shown in figure 4.2, 63% of the SWVs take more than 15 days to process. Some of these SWVs take as many as 40 days to process. Twenty-one percent of the SWVs are processed in less than five days. However, most of these are processed on a priority basis, which means that they are processed on the same day they are received rather than on the usual "first in, first out" basis.

Figure 4.2
Processing Time and Related Percentages



Process time of more than 15 days may be considered slow, in the light of the State comptroller's memorandum, dated February 27, 1968, to all heads of departments and agencies. In that memo, the comptroller states that "a claim has been considered processed late (to DAGS) if more than 45 days were taken by a department to submit the claim to the comptroller, because such claims are generally exposed to the interest penalties under Act 292, SLH 1967." Since the statute provides for the payment of interest on claims not paid within 60 days, the clear implication of this memo is that DAGS will and must process the claims within 15 days of the receipt of the SWVs by DAGS to avoid payment of interest.

A total of 51,228 SWVs were processed by DAGS in fiscal year 1969-70. This means that 63% of the 51,228 SWVs or 32,311 SWVs took more than 15 days to process.

The following are some operational deficiencies at DAGS. Some of these deficiencies explain why a high percentage of SWVs take more than 15 days to process and why the overall average is 21 days.

Effectiveness of the Pre-Audit Program

The number of errors in the SWVs and supporting documents uncovered in pre-audit is minimal in relation to the total number of SWVs processed. Table 4.1 summarizes our findings with respect to the number and nature of the errors uncovered during the period July to December 1970.

As shown in table 4.1, the total number of errors found in the six-month period ended December 1970 was 429. Of this number only 120 or 29% were caught by the pre-audit branch. The remaining 71% were found by the accounting branch.

During the fiscal year 1969-70, DAGS processed a total of more than 51,000 summary warrant vouchers (SWVs) representing an estimated 300,000 transactions. If we assume that the number of transactions to be processed this year (1970-71) is ratably the same as last year, then, during the six-month period ended December 1970, DAGS has processed over 150,000 transactions. The number of errors (120) found by the pre-audit branch during this six-month period over the number of transactions (150,000) is .08%—an infinitesimal rate.

Whether or not this rate of error-discovery denotes success or failure of the pre-audit program of DAGS is difficult to assess. In the *first* place, the objective of DAGS' pre-audit program is unclear. *Second*, DAGS does not maintain that kind of information from which the objective might be gleaned and measures to assess effectiveness determined. For example, there is no information as to the number of SWVs that were examined in detail which led to the discovery of the 120 errors. Thus, it is impossible to state whether the discovery of the 120 errors was the result of examining 10, 100, 200, or 400 SWVs and the success rate was 100%, 80%, or 10% of all SWVs examined in detail.

Table 4.1
Summary of Errors
July to December 1970

Nature of Error	No. of Errors	Percent
Pre-audit branch:		
Missing signatures	37	9
Legality and propriety	28	7
Missing invoice or receiving report	26	6
Other	29	7
Total — Pre-audit branch . . .	120	29%
Accounting branch:		
Insufficient funds	309	71
TOTAL	429	100%

We recommend that DAGS establish an objective for its pre-audit program, determine measures of accomplishment, and begin to retain data necessary to determine success or failure of the program.

Operational Efficiency of Pre-Audit Branch

Not only is the effectiveness of the pre-audit program difficult to assess, but the operational efficiency of the pre-audit branch is also difficult to evaluate in full. Among other things, data which are useful in measuring efficiency do not exist. For example, the pre-audit branch is unable to furnish such simple workload data as the number of "priority" summary warrant vouchers processed, in relation to the total

number of SWVs processed, in a given month. This kind of information is helpful to a program manager in judging whether there are an excessive number of priority vouchers. Despite such difficulties, however, it appears that there are sufficient indicators to conclude that the pre-audit branch is not operating at an optimum efficiency. Correction of some of these deficiencies can enhance the speed with which vendors are currently being paid.

Lack of guidelines on priority items. In the absence of direct data, we took a sample and examined the SWVs included in our sample and noted that 20% or 10,246 of the total 51,228 SWVs processed by DAGS in fiscal year 1969-70 were priority vouchers. Priority vouchers are usually processed in one day since they are "put on top of the pile," and receive immediate attention throughout the DAGS process.

It appears that 20% is a relatively high percentage for priority vouchers. The more priority vouchers, the further back the regular vouchers are pushed for processing. We understand that the departments use their own discretion in submitting claims for processing on a priority basis. We also understand that in almost all cases, a departmental request for priority processing of a voucher is granted. There is currently no standard to determine what constitutes "priority" and no measures by which DAGS can determine whether or not an "excessive" number of priority vouchers are being submitted by a department.

We recommend that DAGS (1) formulate specific guidelines and inform all departments as to the circumstances under which vouchers can be processed on a priority basis and (2) establish measures by which it may detect excessive use of priority vouchers by the various departments.

Lack of standards for selecting SWVs for examination. No standards exist by which SWVs are selected for detailed examination. SWVs are currently selected for detailed examination on the basis of the amounts shown on the face of each SWV. The dollar amount which triggers detailed examination fluctuates with the volume of vouchers received by DAGS for processing. Thus, at peak periods during the year, such as in the last month of each quarter, especially the month in which the fiscal year ends, the dollar amount is raised and a lesser percentage of vouchers are examined. Such basis is artificial at best. In fact, it would appear that probably more of the vouchers should be examined during peak periods.

We recommend that a more rational basis be developed for the selection of vouchers for detailed examination. The criteria for selection could include such things as (1) the controls existing in the departments, (2) the nature of expenditure (such as travel, petty cash reimbursements, etc.) and (3) the departments' past experience in submitting error-filled or errorless vouchers.

Lack of performance measures. Paralleling standards for selecting SWVs for examination are standards to guide performance. Currently

there are no standards to measure how well the pre-audit clerks are performing their functions. For example, there is no workload standard—the number of vouchers that the pre-audit clerks are expected to process in a day, week or month. Without such standards, it is difficult for the pre-audit clerks to gauge whether or not they are performing as expected. This lack of standards explains in part the lack of workload data at DAGS and the low overtime experience in the pre-audit branch, even during those periods when the number of voucher submissions is high.²

We recommend that the State comptroller establish standards of performance.

Duplication of tasks. Some of the tasks performed by the pre-audit clerks in examining those vouchers selected for detailed examination are a duplication of the tasks performed at least once at the departmental level. These include examining the SWVs for:

- . legality and propriety of expenditures
- . attachment of proper supporting invoices and receiving reports
- . proper signatures on supporting documents

²The lack of overtime is also attributable to the practice of increasing the dollar amount of the vouchers during peak periods as the basis for determining which of the vouchers to select for detailed examination.

- . items and amounts on invoices matching those on receiving reports
- . accuracy of additions and extensions.

We recommend that the State comptroller review the operations of his pre-audit branch and eliminate all unnecessary duplication of work presently being performed.

Delays Caused by Insufficient Funds

While processing a SWV, the accounting branch at DAGS sometimes discovers that there are insufficient funds in certain appropriation accounts to support certain claims included in the SWV. (See table 4.1 for the frequency with which this occurred during July to December 1970.) In such instances, the practice is for the accounting branch to return the SWV to the pre-audit branch, which in turn notifies by telephone the department which submitted the voucher. If the department does not submit its corrections within a few days, the entire SWV is returned to the department for reprocessing. The holding up of the SWV and the return of the entire SWV to the department means that payment to all vendors listed on the SWV is delayed, even if the insufficiency of funds affects only one of the transactions or a single vendor. We see no reason why this should be the case.

We recommend that only that transaction resulting in insufficient funds be deleted from the SWV and held up or returned, and that the

SWV continue to be processed as to all the rest of the transactions. Another SWV can be submitted for the item deleted.

Use of Departmental Computer

The SWVs of the university and the department of education are prepared by the computer centers serving those departments. To prepare the warrants, the computer center at DAGS keypunches the information contained on the SWV. We believe that this keypunching at DAGS can be eliminated through the use of the "files" of the computer centers of the university and the department of education.

We recommend that DAGS coordinate its efforts with the other departments for use of their files.

Chapter 5

UNIVERSITY OF HAWAII

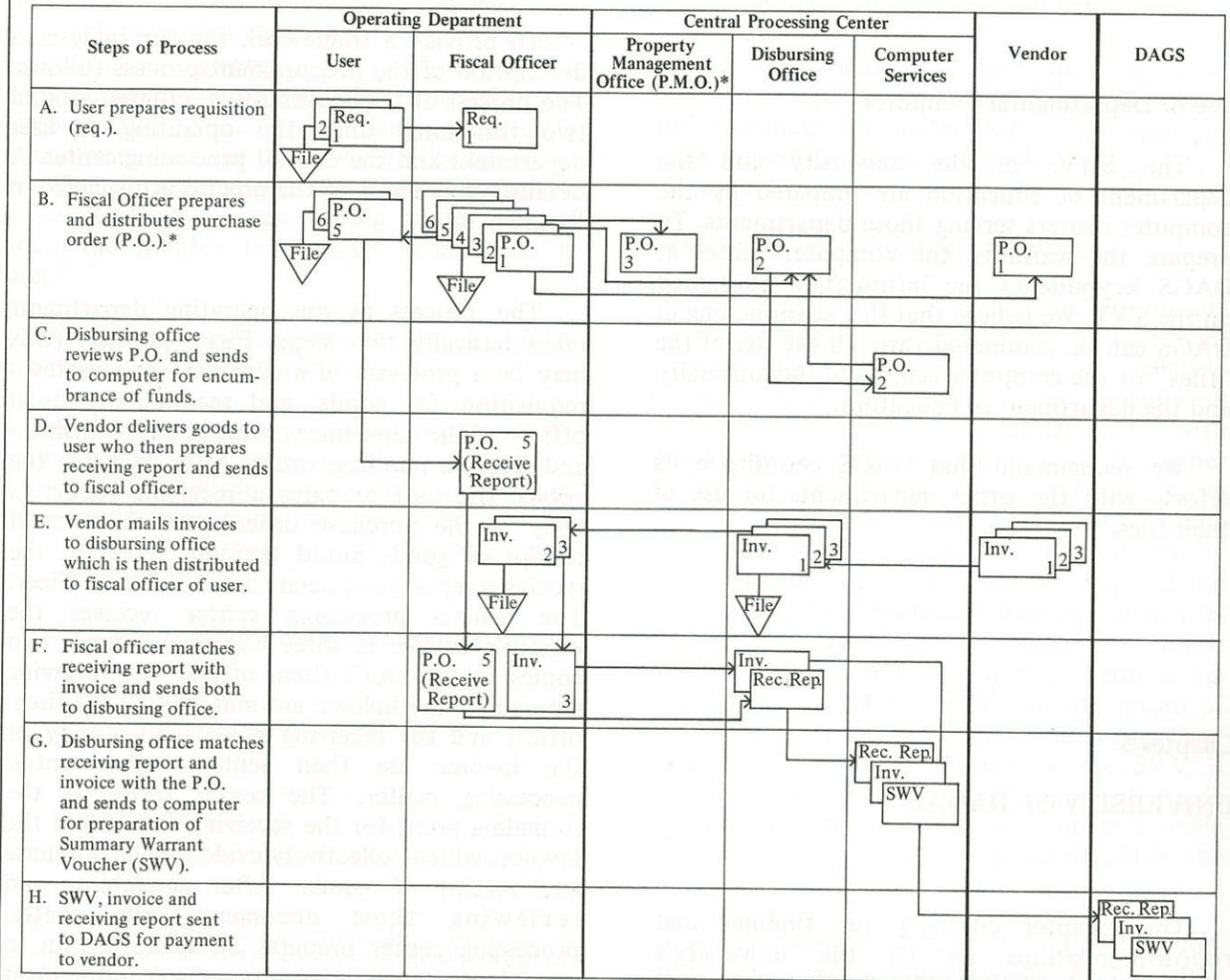
This chapter contains our findings and recommendations on (1) the university's payment process and (2) the functions and activities of the university's petty cash funds.

Procurement Process, Generally

To provide a framework for our analysis, a description of the procurement process follows. The process at the university is centered around two functional units—the operating or user department and the central processing center. A detailed flow chart of the process is displayed in Figure 5.1.

The process at the operating department takes basically two steps. First, the user (this may be a professor of a department) initiates a requisition for goods; and second, the fiscal officer of the department reviews the requisition and issues a purchase order. After receiving the goods, the user prepares a receiving report (a copy of the purchase order, with the fact of receipt of goods noted thereon, serves as the receiving report) and sends it to his fiscal officer. The central processing center receives the vendor's invoice in three copies and sends two copies to the user's fiscal office. The receiving report and the invoice are matched by the fiscal officer and the receiving report and a copy of the invoice are then sent to the central processing center. The center serves as the funneling point for the receiving report and the invoice, which collectively evidence the purchase and receipt of goods. After assembling and reviewing these documents, the central processing center prepares an authorization to pay (the summary warrant voucher) and sends it to DAGS.

Figure 5.1
UNIVERSITY OF HAWAII PROCUREMENT PROCESS



*For purchases over \$100, P.M.O. prepares and distributes P.O.

Analysis of the Payment Process

Our sampling revealed that the university's overall process time for payment to vendors, measured from the time the university receives the goods or the vendor's invoice to the time DAGS receives the summary warrant voucher from the university,¹ averages 28 days. This is shown in Figure 5.2. As shown in Figure 5.2, 32% of the purchases take more than 45 days to process. During the fiscal year 1969-70, the university processed a total of approximately 55,000 purchase orders. This means that 32% of the 55,000 or 17,600 purchase orders took more than 45 days to be processed through the university.

The specific activities of (1) the operating department and (2) the central processing center which contribute to this delay are discussed below.

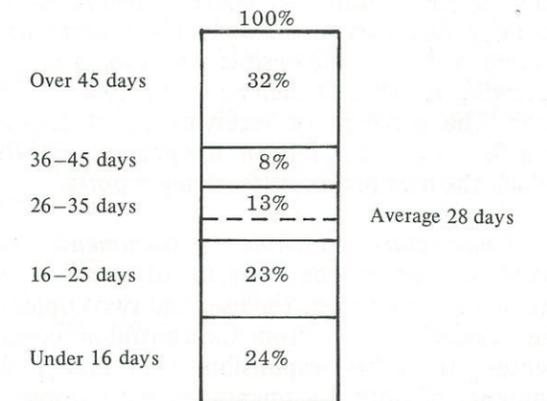
Operating Department

The university reports that it takes the operating departments an average of 17 days to process the necessary documents for payment to vendors. This processing time² ranges from a low of one day to a high of 184 days. We consider the average elapsed time unduly long.

¹While the procurement process commences from the time the operating department prepares the requisition for purchase, the process for payment to the vendor commences from the time the vendor's invoice is received by the university.

²The processing time begins from the receipt of goods or invoice and ends with the submission of the receiving report and invoice to the central processing center.

Figure 5.2
UH Payment Process Time



Delay in submission of receiving report. Much delay is experienced in the submission of the receiving report by the user. The report merely requires the signature of the user upon receipt of the goods before submission to the department's fiscal officer. The receiving report identifies the kinds and quantities of goods received from a vendor and serves as an acknowledgment that the goods ordered were received. We see no reason why the receiving report cannot be submitted immediately by the user. Any delay is inexcusable.

We recommend that the university take a "get tough" position with its users. For example, it can provide the users with the option of receiving direct deliveries from the vendors, as is presently being done, or of

receiving the goods through an intermediary source (some central office of the university). The latter option, of course, means slower delivery of goods to the user. The intermediary source will be responsible for preparing the receiving report and delivering the goods to the user. The privilege of receiving direct delivery can be made dependent on the promptness with which the user processes receiving reports.

Unnecessary matching of documents. The fiscal officer of the department receives the receiving report from the user and two copies of the vendor's invoice from the central processing center. It is his responsibility to match the contents of both documents for the purpose of assuring that the vendor's billing (invoice) is accurate with respect to quantity, pricing and items purchased.

Inasmuch as this matching process is also performed by the disbursing office of the central processing center after it receives both the receiving report and a copy of the invoice from the fiscal officer, there is a duplication of work. Since the frequency with which differences noted between the receiving report and the invoice is minimal, we recommend that the fiscal officer be relieved of this function. We also recommend that the receiving report which the fiscal officer presently receives be sent directly by the user to the central processing center. This will mean that the fiscal officer will be bypassed entirely in the process, thus, saving the time being spent presently at the fiscal officer level. Further, requiring this matching to be done only at the central processing center would also save

the time it now takes to transmit and receive the vendor's invoice to and from the fiscal officer. This means a saving of at least two days, probably more.

The fiscal officer can periodically be supplied by the central processing center with pertinent information on the transactions had for the purpose of updating his fiscal records.

Excessive use of confirming purchases. Ten percent of the purchase orders in our audit sample constituted confirming purchases. A confirming purchase is one in which a purchase commitment is made prior to the preparation and approval of a purchase order. This 10% applied to the total number of purchase orders processed by the university in 1969-70 (55,000) gives 5,500 confirming purchases for that year. We believe this is excessive.

Confirming purchases are generally illegal. A purchase order that authorizes the purchase is generally required before any purchasing is done. The university's procurement manual states that confirming purchases may be resorted to only in situations "that might result in loss of life or damage to buildings, or cause adverse effects to university programs." While it is recognized that there may be situations where it may be necessary for goods to be ordered before a purchase order is prepared, such practice should occur but rarely.

Besides being technically illegal, confirming purchases affect the payment process. In many of the cases noted, purchase orders were not

prepared until after the date of the delivery of the goods ordered. Thus, at the time of delivery, because a copy of the purchase order is used as the receiving report, that receiving report could not be prepared. It is not uncommon for receiving reports, resulting from confirming purchases, to take over 50 days to be transmitted to the central processing center. We see no reason why the purchase order cannot be made soon after the order and before receipt of goods, and thus be available for use as a receiving report at the time of the delivery of the goods. Apparently, either the user fails to inform the fiscal office of the confirming purchase or the fiscal officer "forgets" to prepare the purchase order.

We recommend that (1) the university strictly enforce the rules restricting the use of confirming purchases to "emergency" situations, and (2) the university take a "get tough" position such as removing purchasing privileges and authority from those fiscal officers and users who continue to "forget" to prepare purchase orders for confirming purchases.

Central Processing Center

The central processing center is comprised of two operating units—the disbursing office and the computer service. The processing time at this center averages 11 days.

As figure 5.1 shows, the disbursing office is the collection point of all of the documents

(that is, the purchase order, receiving report and the vendor's invoice) necessary for payment to a vendor. After a review for completeness and accuracy, the documents are assembled in batches and sent to the computer service for the preparation of summary warrant vouchers. The computer service also maintains the records on appropriations, allotments, expenditures and fund balances of the various departments of the university.

Excessive examination of purchase orders. The clerks in the disbursing office examine all purchase orders. The examination includes the verification of:

- . the cost of each item and the total cost of all items.
- . the various account codes contained on the purchase order (such as the object of expenditure, appropriation account and the vendor code number).
- . the approval of the purchase order by an authorized person.
- . the certification by the user's departmental fiscal officer regarding availability of funds.

We find such an extensive examination of purchase orders unnecessary. Much of the verification is presently being done by the user department's fiscal officer (or the property management office where the purchases are over \$100). We noted some minor

areas where a review by the disbursing office's clerks may still be necessary. These include such things as inserting the vendor code number where the number is not known by the user department at the time the purchase order is prepared. We understand that the number of errors noted by the disbursing clerks has been very low. We thus recommend that the disbursing office establish a more selective method of examining purchase orders.

Insufficient funds. For accounting purposes, the funds appropriated to the university, like those of other State agencies, are divided into several appropriation categories. The funds in each category are allotted for use on a quarterly basis. Whenever expenditures exceed the amount allotted for the quarter, insufficiency of funds occurs in that appropriation category. At the present time, this insufficiency of funds is not discovered until DAGS, as a part of its accounting function, posts the expenditures noted on the summary warrant vouchers to the appropriation ledgers. This means that a summary warrant voucher, which contains a list of vendors to be paid, can go through the entire payment process at the university only to be eventually rejected by DAGS for insufficient funds. Moreover, DAGS rejects the entire summary warrant voucher even if only one of the purchase transactions noted thereon results in insufficient fund to an appropriation category. Thus, the rejection of a summary warrant voucher automatically holds up payment to not only that single vendor whose transaction is in question, but to all other vendors listed on the summary warrant voucher,

even if their transactions are backed by sufficient funds.

During a three-month period, DAGS rejected a total of 199 SWVs for insufficient funds. Payments to vendors listed on these SWVs took more than 60 days to process. As stated earlier in chapter 4, it is not necessary for the entire SWV to be rejected by DAGS. Instead, only that transaction which results in insufficient funds should be deleted from the SWV and the SWV should continue to be processed as to all other transactions. Another SWV can be submitted for the item deleted.

In addition to this change in process at DAGS, we think that the delays caused by insufficient funds can be avoided if the university will take the following corrective actions. *First*, the responsibility for determining whether the fund balance of a particular account is sufficient to cover the cost of the purchase should be lodged with the user department's fiscal officer. This means that the fiscal officer must maintain an accurate record of account, and he should be supplied from time to time with reports from the university's central accounting office on the status of the accounts to enable the fiscal officer to verify his records. Currently, it appears that the fiscal officers do not all maintain up-to-date, accurate records of account, that they are not supplied with accurate reports of accounts by the university's central accounting office and that, thus, the fiscal officers do not or cannot adequately carry out the responsibility of checking purchases against funds.

Second, if insufficiency of funds is not uncovered by the fiscal officer, it should be possible to discover the insufficiency at the time the purchase transaction is encumbered by the computer center. Since encumbrance occurs shortly after the goods are ordered from the vendor, the insufficiency can be caught far in advance of the preparation of the SWV. Insufficient fund transactions caught at the encumbering stage would eliminate the need to work on the SWV which will be for naught upon examination by DAGS. This process requires, of course, that the university's accounting system to be accurate.

We recommend that: (1) the university take steps to insure the accuracy of its account and to maintain it in that status, that the user department's fiscal officer himself maintain accurate records of his account, and that the university's accounting office periodically supply to the fiscal officer a report on the status of the user department's accounts; (2) the user department's fiscal officer be primarily responsible for checking purchase transactions for sufficiency of funds; and (3) where the insufficiency is not uncovered by the user's fiscal officer, that the same be discovered at the time of encumbering the purchase transaction at the university's computer center.

Infrequency of preparation of summary warrant vouchers. SWVs are prepared twice weekly by the university's computer. This means that transactions which are ready for processing by the computer must wait up to three or four days before the next processing time. Since the

frequency of SWV preparation by the computer depends on the overall workload of the computer, we recommend that the university review its computer scheduling time to see whether SWVs can be processed at more frequent intervals.

Deficiency in design of purchase order form. The university's purchase order form instructs vendors to send all invoices to the disbursing office. However, sometimes invoices are sent by vendors to the user departments instead. This has caused some invoices to be lost or temporarily misplaced, and the user department to send receiving reports to the disbursing office without the invoices. Upon receipt of such receiving reports, the disbursing office is unaware of the existence of the invoices and must then trace their location, resulting in delays in processing the vendors' claims.

A contributing reason for the mailing of invoices by vendors to the user departments is the inconspicuous positioning and the extremely small print of the instruction (to vendors to send invoices to the disbursing office) on the purchase order form. We recommend that the university redesign the form so that vendors would not miss reading the instructions.

Imprest Funds at the University

The university maintains several imprest funds at the various campuses. An imprest fund is a fixed sum of money in the form of cash on

hand (commonly termed, "petty cash fund") or cash in a bank checking account. An imprest fund is established to pay for purchases or to make disbursements of relatively low dollar values and is replenished from time to time when the balance in the account becomes low. The petty cash fund is also sometimes used to give change.

Our examination revealed that generally the imprest funds are not being used effectively and that internal controls over the funds are weak. A discussion follows.

Size of imprest fund. As table 5.1 shows, in October 1970, the university had a total of 92 petty cash funds totalling \$32,350, most of which were under \$500 per fund. There were 20 bank checking accounts totalling \$54,900, with amounts ranging from \$500 to \$10,000 per account.

Legislation. Section 40-84, HRS, sets forth the basic legislation limiting each agency of the State to a maximum total of \$5,000 in imprest funds. In 1969, the legislature enacted Act 100 which eliminated the \$5,000 ceiling for the university. The removal of the ceiling was intended to encourage wider use of imprest funds so as to (1) reduce the number of purchase orders issued for small purchases, especially those under \$25, and (2) expedite the processing of payment to vendors.³

³Standing Committee Report, Senate Bill 160, Session Laws 1969, Fifth State Legislature.

Table 5.1
Total Imprest Funds at the UH

Type and Size of Account	Number of Funds	Amount
Petty Cash		
Less than \$100	28	\$ 1,095
\$101 — \$500	58	10,765
Over \$500	<u>6</u>	<u>20,490</u>
Total—Petty Cash	<u>92</u>	<u>\$32,350</u>
Bank Checking Accounts		
Less than \$500	1	\$ 500
\$501 — \$2,000	11	15,000
\$2,001 — \$5,000	7	29,400
\$10,000	<u>1</u>	<u>10,000</u>
Total—Checking Accounts	<u>20</u>	<u>\$54,900</u>
TOTAL	<u>112</u>	<u>\$87,250</u>

Underutilization of imprest funds. Since the enactment of Act 100, the total amount in all of the university's imprest funds has increased from \$5,000 to \$87,250, as of October 1970. Despite this increase, we find that the funds have been grossly underutilized. The turnover rate of the funds (that is, the length of time it takes to use the full amount of a fund) averages about once in three months. Table 5.2 below illustrates this underutilization. It illustrates the turnover rates of those funds with the worst utilization record. As noted, the turnover rates of some of the funds are less than once in three months.

Table 5.2
Examples of Underutilization of Imprest Funds

Fund	(1) Authorized Amount	(2) Reimbursement	(2) ÷ (1) Turn-over
Bank Check Account:			
Continuing Education and Community Services	\$5,000	\$1,284	.26
Office of Student Affairs	2,000	1,067	.53
Petty Cash:			
Leahi Hospital	1,000	759	.84
Institute of Astronomy	750	820	1.0

While there is no one turnover rate which would be applicable in all situations, we believe the turnover rate experienced by the university is too low. Such an experience rate means that much of the moneys in the funds remain "unused," on the average, for a period of up to three months. There are at least three possible consequences which flow from such underutilization. *First*, as discussed more fully below, low utilization of imprest funds is usually accompanied by high use of purchase orders for low value purchases, particularly in agencies such as the university where there are overall a high number of low dollar value purchase transactions. *Second*, from an economic standpoint, the idle money in the underutilized funds could be, but is not being, invested and generating earnings. *Third*, with respect to petty cash funds, the larger the amount of money in it

and the longer it remains idle in the cash box, the greater the risk of theft or loss.

Continued use of purchase orders for under \$25 purchases. Low utilization of imprest funds at the university is accompanied by a continued use by the university of purchase orders for purchases under \$25. The university policy permits a maximum of \$25 for a single transaction when a petty cash fund is used, and a maximum of \$100 when a bank checking account is used. However, our audit revealed that approximately 20% of the purchase orders issued are under \$25. Applying this rate to the total purchase orders (55,000) issued during 1969–70, the number of purchase orders issued under \$25 amounts to 11,000.

This high rate of purchase orders for purchases of less than \$25 appears to be due to insufficient instructions and directions to user departments on the use of imprest funds. In addition, it appears that not all colleges and departments have imprest funds and that some of the colleges and departments prefer to use purchase orders, rather than imprest funds. This means that if the use of imprest funds for small purchases is to be encouraged, an educational program is necessary to acquaint the user departments on the purposes and advantages of imprest funds and that such funds should be created where they do not now exist.

We recommend that the university embark upon an educational program to encourage and direct its users to make more frequent use of imprest funds, where they now exist, for

purchases under \$25, and that it establish imprest funds where they do not now exist and that it adopt uniform, university-wide policies on the use of imprest funds.

*Weaknesses in internal control.*⁴ While we recommend greater use of imprest funds for purchases under \$25, we believe that such greater use should be accompanied by proper systems of internal control. To some extent, the university has prescribed in the form of rules and regulations guidelines on internal control. For example, policy no. 4131.3.d of the university's business manual states, "The fiscal officer or program director will authorize by signature all payments, but custody and actual expenditures will be handled by the custodian." On the other hand, it has also left to each college and agency authorized a petty cash fund, "the responsibility for instituting procedures of internal control to include periodic cash counts and regular reviews." (Policy no. 4131.4.e.)

In those areas where the university has established rules, we find that these rules are

⁴The term "system of internal control" means the plan of organization and all the methods within the department to check the accuracy and reliability of accounting data, to promote operational efficiency, and to encourage adherence to prescribed laws, policies, and rules and regulations of the State and the university. A sound system of internal control includes two basic elements. The first is a system of authorization and recording procedures to provide adequate accounting control. The second is an appropriate segregation of duties assigned in a manner that no one individual controls all phases of a transaction.

often disregarded by those user departments which now have imprest funds. Thus, in violation of policy no. 4131.3.d, which provides for a segregation of duties, 22 out of 92 fund custodians are also the fiscal officers with authority to approve purchases. In one extreme instance, the program director of a department who acts as the custodian of the petty cash fund approves cash disbursement to himself for mileage claims. In other instances cash is advanced without the authorization of program directors and without supportive documents.

In those areas where the user department is expected to institute internal control procedures on its own, we find that the technical competence needed to do so is lacking. Usually the custodians of petty cash are clerical personnel, who do not even conduct or cause to be conducted independent cash counts and reviews of the procedures.

Inasmuch as the imprest funds now play a significant role in the vendor payment process of the university, the university must be assured that adequate internal controls are established for all of the imprest funds. We recommend that (1) the university strictly enforce policy no. 4131.3.d and all other rules and regulations that it may have on internal control; and (2) the university's internal auditor lend assistance to those departments lacking the expertise to establish adequate internal control procedures; and (3) the university's internal auditor make frequent reviews of the procedures and practices of the user departments to insure proper control systems.

Chapter 6

DEPARTMENT OF EDUCATION

This chapter contains our findings and recommendations on the DOE's payment process including a discussion on the department's imprest funds. A description of the process activities is presented followed by our analysis and recommendations.

The Procurement Process

The procurement process at the DOE involves several organizational units—the user (schools and offices), the purchasing office, the vouchering section, and data processing. A flow chart of the process is presented in figure 6.1.

Generally, the user initiates the request for the purchase of goods by submitting a purchase order to the purchasing office and the vouchering section. (Where more than one purchase order is prepared, a summary of all purchase orders is prepared and sent with the purchase orders.) After approval by both the purchasing office and the vouchering section, the vouchering section sends the purchase order to the vendor. After delivery of the goods, the vendor sends his invoice directly to the user. A copy of the invoice is used by the user as a receiving report. The user accumulates several invoices and periodically sends them to the vouchering section with an invoice transmittal

form attached to the batch of invoices. The invoice transmittal form summarizes pertinent information about the attached invoices, to-wit: the vendors' names, purchase order numbers, invoice numbers, dates and amounts of each invoice and the total of all invoices. The vouchering section reviews the documents and then transmits the invoice transmittal form and the purchase order (or purchase order summary) to data processing which prepares a summary warrant voucher. The SWV is then transmitted to DAGS by the vouchering section, with a copy of the purchase order and the invoice attached.

Analysis of the Payment Process

Based on our sampling, we find that the DOE's overall process time for payment to vendors, measured from the receipt of the vendor's invoice by the user to the time DAGS receives the summary warrant voucher from the DOE, averages 31 days. Figure 6.2 displays this overall payment time. As shown in figure 6.2, 17% of the purchases take over 45 days to process. Since the DOE processes about 80,000 purchases annually, this means that 17% of 80,000, or 13,600 purchases take over 45 days to process.

The following is a discussion of the specific activities at the user level and at central services (vouchering section and data processing) which contribute to this delay in processing payment.

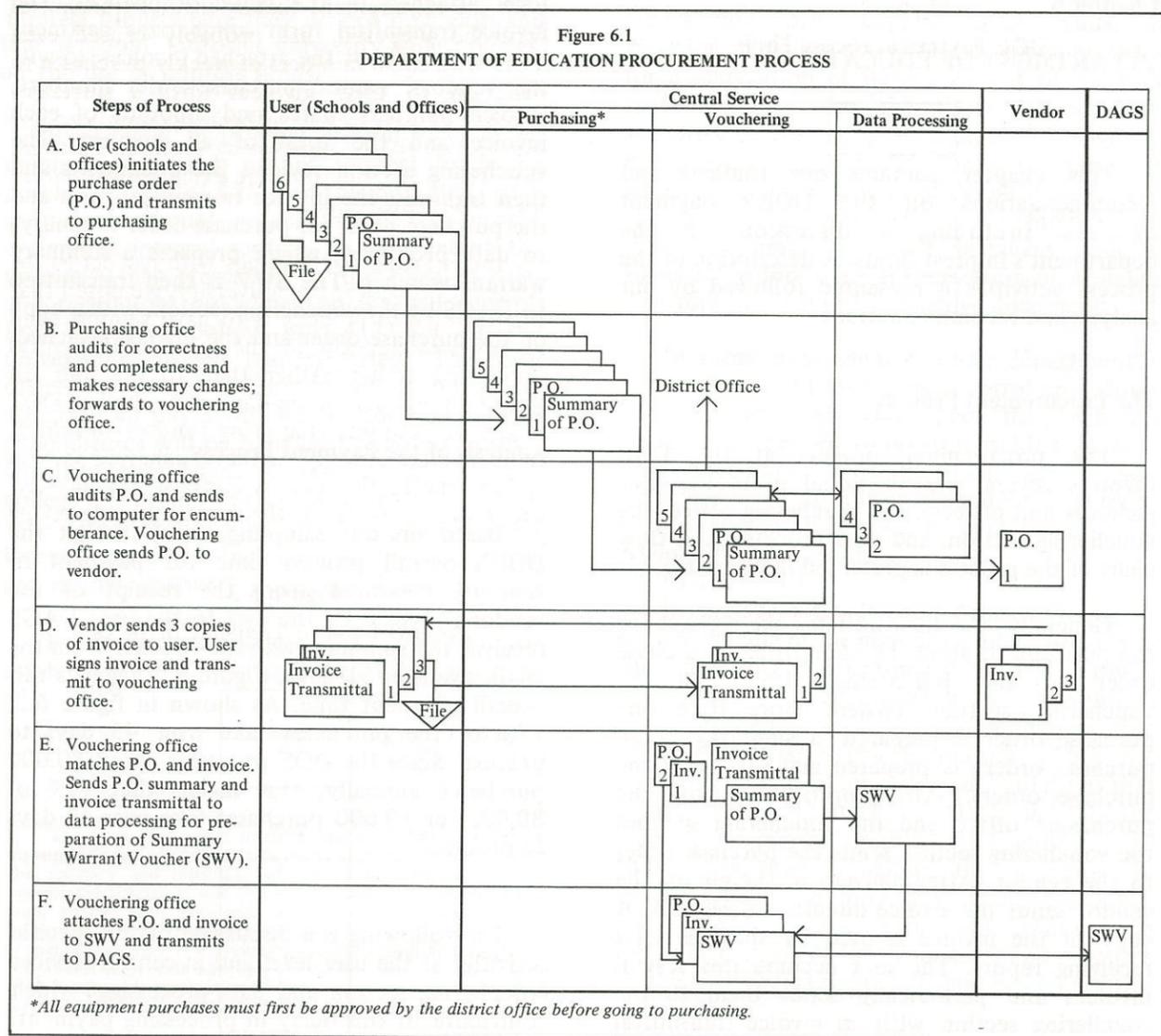
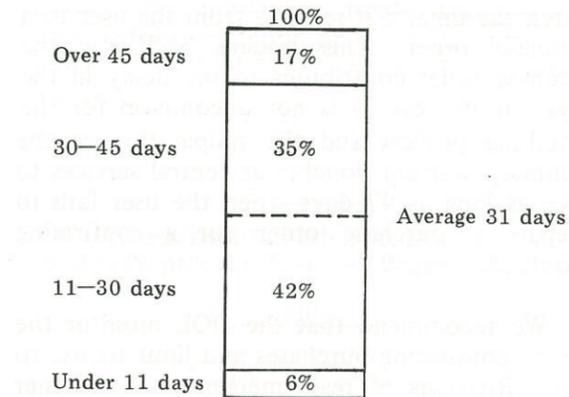


Figure 6.2
DOE Payment Process Time



User

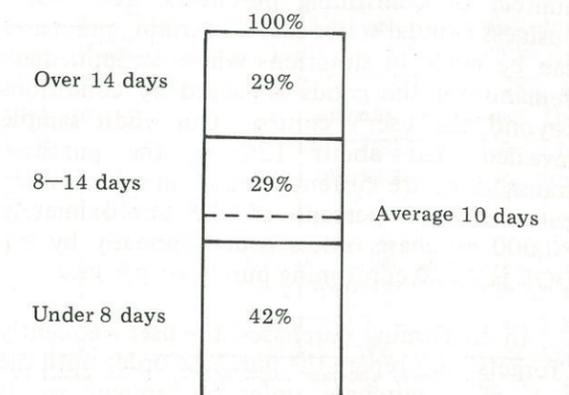
Our audit sample revealed that 58% of the invoices take over seven days to reach the vouchering section, and that the average time is 10 days. This is displayed in figure 6.3. A number of reasons contribute to this long delay.

Accumulating invoices. Under the DOE's policy, the user is supposed to forward to the vouchering section *at least weekly* all invoices it receives from vendors. Although surely not intended, this policy has encouraged, rather than discouraged, users to hang on to the invoices they receive for more than seven days—in 29% of the cases for more than two weeks. The policy was worded the way it is probably to assist those users who make large numbers of purchases, but in effect, this policy, combined

with the requirement that an invoice transmittal form be prepared, has probably caused even users with small numbers of weekly purchases to hang on to their invoices until a sufficient number of invoices have been accumulated for transmittal to the vouchering section. We think that the policy requires re-examination, or at least strict enforcement.

In reporting our findings with respect to the payment process at the university, we noted that the university's practice is to have vendors send all invoices directly to the university's central processing center rather than to the user. In re-examining its seven-day policy, the DOE might well consider requiring vendors to submit their invoices directly to the vouchering section rather than to the user. A copy of the purchase order can be used by the user as the receiving

Figure 6.3
Process Time to Transmit Invoices



report to evidence receipt of goods. Such a system would eliminate the "waiting time" that now exists between the receipt of the invoice by the user and its transmittal to the vouchering section, it would eliminate the need for invoice transmittal forms. The copy of the purchase order which serves as the receiving report would be sent to the vouchering section immediately upon receipt of the goods ordered.

We recommend that the DOE re-examine its policy of requiring transmittal of vendors' invoices by users to the vouchering section at least weekly. We further recommend that in such re-examination, the DOE consider requiring vendors to send their invoices directly to the vouchering section, rather than to the users. If the current policy is retained, we recommend that the seven-day limitation be strictly enforced.

Excessive use of confirming purchases. The DOE, like the university, makes an excessive number of confirming purchases. The DOE's business manual states that confirming purchases can be made in situations where an immediate demand for the goods is caused by conditions beyond the user's control. Our audit sample revealed that about 12% of the purchase transactions are currently made on a confirming basis. Twelve percent of the approximately 80,000 purchase orders issued annually by the DOE is 9,600 confirming purchases per year.

In confirming purchases, the user frequently "forgets" to prepare the purchase order until the lack of a purchase order is brought to its

attention by the vouchering section. The vouchering section becomes aware that the purchase order is missing when it attempts to match the invoice it receives from the user to a purchase order. This tracing back for the purchase order contributes to the delay in the payment process. It is not uncommon for the matching process and the preparation of the summary warrant voucher at central services to take as long as 47 days when the user fails to prepare a purchase order for a confirming purchase.

We recommend that the DOE monitor the use of confirming purchases and limit its use to only situations of real emergency. We further recommend that the DOE take such steps as will insure prompt preparation of purchase orders when confirming purchases are made.

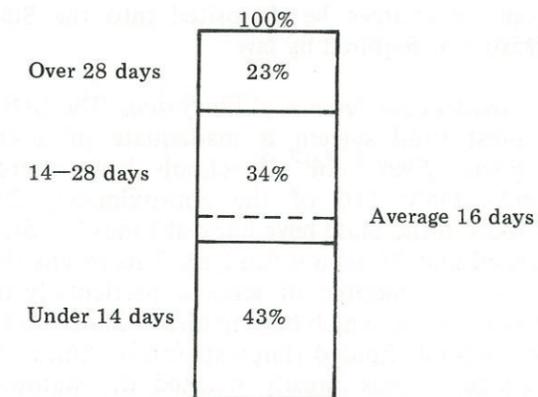
Central Services

The process time at central services where matching of purchase orders and invoices and the preparation of the summary warrant voucher take place is measured by the elapsed time between the receipt of the invoice from the user and the date of preparation of the summary warrant voucher. Figure 6.4 summarizes this process time and was constructed on the basis of the data gathered from a sample of the purchase orders processed.

The deviation from the average process time of 16 days is due to many of the same reasons found at the university. Among them are

excessive use of confirming purchase orders by the users, as discussed above, the infrequent use of the computer to prepare summary warrant vouchers, and insufficient funds. Also, the high number of errors found on purchase orders and invoice transmittal forms adds to the processing time.

Figure 6.4
Process Time to Match the Documents
and to Prepare the Summary Warrant Voucher



Errors in PO and invoice transmittal form. We are informed that a 100% review of purchase orders and invoice transmittal forms is performed by the vouchering clerks. This is necessitated, we are told, by the high number of errors found in these forms. Approximately 20 out of 100 documents contain errors, such as incorrect account codes on purchase orders and

non-listing of invoices on transmittal forms. We see no reason for such a high rate of error. An analysis by the DOE as to why errors occur with such frequency is due. Lessening the frequency of such errors and the attendant lessening of the need to review 100% of the transactions will go a long way in reducing the time it now takes at central services to process payments.

We recommend that the DOE conduct an analysis to determine the causes for the errors in purchase orders and invoice transmittal forms and take necessary steps (e.g., education of users) to minimize the occurrence of such errors. In addition, we reiterate our earlier recommendation that the DOE require vendors to send their invoices directly to the vouchering section and thus make the invoice transmittal forms unnecessary. This course of action will eliminate the time now devoted to correcting errors on the transmittal forms.

Infrequency of summary warrant voucher preparation. The summary warrant vouchers are prepared only once weekly by the computer. This means that transactions which are ready for processing must wait up to seven days before they are processed. We recommend that the DOE request additional computer time to increase the frequency of summary warrant voucher preparation.

Insufficient funds. The problem of insufficient funds to support the transactions listed in the summary warrant vouchers is similar to that of the university. We find that the findings and recommendations directed at the

university are equally applicable to the DOE, with one exception. While at the university, it is reported that fund balance reports are prepared bi-monthly; at the DOE such reports are prepared only once a month. The less frequent the issuance of fund balance reports, the greater the possibility for discrepancies between the actual fund balances and the report balances to occur. We recommend that the DOE issue its fund balance reports more frequently, or alternatively make more than usual effort to discover insufficiency of funds at the time encumbrances are recorded at the computer center.

Imprest Funds

There are 188 imprest funds at the department of education, totaling \$14,244. (See table 6.1.)

As shown on table 6.1, there are two kinds of imprest funds—State funded (appropriated) and school funded. Both are similar in every respect except the manner in which the funds were initially created. State funded imprest funds are those which were initially created by State appropriated monies. This is the manner in which imprest funds are ordinarily created and funded. There are 117 State funded imprest funds, totaling \$5,000. As table 6.1 shows, most of these 117 funds are individual petty cash funds of \$25 or less.

School funded imprest funds were initially created from monies raised by schools over

many years from such varied activities as donations, fund raising and other school and student activities. A portion of the monies thus raised was used to create the currently existing 71 school funded imprest funds, totaling \$9,244. As an aside, note that the monies raised by schools in the past, including the imprest funds created therefrom, are not deposited in the State treasury, but are kept in separate bank accounts. This practice violates section 296-32, HRS, which requires that all monies collected by the DOE be deposited in the State treasury. We recommend that all school monies collected from all sources be deposited into the State treasury as required by law.

Inadequate imprest fund system. The DOE's imprest fund system is inadequate in several respects. *First*, not all schools have imprest funds. Only 116 of the approximately 215 schools in the State have imprest funds (45 State funded and 71 school funded). This means that there are a number of schools, particularly the newer schools which have neither a State funded nor school funded imprest funds. Since the department has already reached the statutory limit of \$5,000, no additional petty cash funds can be authorized by the State comptroller to accommodate these schools, unless the statute (HRS 40-84) is amended to provide an exception to the DOE.

Second, the amounts in most of the petty cash funds are too low. A majority of the funds are \$25 or less and only 20 of the 116 funds are over \$100. An effective system of using petty cash for low dollar value purchases cannot

Table 6.1
Total Imprest Funds, October 1970

	No. of Funds	Amount
State Fund (Appropriated)		
Schools and Offices		
\$1 - \$25	52	\$ 825
\$26 - \$50	11	540
\$51 - \$100	7	640
Over \$100	<u>1</u>	<u>500</u>
Total—Schools and Offices	71	2,505
Libraries	<u>46</u>	<u>2,495</u>
Total State Funds (Appropriated) ...	<u>117</u>	<u>5,000</u>
School Funded		
Schools		
\$1 - \$25	25	\$ 410
\$26 - \$50	18	776
\$51 - \$100	8	645
\$101 - \$500	17	4,413
Over \$500	<u>3</u>	<u>3,000</u>
Total—School Funds	<u>71</u>	<u>9,244</u>
Grand Total	<u>188</u>	<u>\$14,244</u>

operate on such nominal fund amounts. The DOE's continued use of purchase orders for small purchases illustrates the need for larger

amounts in the imprest funds. Our audit revealed that approximately 30% of the purchase orders issued are for purchases under

\$25. This rate applied to the estimated total number of purchase orders (80,000) issued annually by the DOE results in 24,000 purchase orders being issued yearly for purchases under \$25.

Currently, there is no statutory dollar limitation on the imprest funds at the university. Whether or not such limitation should be lifted for the DOE is a question beyond the scope of this audit to determine. We recommend that DAGS examine the cash requirements of the DOE and recommend to the legislature such changes to the statute as may be advisable before or at the 1972 session.

In any system of imprest funds, it is imperative that an adequate system of internal controls be established and maintained. We urge the DOE to make periodic examinations of the internal control systems and petty cash practices to assure the continuing adequacy of controls and propriety of expenditures.

Chapter 7

DEPARTMENT OF HEALTH

This chapter contains our findings and recommendations regarding the department of health's (DOH) payment process and imprest funds.

Payment Process

Our audit revealed no significant deficiencies in the health department's payment process. The average payment processing time at the DOH is 20 days. There are no significant deviations from this average.

One area which deserves comment is that of confirming purchases. In our audit sample for 1969-70, we noted that 19% of the purchase orders were confirming purchases. This percentage applied to the total estimated number of purchase orders processed by the DOH in that year (36,000) results in 7,000 confirming purchases. We believe this number is excessive. In 1968, we made a similar finding in our financial audit of the DOH.¹ Since that audit, the department has not as yet formulated any policy on confirming purchases. However, it should be noted, that the use of confirming purchases has no appreciable adverse effect on the payment process at the DOH. Purchase orders are usually prepared within a few days of the commitment to purchase.

Although the use of confirming purchases does not adversely affect the process, it should be reserved for exceptional or emergency situations.

We recommend that the DOH formulate a policy which defines explicitly the situations

¹Legislative Auditor, *Financial Audit of the State Department of Health, Fiscal Year Ended June 30, 1967, Audit Report No. 68-1.*

when and the conditions under which confirming purchase orders may be used, and that it enforce such policy rigidly.

Imprest Funds at the Department of Health

As shown in table 7.1, the DOH has 20 imprest funds, totaling \$11,475 as of December 1970.

Table 7.1
Total Imprest Funds at the DOH

	No. of Funds	Amount
Department of Health . . .	9	\$ 2,445
Act 97 Hospitals	10	4,030
Hawaii State Hospital . . .	1	5,000
TOTALS	20	\$11,475

The \$11,475 total appears to exceed the \$5,000 statutory limitation (section 40-84, HRS). However, we understand that the State comptroller has approved the DOH's request for funds in excess of \$5,000 on the basis that the Act 97 hospital system and the Hawaii State Hospital are separate "agencies" within the meaning of the statute and thus separately subject to the \$5,000 statutory limitation.

The imprest fund at the Hawaii State Hospital is used primarily to make advances to

patients to be subsequently reimbursed from the patients' trust fund. To a much lesser degree, it is used for hospital operations. It is estimated that approximately \$4,000 of the \$5,000 is used for making advances to patients.

We do not believe that State funds should be used for this purpose. The patients' funds should be used instead. A certain portion of each patient's monies, sufficient to meet his average, daily dollar needs for a period of a week, month or any other reasonable period, can be set aside to create a patients' cash fund from which advances can be made.

In this connection, we note that patients' monies are still being deposited in the State treasury, although in our audit report² of the DOH over three years ago, we suggested that patients' funds be deposited in a commercial bank or savings institution, with interests earned thereon credited to the individual patients.

We recommend that (1) the hospital deposit patients' funds in a commercial bank or savings institution as recommended in our audit report no. 68-1; (2) a cash fund be created from patients' monies, sufficient to meet patients' average, daily dollar needs for a week, month or any other reasonable period; and (3) so much of the imprest fund now being used to make advances to patients be returned to the State general fund.

²Legislative Auditor, *Financial Audit of the State Department of Health, Audit Report No. 68-1, January 1968, Part II, p. 22.*

**PART III
RESPONSES OF AFFECTED AGENCIES**

Upon the completion of the preliminary draft of this report in early March 1971, we distributed copies of it to the president of the senate, the speaker of the house of representatives, the governor, the State comptroller, the chairman of the board of education, the chairman of the board of regents of the university of Hawaii and the director of the department of health. A copy of our transmittal letter to one of the departments (department of accounting and general services) is attached as attachment no. 1.

The office of the governor coordinated the actions of the agencies in responding to our report. The governor's letter, transmitting the departments' responses, is attached as attachment no. 2. The individual responses of the departments are attached as follows: attachment no. 3, department of accounting and general services; attachment no. 4, university of Hawaii; attachment no. 5, department of education; and attachment no. 6, department of health.

The governor and the agencies examined concur with the basic findings and recommendations contained in our report. We note that the administration has already taken and has stated that it will continue to take positive steps toward reducing the processing time to pay vendors.

We offer the following comments on certain portions of the agencies' responses primarily as points of clarification or amplification of our findings.

Audit Sample

The State comptroller has stated that, "It appears that the voucher sample selected to estimate processing time in your report was heavily taken from peak backlog periods that admittedly still occur but which are not representative of the general improvements that have been made."

Our comment:

The audit sample was not taken at peak backlog periods. We selected our sample on a random basis from all transactions during the entire 1969-70 fiscal year. By random, we mean that each transaction during the fiscal year had an equal chance of being selected for inclusion in the sample.

Priority Vouchers

Our report stated that the departments are using their own discretion in submitting claims to DAGS for processing on a priority basis. We thus recommended that DAGS formulate specific guidelines and inform all departments as to the circumstances under which vouchers can be processed on a priority basis. The State comptroller commented thus, in part: "... the departments are in the best position to know when they are necessary... only the vendor stands to suffer were the pre-audit program to disagree as to the need for priority."

Our comment:

The point of our finding is that processing vouchers on a priority basis results in "pushing back" non-priority vouchers submitted earlier. This means that the vendors of these other vouchers must suffer.

To control the departments' use of priority, we believe that the State comptroller should establish strict guidelines.

Policies and Procedures Relating to Imprest Funds

The university has stated that, "we do disagree with your implications that there are no university-wide policies and procedures on the use of these imprest funds."

Our comment:

We do not believe that such an implication was made. We found and stated in our report that certain university policies are not being adhered to by the users and that others are of questionable soundness.

ATTACHMENT NO. 1

COPY

THE OFFICE OF THE AUDITOR
State of Hawaii
State Capitol
Honolulu, Hawaii 96813

Clinton T. Tanimura
Auditor

Yukio Naito
Deputy Auditor

March 4, 1971

Honorable KeNam Kim
State Comptroller
State of Hawaii
Honolulu, Hawaii

Dear Mr. Kim:

Enclosed is a copy of our preliminary report on the *Audit of the State Vendor Payment Process*.

The term "preliminary" indicates that the report has not been released for general distribution. However, copies of this report have been forwarded to the Governor and the presiding officers of both houses of the Sixth State Legislature. In addition, we have forwarded copies of the report to the other affected departments.

The report contains a number of recommendations. I would appreciate receiving your written comments on them, including information as to the specific actions that have been taken or will be taken with respect to the recommendations. Please have your written comments submitted to us by March 10, 1971. Your comments will be incorporated into the report and 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, at our office, on or before March 8, 1971. Please call our office to fix an appointment. A "no call" will be assumed to mean that a meeting is not required.

We appreciate the assistance and cooperation extended by your department's staff to our auditors.

Sincerely,

/s/ Clinton T. Tanimura
Clinton T. Tanimura
Legislative Auditor

Encl.

ATTACHMENT NO. 2

COPY

EXECUTIVE CHAMBERS
Honolulu

John A. Burns
Governor

March 19, 1971

Dear Mr. Tanimura:

I am pleased to transmit herewith, in response to your letter of March 4, 1971, the comments of the four departments covered in your preliminary report on the "Audit of the State Vendor Payment Process." I appreciate the extension of the deadline to which you agreed in our telephone conversation.

As I have indicated to you, I found your preliminary report to be sound and objective in its findings. I believe you will find from the departmental comments attached that very marked improvements have been made in the State vendor payment process. This Administration will continue to keep an active interest in keeping our payments to vendors prompt and efficient.

Aloha, and may the Almighty be with you and yours always.

Sincerely,

/s/ JOHN A BURNS

Mr. Clinton T. Tanimura
Legislative Auditor
Office of the Auditor
State Capitol
Honolulu, Hawaii 96813

Enclosure

ATTACHMENT NO. 3

John A. Burns
Governor

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES
P. O. Box 119
Honolulu, Hawaii 96810

Kenam Kim
Comptroller

March 10, 1971

Mr. Clinton T. Tanimura
Legislative Auditor
State of Hawaii
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

This letter is submitted in response to your request of March 4, 1971, for comments on your preliminary report entitled Audit of the State Vendor Payment Process. We appreciate your extending the time allowed for response to March 12, 1971.

In fairness to all agencies involved in the vendor payment process, it should be clearly stated that the timely payment of the State's liabilities is a concern shared throughout the government. Numerous efforts have been made, especially in the last several years, to eliminate parts of the process not absolutely essential, to remove useless duplication of work, and to rearrange the remaining work in the most efficient manner possible. The result of these efforts has been a marked reduction in late payments, which at one time regularly lagged for several months.

The over-all payment process has improved substantially and is evidenced by the favorable comment received from vendors appreciative of prompt payment. Complaints of slow payment also continue to be received, but they are far less frequent than they were several years ago. It appears that the voucher sample selected to estimate processing time in your report was heavily taken from peak backlog periods that admittedly still occur, but which are not representative of the general improvements that have been made.

We are continuing our program of improvements and are especially encouraged by the project now in progress to revise the system itself. It has become apparent that a fundamental change in the system is required if we are to take appropriate advantage of present mechanization possibilities. In connection with our project to revise the state's accounting system, we have emphasized the requirement of data processing services needed for efficiently processing vendor payments, including an integration of related activities on both the departmental and the statewide levels. While computer services are not viewed as a cure-all for every shortcoming of the existing system, such services do provide the only realistic alternative to continued patchwork improvements on the present system.

Attached are further comments on the specific recommendations in your report, under headings that conform to those of the report. Neither the foregoing discussion nor the attached is meant to detract from the conclusion of your report that the vendor payment process can be speeded up. As part of our effort toward that end, your report will be helpful to the pre-audit program's staff, and we would therefore like to have 10 copies of the report if available when it is final. If we can provide your staff with further information or assistance, please let me know.

Very truly yours,

s/ KENAM KIM
KENAM KIM
State Comptroller

Att.

cc: The Honorable John A. Burns
Governor, State of Hawaii

Effectiveness of the pre-audit program

The report discusses the objective of the pre-audit program and the need for measures as to how successfully that objective is accomplished. This matter has received considerable study in connection with our efforts relating to PPBS, to which the entire administration is fully committed. In our PPBS program plan, the objective of the pre-audit program has been established as payment of the State's liabilities with assurance as to the legality, propriety, and timeliness of the payments. Every activity under the pre-audit program is directly in support of that objective. As an accounting control program, complemented by detailed internal departmental audit and by external post-audit, it is designed to assure that public monies are being paid out of the State Treasury properly and legally, and as promptly as possible.

It is recognized that a simple means of measuring the effectiveness of those activities, as they relate to voucher payments, would be helpful. The report contains a summary of errors that is discussed as a measure of effectiveness. The summary of errors appears to have been extracted from the file of audit correction slips prepared under certain circumstances. As the audit report suggests, these slips are a questionable measure of effectiveness and are therefore not used for such purposes. They are prepared only when a voucher must be returned to a department or when a department must be advised of an accounting change made in the process of approving a voucher. They do not cover the many audit inquiries made by telephone which hopefully will result in approving the voucher without the necessity of preparing an audit correction slip. For example, a missing document can be requested by telephone and included in the voucher without returning the voucher or making an accounting change on it.

Attempts have been made in the past to maintain a record of audit inquiries made by telephone for the very purpose discussed in the audit report. Maintaining the record further delayed the pre-audit of vouchers, and it was temporarily discontinued during a serious backlog period. A similar attempt was made to tally the number of vouchers processed, and the number of vouchers examined in detail. For the same reason, it was temporarily discontinued. Pressed with having to make an immediate choice between speeding the processing of vouchers or continuing to maintain such records, the choice has been in favor of processing vouchers. It is agreed, however, that the records would be helpful, and the time to maintain them could be provided by elimination of the voucher backlog, which is discussed under a subsequent heading.

Lack of guidelines on priority items

There are several grades of priority that can be given to vouchers, depending upon how much earlier, according to the department, the voucher must be paid than it otherwise would be. These grades

of priority can be grouped under categories of increasing urgency as:

1. those vouchers which the department requests be placed among vouchers being currently processed; this grade of priority will result in payment within two to five days.
2. those vouchers which a department red-tags, indicating that the voucher should be paid the day after it is received.
3. those vouchers which a department advises must be paid on the day received.
4. those vouchers brought in by a department with the payee waiting for payment.

Within each of these categories except the last, there are varying shades of urgency. Except where abuses of the priority privilege are obvious, departments are depended upon to set the grade of priority required. Because categories No. 3 and No. 4 are very disruptive and time-consuming to the operations of both the pre-audit program and the related programs involved (in the Uniform Accounting and Reporting Branch and in the Computer Center Division), and because they are seldom justified if the department is performing on a basis that is at all acceptable, they are strongly discouraged, although sometimes necessary. Categories No. 1 and No. 2 are much less disruptive, and the departments are in the best position to know when they are necessary. Almost all vendor relationships are with the departments. For the pre-audit program to establish guidelines more stringent than those above would require that the pre-audit program investigate virtually every priority request. At that stage of the total payment process, only the vendor stands to suffer were the pre-audit program to disagree as to the need for priority.

As an ideal, and with rare exceptions, priority procedures can become unnecessary if the voucher backlog can become permanently eliminated in the pre-audit program and if the departments prepare vouchers promptly and correctly. As was the case with the effectiveness measures discussed under the previous heading, the voucher backlog itself compounds small activities into large problems. In addition to taking time that would otherwise be available for keeping performance data, the voucher backlog results in increased telephone inquiries as to the status of particular voucher payments. It also creates pressures in related programs that decrease their operating efficiency.

The voucher backlog has been reduced to zero at times in the past, but only temporarily. The backlog is measured by the pre-audit program in terms of the number of working days elapsed since the earliest day on which vouchers which are yet unaudited were received. This backlog fluctuates under a number of different outside influences, including the irregularity with which vouchers are received from departments, and the semi-monthly payroll cycle which affects the manpower applied to the voucher

payment process. Through projects that are now in progress to revise the State's accounting system (including the payroll subsystem), these adverse influences will be corrected. It is through elimination of the voucher backlog that priority problems resulting from the backlog will also be eliminated.

Lack of standards of selecting SWVs for examination

As the report indicates, the pre-audit program does not examine all vouchers in detail. Certain types of payments must be examined closely because of special statutes or other legal requirements, such as vouchers for foreign purchases, for travel, for contract items subject to competitive bid, for petty cash reimbursement, and for non-civil service personal services. Payments that do not fall into such special categories, however, are examined only on a test basis.

At the present time, because of the volume of vouchers being processed and because of the existing backlog, the test has been pared to a pattern of selection according to dollar amounts of payments. It is agreed that the test pattern for these vouchers is a matter that should have continuing evaluation. It is also agreed that it can be appropriately varied by the known controls and performance of individual departments. Such judgment is in fact practiced by the staff of pre-auditors presently. The element of judgment that is acquired by the staff constantly reviewing vouchers of the various departments is of considerable value on this particular point.

It is readily acknowledged that computer-selection of vouchers requiring close examination is entirely feasible. This is one of the many improvements that the pre-audit program looks forward to in the project now in progress to revise the State's accounting system. Given the time that the resulting efficiency should provide, both the test pattern and the evaluation of its effectiveness can be more rationally devised.

Lack of performance measures

The audit report recommends that standards be established for the performance of the staff examining vouchers. Only the broadest workload data exists at the present time in terms of the total vouchers processed during fiscal periods as compared to the number of pre-auditors during those periods.

In connection with the discussion above under the heading, "effectiveness of the pre-audit program", attempts are being made to gather other statistical data that would enable more useful measurements. One of the successful efforts begun in 1970 is a record of time charges in the pre-audit program classified by function and detailed activity, in addition to the timekeeping required for personnel/payroll purposes. Although this effort has taken additional time on the part of each staff member, it is proving helpful, especially in the over-all allocation of the program's manpower resources.

Along with concern for workload quantity, there is concern for the quality of performance, and consideration for quality must be reflected in any performance measure established. The time required to pre-audit a particular voucher is not predictable under the present system until the pre-audit process is complete, because the types of expenditures in the voucher are not segregated, nor are segregations made by dollar amount to conform to the pre-audit program's test pattern.

As has been stated previously, attempts are continuing in an effort to develop standards that are fair to both the quantity and the quality aspects of the program.

Duplication of tasks

Duplication of work is removed from the pre-audit program's activities at every point it can be identified. It is perhaps unfortunate that some departments refer to portions of their disbursing activities as "pre-audit", because such reference leads some observers to the conclusion that the same activity occurs there and under the Comptroller's pre-audit program.

Whereas the expending departments match documents, verify quantities, check arithmetic extensions and footings, and check purchases for propriety and legality, the pre-audit program only tests these items, under the pattern discussed earlier, to provide assurance that the whole is acceptable for payment. The pre-audit program does not re-check additions and extensions, although omitting this departmental activity from the test has been questioned from time to time in the past. Neither does the pre-audit program check for proper signatures on supporting documents, but merely checks to see, on those vouchers selected for pre-audit, that signatures or initials are there indicating that someone had firsthand knowledge of actual receipt of good or services. Pre-auditors could not possibly know the validity of the thousands of signatures that are on supporting documents received in vouchers.

It has been the need to conserve time for faster processing of vouchers that causes the constant effort in the pre-audit program to identify and to remove duplications, as well as activities that are not necessary. Among procedures that have been eliminated in this manner are detailed checking on mileage claims, and checking on certain contract requirements that were found also to be checked thoroughly in several of the larger departments. There is complete agreement that this effort must be a continuing one.

Delays caused by insufficient funds

The problem addressed in this part of the report has been a serious one for the pre-audit program. Until relatively recently, those items in a voucher that would overdraw an account were removed by the pre-audit staff, and the remainder of the voucher was processed. That practice has been continued,

except in those cases where so many vouchers are involved at one time (usually at the end of a quarter) that valuable pre-audit time is heavily consumed in re-making the voucher and re-computing the account charges. After earlier attempts to resolve the problem had not brought improvement, and after sufficient notice had been given to the departments involved, overdraft vouchers were returned to the departments. Such departments were always given a choice of sending someone to correct the vouchers, or having the vouchers returned.

The result of present policy has been a greater effort on the part of the departments to confine their purchase obligations to available funds, and to expedite allotment adjustments when they are called for. A department that seriously overexpends available funds exposes the fact that it does not have adequate control of its funds. The pre-audit program has been assured by the departments involved that their funds are now under control and that the problems relating to return of vouchers for insufficient funds should no longer occur.

In the exercise of the Comptroller's responsibility for payments out of the State Treasury, the pre-audit program could refuse to accept any departmental voucher in error, regardless of how minor the error might be. Primarily out of consideration for vendors defective vouchers are adjusted by the pre-audit program when possible and are returned to departments only as a last resort. This policy extends to all errors, including the serious problem of overdrafts.

Use of departmental computer

Since the time the University of Hawaii and the Department of Education acquired their sizeable computer applications, there has been a desire to integrate them, especially with regard to warrant-writing routines, into the parallel procedures of the pre-audit program. The project mentioned several times earlier to revise the State's accounting system is currently evaluating the various approaches by which this may be done. In connection with earlier discussion on duplication of work, the present warrant-writing routine has been recognized in the project as a duplication that can be removed in the over-all systems revision.

As the accounting system revision is of such primary importance to many areas of government operations, including those addressed in the report, the support of your office is sought for its successful implementation.

ATTACHMENT NO. 4

UNIVERSITY OF HAWAII . HONOLULU, HAWAII 96822

The President

March 10, 1971

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

Dear Mr. Tanimura:

The Chairman of the Board of Regents, Mr. Charles S. Ota, has asked me to reply to your letter and report of March 4, 1971 on your Audit of the State Vendor Payment Process.

Our comments, together with our action plans, are as follows and relate to the headings in the report:

OPERATING DEPARTMENT

In recent months the University has taken action, in several ways, to promote the more rapid transmission of documents from departments to its Central Processing Center. Management personnel from the Processing Center (Disbursing) call on fiscal officers to urge them to, in turn, require timely submission of payment documents from requisitioners. Lists of outstanding purchase orders are sent periodically to fiscal officers, calling their attention to problem purchase orders. Twice each semester a notice from me to all faculty and staff members has accompanied each pay check to remind them that everyone needs to cooperate in the bill paying process by timely submission of receiving reports.

We agree with the need to "get tough" with the users, as you suggest. However, we do not now have the fiscal or personnel resources to operate a central receiving service. Such a facility would be rather costly and require people and space not now available. (It has been studied several times and rejected for that reason.) However, we are in the process of endeavoring to establish a central purchasing, receiving and distribution unit for chemical supplies. Such supplies constitute one of our greatest

problem areas in the payment of bills. We are planning to establish this within our Manoa campus Chemistry Department with little, if any, budgetary resources. Our target date for operation is July 1, 1971.

With regard to the comment that the matching of documents by departmental fiscal officers is unnecessary, let me say that the University, for several years, operated in the manner you have suggested with matching being accomplished by the central disbursing section. Although the difference in total price between the purchase order and the invoice is usually not great, there were enough appreciable differences to require a considerable volume of telephoning and memoranda between the disbursing section and the fiscal officers to determine what the total-to-pay should really be. We felt that the fiscal officer who had done the purchasing was the proper one to resolve such discrepancies. In spite of these previously encountered problems, we shall study your suggestion anew as it could have the effect of saving two or more days on each transaction.

We are aware that there has been excessive use of confirming purchase orders which have an adverse effect on the payment process. The University has recently taken additional steps to enforce the rules already in existence on such orders. Fiscal officers and faculty have been so notified and we have sent letters to all of our vendors advising them of these policies. Copies are appended hereto as Exhibit I.

CENTRAL PROCESSING CENTER

We believe we have already reduced the examination of purchase orders by the disbursing section to nearly a minimum. On October 1, 1970 the attached memo, Exhibit II, was issued which stated a policy that extensions and footings on invoices under \$200 would not be checked. We do not verify the accuracy of the various codes as your report seems to indicate. However, we do verify the completeness of each form because the controls established for the computerized accounting system will reject transactions on which these are incomplete, causing a further delay in payment. We have been criticized by public accounting firms for not being certain that availability of funds is properly certified by a fiscal officer. Thus, we would hesitate to forego this check and control. However, your suggestion that we do not need to check so closely for approval of the purchase may be a good one, and we shall look into it.

We agree with your recommendation that DAGS should process all items on a summary warrant voucher except those that may have a temporary insufficiency of funds. We also agree that we must control the commitment of University funds so that orders are not issued against accounts lacking

proper balances. The University has recently designed a new Status of Allotments report for State Funds which is produced by the computer and which we believe is now accurate. It is issued to fiscal officers twice a month. The remaining problem seems to be the volume of transactions in the pipeline at any one point in time which have not yet appeared on the report. This volume problem can probably be completely solved only by application of source data automation techniques within our computer system. This may be both expensive and several years away, so in the meantime we are endeavoring to do as you have suggested, emphasizing that fiscal officers are responsible for control. Two memoranda dated December 21, 1970 from key members of the central staff do just that and advise deans and fiscal officers of another "get tough" policy. Copies are attached as Exhibit III. We are also carefully examining these Status of Allotments Reports at a central point to discover potential insufficiency problems in advance so that any fiscal officer who is not on his toes may be warned.

We believe that Summary Warrant Vouchers could be processed by the University's computer more often as you have suggested. This has been studied on several occasions, most lately by our auditors . . . Peat, Marwick, Mitchell & Company . . . who suggested that it be done more frequently only at the end of quarters and the fiscal years. We have an as-yet-uncompleted project to do just that. Presently the computer consolidates a number of payments to a given firm into one voucher and check. Processing more frequently on a regular basis would increase the amount of paper and the number of checks which would be produced by both the University and DAGS. Thus there is some doubt about its advisability.

Your suggestion to enhance the instructions printed on our purchase orders as to addressing and invoicing is a good one. It has already been implemented and will appear on our 1971-72 series of purchase orders. In addition to this, vendors who do not comply are being contacted.

IMPREST FUNDS AT THE UNIVERSITY

We agree with the need to increase the utilization of the imprest petty cash funds. However, we do disagree with your implications that there are no University-wide policies and procedures on the use of these imprest funds. In fact, the procedures outlined in University Business Manual Instructions 4131 and 4133 are quite detailed. We might add that they are currently under review by the University Comptroller whose staff is endeavoring to clarify and upgrade these instructions based upon our experience to date. We do realize that we need to take two kinds of actions with regard to these funds: First, we need to take some of the funds away from chronic under-users and second, we need to establish more of them where they do not now exist. With regard to the first, let me say that many of these funds have been established for less than a year, and that we realized there would need

to be some realignment of them as soon as we had experience. With regard to the second, there are problems of reluctance of clerical personnel to handle money, and, in a number of cases, lack of enough staff to provide the controls you refer to below under "Weaknesses in Internal Control". We realize that these suggestions of yours are valid and that we need to increase our educational programs in this area, and we shall endeavor to do the best we can.

We are in essential agreement with your comments on internal control of the petty cash funds. As indicated above, we are in the process of upgrading the rules and will review the segregation of duties which are established under 4131.3d of the University Business Manual, as you have suggested. We must point out that in some cases departments are so short of staff that the desired segregation is impossible. In such cases, we must make a decision whether to take the fund away or live with less than the optimum controls.

The University Treasury Officer and the Internal Auditor are making as many surprise cash counts and reviews of these practices as their limited staff will permit. We are now endeavoring to do some of this with student help from the College of Business Administration.

Thank you for the good suggestions and for your help and cooperation in this matter. We realize that there is much to be done, but at the same time we appreciate this opportunity to point out that we have not been standing still on these matters, even in the face of a significant lack of proper staffing in our Business Affairs areas. We would like to say in closing that we feel these problems will never be satisfactorily and completely solved until at least, the major agencies are given the authority to write checks on their State funds. It would be possible to do this and at the same time provide the State Comptroller with the controls he needs to carry out his statutory responsibilities.

Sincerely,

/s/ Richard S. Takasaki
for Harlan Cleveland

Enclosures

cc: Governor John Burns
Chairman Charles Ota
William Parsons

UNIVERSITY OF HAWAII

EXHIBIT I

Vice-President for Business Affairs

February 22, 1971

Gentlemen:

Subject: University of Hawaii Purchasing Authority and Methods

This is to advise you that the University of Hawaii is enforcing its policy of honoring only those purchases of goods and services made by an authorized official through one of its authorized purchasing methods. These methods are:

Contractual Document	—	Contract Purchase Order
Imprest Petty Cash	—	Limited to \$25.00
Imprest Check	—	Limited to \$100.00
Verbal Order	—	Emergency conditions only and accompanied by a contract or purchase order number

The University will not assume responsibility for purchases unless ordered through one of these methods by an authorized official. Selected University officials only are delegated authority to purchase, and clarification of authority may be obtained by querying the Procurement and Property Management Office at 944-7156.

Sincerely,

/s/ William W. Parsons
William W. Parsons

Bachman Hall - Room 211 - 2444 Dole Street - Honolulu, Hawaii 96822/Cable Address: UNIHAW

UNIVERSITY OF HAWAII

EXHIBIT II

Office of the University Comptroller
Disbursing Office

MEMORANDUM

October 1, 1970

TO: Supervisors
FROM: Al Cason /s/ Al Cason
RE: Pre-Audit

After consideration of savings realized as compared to the cost in time and effort of realizing such savings, it has been decided that we should not verify the arithmetic computations of extensions and footings on payments where the invoice totals \$200 or less. The University of California adopted this policy after careful study, and a similar policy is followed elsewhere. Mr. Elias Matthews of DAGS has been advised of our intention.

After consultation with our auditing firm, it was decided that at regular intervals we should make the complete arithmetic check. Initially this will be once every two weeks, on Fridays. During the initial period, we should keep statistics on arithmetic errors found, indicating the net gain or loss the University realized as a result of the 100% verification on each of the verification days. Statistics should also indicate the number of errors (plus and minus) that contributed to the net difference, and the range of errors.

We shall continue to verify the number of line items on the invoice vs. the number of line items indicated on the receiving report for payment in each case; however, we shall discontinue detailed verification of the wording of line items on invoices vs. receiving reports. Also, please continue to scan for gross and obvious errors.

This new procedure will be effective on Friday, October 2, 1970, with October 16 as the first verification day.

EXHIBIT III

UNIVERSITY OF HAWAII

Office of the Vice-President for Business Affairs

MEMORANDUM

December 21, 1970

TO: Provost, Deans, Directors, Department Chairmen and Fiscal Officers
FROM: William W. Parsons /s/ William W. Parsons

The attached memorandum of this date from Keith Snyder and Kenji Sumida points up some serious problems which must have your immediate attention. For too long, the University's budgetary controls in a number of colleges and programs have been administered on a hit or miss basis. For too long, the University has been unable to correctly assess its budgetary position and its resources at any one time.

Problems with the new fiscal system have offered a ready-made and sometimes valid excuse for these shortcomings. The system, while not yet 100% perfect, is now at a stage where we must insist on complete performance from all fiscal officers. As you know, they bear a major responsibility to this office to control all encumbrances and expenditures within allotment and cash resources.

With this memorandum, I am putting all fiscal officers on notice that they must live up to these responsibilities. However, they cannot be effective unless their day-to-day supervisors (Provosts, Deans, Directors or Department Chairmen in some cases) support them in this effort. As the great University System grows, it must begin to develop better controls of its own to replace those exercised over it by several departments of the State Government. If we cannot control our own spending, we can expect little relaxation of these controls from outside the University. Thus, we could find it necessary to change our decentralized fiscal control system to a more centralized type.

Before I would recommend such a change, there are some remedies that I would be forced to try which could include reprimand, removal of purchasing and/or other fiscal authority in individual cases, or even recourse to the provisions of Section 37-42 of the Hawaii Revised Statutes in a significant case.

All of this does not apply to many of our fiscal officers. In most cases where it does apply, some of the blame must be shared by the fiscal officer's supervisor. May a word to the wise be sufficient.

Let me take this opportunity to remind all Deans and Directors that fiscal officers may not be appointed without the concurrence of the University Comptroller, acting as my representative (Section 1142, U.H. Business Manual).

Enclosure

UNIVERSITY OF HAWAII

Office of the University Comptroller

MEMORANDUM

December 21, 1970

TO: All University Fiscal Officers

FROM: Keith Snyder – University Comptroller /s/ *Keith Snyder*
Kenji Sumida – Coordinator for Planning and Budgeting /s/ *Kenji Sumida*

RE: Budgetary control of Expenditures

Proper expenditure control through the quarterly allotment system has long been a problem at the University. Given the problem in developing a viable University-wide budgetary-fiscal system, this could not always be blamed on the operating department or on its fiscal officer. However, many fiscal officers have developed their own systems for keeping expenditures within budgetary limitations, and they are to be praised for their initiative. (There will always be need for some departmental bookkeeping. Even in the simplest situation, the lag between the submission of documents and the production of the report will require an elementary filing-bookkeeping system. Some more complex operations will require more sophisticated local systems.)

The system is still under development with new accounting reports being programmed and modifications being made to existing ones; but the tools are available to permit a systematic method of expenditure control. Please note that with respect to budgetary control, an encumbrance is the same as an expenditure. The funds are committed and not available for any other purpose.

Those tools for budgetary control are the Encumbrance & Expenditure Ledger and the Status of Allotments Report. A knowledge of their use, of course, is essential.

The Encumbrance & Expenditure Ledger is important in verifying the input of individual transaction documents into the system and in keeping track of encumbrances and their age.

The Status of Allotments Report is primarily designed for General and Special funds which are appropriated by the State. In order to provide budgetary control via this report, the allotments must be cranked into the computer on Form 23A. Normally, this is done each quarter by the Budget Division. These quarterly allotments are the totals provided to each college or division. In connection with G and S funds, the following factors are important:

1. Further breakdowns to minor sub-codes are possible to permit you to control your budgets by individual departments or programs. This is done with Form 23B (Request for Allocation/Allotment to Detail Accounts). If you need instructions in its use, do not hesitate to call De Pollom at 7126.
2. Not all G and S funds are presently reflected in the allotment section of the report; but the Budget Office will enter all of them into the system by January 15, 1971. Generally, these unallotted G and S funds include:
 - a. Federal funds (including Title I, Vocational Education and Manpower Development) provided through DAGS; thus, they become G funds in the State system.
 - b. Funds appropriated by the State for Special Projects.
 - c. All Special funds.
3. Those with Special funds must give scrupulous attention to their cash position (as well as to the status of their allotments). For this purpose, a new cash report (423B) has been designed. If you don't receive it or don't know how to use it, see Morio Morihara in Bachman Hall, Room 112, immediately. You must watch your cash position.

Funds other than G and S may also be allotted by use of Form 23B. At this time, Budget does not require allotments for them, but it may be helpful to you to control them in this manner:

1. This is the only method of budgeting and allotting A and some T funds.
2. All F and T funds for research and training contracts and grants will be budgeted and allotted

by the Research and Training Budget Status Report, an improved version of which is now being programmed.

3. The cash position of your A and T funds is also of prime importance, and Cash Report 423B is your key to this kind of control.

In order to make this system work, there are some very important items which must be attended to and which are now being given little or no attention in some cases. This system requires meticulous attention to allotments, encumbrances and expenditures:

1. Allotments must be planned realistically in relationship to projected encumbrances and direct expenditures in each quarter. In many cases, this is not done; some merely divide the allocation into four equal quarters even though they know the rate will not be equal. The total of encumbrances and expenditures in any one quarter must be considered in planning and allotment. Too many seem to feel that encumbrances are of little importance. You are then surprised when, after you put through a major encumbrance in one quarter, you are advised that you are out of allotted funds. This leads very naturally into the next warning.
2. Whenever it becomes apparent that encumbrances and expenditures are being made at a rate which may exceed your allotment for the quarter, you should reduce expenditures and/or initiate a request for a change in allotment before the situation becomes critical. Special attention must be given to major encumbrances whether by contract or purchase order in any one quarter. Don't make the encumbrance until you are certain that you have enough funds allotted in that quarter. The total encumbrance reduces your allotment balance for that quarter even though the cash may not be paid out until the following quarters.

If you have any questions about any of the foregoing, don't hesitate to call either one of us. If we don't have the answer at hand, we will get it for you.

It is up to you to play your part in making this system work. We can be certain that if our unique decentralized fiscal responsibility system does not work, the University will have no alternative but to change to a much more centralized plan.

cc: Provosts, Deans, Directors and Department Chairmen

ATTACHMENT NO. 5

STATE OF HAWAII
BOARD OF EDUCATION
P.O. Box 2360
Honolulu, Hawaii 96804

March 10, 1971

MEMO TO: Mr. Clinton T. Tanimura, Legislative Auditor
The State Capitol

FROM: Richard E. Ando, Chairman
Board of Education

SUBJECT: Audit of the State Vendor Payment Process

The preliminary report of the audit of the State vendor payment process was reviewed by the Department of Education staff with your staff on March 8, 1971.

We appreciate the opportunity to review and comment on the report. The objective appraisal by your staff and the recommendations resulting from it have provided us with some good suggestions to improve our operations.

Attached are specific comments to the report.

Attach.

cc: Dr. Shiro Amioka
Mr. Koichi H. Tokushige

STATE OF HAWAII
DEPARTMENT OF EDUCATION
P.O. Box 2360
Honolulu, Hawaii 96804

OFFICE OF THE SUPERINTENDENT

March 10, 1971

MEMO TO: Dr. Richard Ando, Chairman
Board of Education

FROM: Shiro Amioka, Superintendent /s/ Shiro Amioka

SUBJECT: Audit of the State Vendor Payment Process.

The preliminary report of the subject audit was reviewed by my staff and comments are made on the attached report to the Legislative Auditor.

The audit report contains an objective appraisal of our performance in the vendor payment process. Some recommendations are given and we hope to implement those which are considered helpful in improving our operations without resulting in any undue additional cost or workload. My staff met with the Legislative Auditor's staff on March 8, 1971 to discuss the findings and recommendations.

Some of the salient points discussed in the audit report are:

1. Delays in processing of invoices from the schools, public libraries and offices to the State Comptroller. We are taking the necessary action to reduce this problem through stricter enforcement of policies and procedures.
2. Excessive use of confirming purchases delays processing of invoices for payment. Stricter enforcement of policies and procedures will be used also.

3. Higher than average error rate on purchase orders and invoice transmittal forms. We will conduct an analysis to determine the causes for the errors and take necessary steps (e.g. education of users) to minimize the occurrence of errors.
4. Infrequency of summary warrant voucher preparation causes delays in vendor invoice payment. We will request additional computer time to increase frequency of summary warrant voucher preparation.
5. Insufficient funds in operational expenditure plans by quarters cause delays in payments also.

We will request SWIS to provide more frequent appropriation status reports so that the Planning Office and Business Office can monitor programs more carefully.
6. Inadequate imprest fund system causes small purchases to be processed through involved payment procedure. We have requested legislation to lift the \$5,000 ceiling from DOE to permit greater use of the imprest fund system.

COMMENTS ON AUDIT REPORT

1. Analysis of the Payment Process.

a. Page [25] . Accumulating Invoices.

We have reviewed the two alternatives of:

- 1) requiring the invoices from the vendors to be submitted directly to the Vouchering Section for matching with receipt documents from the requesting schools or offices and
- 2) continuing the current procedure with stricter enforcement.

The first alternative is considered desirable; however, its implementation will;

- 1) require additional costs in manpower (4 additional clerks) and equipment (6 tub files and office furniture); and
- 2) limit purchase order to one line item, thereby increasing the workload at the requestor level (school, public library or office) at least threefold, because the present purchase order system permits multiple line items on each purchase order per vendor.

The reconciliation of the vendor's invoice with a receiving document from the recipient of goods and services will require more time to review, verify and record necessary information to be fed into the computer than the current system of review for correctness and recording of vendor code for submission to the Computer Center. As a result, four more clerks will be needed to handle the additional workload. The additional space required to house the four clerks and the related office equipment and furniture will aggravate the existing crowded condition of the Vouchering Section.

The purchase order has to be limited to one line item only, because the reconciliation between invoices and receiving documents (copies of purchase order) will be hampered severely whenever partial deliveries are made by the vendors. There are numerous partial deliveries, approximating 33%.

Note: Page references in the original of these comments related to the pagination contained in the preliminary report. However, the page numbering in the final report differs from that of the preliminary report. Thus, for the convenience of the reader, in this copy of the comments, all page references contained in the original have been altered to conform to the numbering in the final report and are enclosed in brackets.

Because of the additional costs and workload involved in converting to the first alternative, we recommend the continuation of the current system with

- 1) stricter enforcement of policies and procedures at the school level (See attached memo from Superintendent of Education to District Superintendents) requiring field visitations by District Business Staff Specialists to schools for adherence to fiscal procedures which includes processing of invoices;
- 2) increasing the once to twice per week vouchering process through Computer Center No. 3 and
- 3) obtaining more frequent summary fiscal status weekly reports than the current monthly report to prevent overexpenditure of funds by quarters.

b. Page [26]. Excessive Use of Confirming Purchases.

We will adhere to the policy that confirming purchases be allowed in emergency situations only. All schools, libraries and offices will be reminded of this requirement by written notification. The Purchasing Section and the Vouchering Section will monitor this requirement. In cases, wherein confirming purchases are allowed for emergency purposes, the requestor will be required to submit the invoices within two days of the receipt of the invoices.

2. Central Services.

a. Page [27]. Errors in Purchase Order and Invoice Transmittal Form.

We will implement immediately an analysis to ascertain causes of errors in purchase orders and invoice transmittal forms, so that we can structure training classes or notices reminding the school, public library or office personnel of the necessary corrective procedures.

As discussed earlier, the suggestion to institute the procedure of requiring the invoices to be forwarded directly to the Vouchering Section from the vendors is not considered feasible.

b. Page [27]. Infrequency of Summary Warrant Voucher Preparation.

We agree that the summary warrant vouchers should be prepared twice a week. We will submit a request to SWIS to meet this requirement.

c. Page [27]. Insufficient Funds.

A few programs lacked sufficient funds, because of errors in computing estimated costs in the operational expenditure plan for FY 1970-71. We have requested SWIS to provide us with

weekly summarized appropriation status reports, so that our Planning Office and the Business Office can monitor the programs more effectively and take necessary steps to adjust the quarterly allocation of funds by appropriations.

3. Imprest Funds.

- a. Page [28]. Non-Appropriated funds which are maintained at the school level have been deposited into the State Treasury in stages for better control and administration of such funds. The following types of non-appropriated funds have been brought into the State Treasury

- 1) School Lunch receipts
- 2) Summer School Collections
- 3) Athletic funds

We are planning to have the remainder of the funds (elementary and secondary schools) brought into the State Treasury in the next two years (July 1, 1973).

b. Page [28]. Inadequate Imprest Fund System.

We requested exemption from the \$5,000 legal limitation during the 1970 Legislative Session, but the bill was not approved by the Senate, although approved by the House. We are requesting the exemption again in the current legislative session.

c. Page [30]. Establishment of Adequate System of Internal Controls.

We have procedures to provide adequate internal controls. We will continue to assess the effectiveness of the prescribed controls.

STATE OF HAWAII
DEPARTMENT OF EDUCATION
P.O. Box 2360
Honolulu, Hawaii 96804

Office of the Superintendent

March 10, 1971

MEMO TO: District Superintendents
FROM: Shiro Amioka, Superintendent
SUBJECT: School Visitations by District Personnel

The Legislative Auditor completed an audit of the State vendor payment process. Exceptions were noted in the audit report, wherein vendor invoices were not submitted promptly in many cases and too many confirming purchases were executed.

The attached Memorandum of Agreement, Role of District Business Office, specifies that the District Business Office will provide technical guidance, including in-service and supervision, to school principals, secretaries and other clerical staff in their business activities related to financial ... management procedures ... purchasing, processing invoices

All District Superintendents will ensure that this phase of the Memorandum of Agreement will be executed as soon as possible. I am, therefore, requesting all District Business Staff Specialists to perform test audits of the above audit exceptions at the school level. Such visitations should be started no later than March 29, 1971.

Attach.
cc: Mr. Koichi H. Tokushige

MEMORANDUM OF AGREEMENT
ROLE OF DISTRICT BUSINESS OFFICE

The following Memorandum of Agreement has been developed pursuant to our conference on June 2, 1970. It is agreed that the District Business Office shall provide the following staff services for the District Superintendent.

- A. Technical guidance including in-service and supervision to school principals, secretaries and other clerical staffs in their business activities related to financial and facilities management procedures.
 1. Finance procedures
 - a. Payroll, purchasing, processing invoices, inventory, financial accounting of State, Federal and local funds and other general office procedures.
 - b. Inter-relationship of various State and County agencies.
 2. Facilities procedures
 - a. Custodial operations, enrollment projections, facilities inventory, CIP and R&M budget development and implementation.
 - b. Inter-relationship of various State and County agencies.
- B. Analytical studies for budget development and implementation by schools
 1. Interpret financial statements, project status and inventory reports and relate them to educational program requirements.
 2. Provide special analytical studies relating to specific requirements relating to judicious expenditures of funds and the reasonableness of requests for resources.
- C. State guidelines and technical advice shall be provided by the Office of Business Services and the Office of Planning and Analytical Studies.
- D. Amendments may be made by mutual agreement.

AGREED:

HONOLULU DISTRICT	By: /s/ Teichiro Hirata
LEEWARD DISTRICT	/s/ D. Los Banos, Jr.
CENTRAL DISTRICT	/s/ F. Hatanaka
WINDWARD DISTRICT	/s/ Albert H. Miyasato
HAWAII DISTRICT	/s/ Harry C. Chuck
MAUI DISTRICT	/s/ Andy Y. Nii
KAUAI DISTRICT	/s/ Barton H. Nagata
OFFICE OF BUSINESS SERVICES	/s/ Harold K. Fukunaga
OFFICE OF PLANNING & ANALYTICAL STUDIES	/s/ Louis K. Yamauchi

APPROVED:

/s/ William A. Waters
for SUPERINTENDENT OF EDUCATION

July 2, 1970

JOHN A. BURNS
GOVERNOR OF HAWAII

STATE OF HAWAII
DEPARTMENT OF HEALTH
P.O. Box 3378
Honolulu, Hawaii 96801

WALTER B. QUISENBERRY, M.P.H., M.D.
DIRECTOR OF HEALTH

WILBUR S. LUMMIS JR., M.S., M.D.
DEPUTY DIRECTOR OF HEALTH

March 9, 1971

IN REPLY, PLEASE REFER TO:
FILE: ASO

Mr. Clinton Tanimura
Legislative Auditor
State Capitol
Honolulu, Hawaii

Dear Mr. Tanimura:

Subject: Audit of State Vendor Payments

Thank you for sending us a preliminary copy of the above report for our comment. We were pleased that the audit revealed no significant deficiencies in the health department's payment and were happy to receive your recommendations for improvement.

Concerning confirming purchase orders, we shall develop a departmental policy in the very near future to reduce the incidence of such confirming purchase orders.

We are this day requesting approval of the State Comptroller to deposit funds of Hawaii State Hospital patients in a commercial bank or savings institution, with interest to be credited to individual patients.

We have some questions as to the practicality of using patients' funds for an imprest fund and shall consult with the State Comptroller in this regard. The first question involves the appropriateness of such use of patients' funds and the second involves the bookkeeping problem of how much of each patient's account should be diverted to the imprest fund.

In the future, may we request a little more time to respond to audit reports? The six calendar days you gave us this time included a weekend and barely allowed sufficient time for transit and routing.

Sincerely yours,

/s/ Walter B. Quisenberry
WALTER B. QUISENBERRY, M.D.
Director of Health

PUBLISHED REPORTS OF THE LEGISLATIVE AUDITOR

Audit Reports

- 1966 1. Examination of the Office of the Revisor of Statutes, 66 pp. (out of print).
- 1967 1. Overtime in the State Government, 107 pp.
2. Management Audit of Kula Sanatorium, 136 pp.
- 1968 1. Financial Audit of the Department of Health for the Fiscal Year Ended June 30, 1967, v.p. (out of print).
2. Financial Audit of the Department of Planning and Economic Development for the Fiscal Year Ended June 30, 1967, v.p. (out of print).
3. Financial Audit of the Department of Regulatory Agencies for the Fiscal Year Ended June 30, 1967, v.p. (out of print).
4. Financial Audit of the Department of Hawaiian Home Lands for the Fiscal Year Ended June 30, 1967, 54 pp.
5. Financial Audit of the Oahu Transportation Study for the Period July 1, 1962 to August 31, 1967, 68 pp.
6. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1966 to January 31, 1968, 69 pp. (out of print).
7. State Capital Improvements Planning Process, 55 pp. (out of print).
8. Financial Audit of the Hilo Hospital for the Fiscal Year Ended June 30, 1967, 43 pp. (out of print).
9. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1967 to June 30, 1968, 42 pp.
- 1969 1. Financial Audit of the General Fund, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p. (out of print).
2. Financial Audit of the Judicial Branch, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p. (out of print).
3. Financial Audit of the State Department of Budget and Finance for the Fiscal Year Ended June 30, 1968, v.p.
4. General Audit of the Department of Personnel Services, State of Hawaii, 129 pp. (out of print).
4. A Summary of the General Audit of the Department of Personnel Services, 53 pp.
5. Financial Audit of the Samuel Mahelona Memorial Hospital for the Fiscal Year Ended June 30, 1968, 34 pp.
6. Financial Audit of the Honokaa Hospital for the Fiscal Year Ended June 30, 1968, 41 pp.
7. Financial Audit of the Kohala Hospital for the Fiscal Year Ended June 30, 1968, 34 pp.
8. Financial Audit of the Kona Hospital for the Fiscal Year Ended June 30, 1968, 44 pp.

9. Financial Audit of the Kauai Veterans Memorial Hospital for the Fiscal Year Ended June 30, 1968, 30 pp.

10. An Overview of the Audits of the Act 97 Hospitals, 18 pp.

1970 1. Management Audit of the Department of Water County of Kauai, 65 pp.

2. Audit of the Kamehameha Day Celebration Commission, 47 pp.

3. Audit of the Medical Assistance Program of the State of Hawaii, 392 pp.

1971 1. Financial Audit of the State School Lunch Services Program, Department of Education, for the Fiscal Year Ended June 30, 1970, v.p.

2. Audit of the County/State Hospital Program, 124 pp.

Other Reports

1965 1. Long and Short Range Programs of the Office of the Auditor, 48 pp. (out of print).

2. A Preliminary Survey of the Problem of Hospital Care in Low Population Areas in the State of Hawaii, 17 pp.

1966 1. Procedural Changes for Expediting Implementation of Capital Improvement Projects, 9 pp.

1967 1. The Large School: A Preliminary Survey of Its Educational Feasibility for Hawaii, 15 pp.

2. State-City Relationships in Highway Maintenance, and Traffic Control Functions, 28 pp.

3. Manual of Guides of the Office of the Legislative Auditor, v.p.

1969 1. Transcript of Seminar in Planning-Programming-Budgeting for the State of Hawaii, 256 pp.

2. Airports System Financing Through Revenue Bonds, 9 pp (out of print)

3. Second Annual Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967 (Relating to State-County Relationships), 13 pp. (out of print).

4. An Overview of the Governor's 1969-70 Capital Improvements Budget, 61 pp. (out of print)

5. A Supplementary Report on the Audit of the Hawaii Visitors Bureau, 2 pp. (out of print)

1970 1. A Study of the Compensation of Coaches of Interscholastic Athletics of the State Department of Education, 31 pp.

1971 1. A Study of the State Highway Special Fund, 14 pp.

LEGISLATIVE AUDITOR
STATE CAPITOL
HONOLULU, HAWAII 96813