

AUDIT REPORT NO. 74-1
MARCH 1974



FINANCIAL AUDIT OF THE DEPARTMENT OF REGULATORY AGENCIES

A REPORT TO THE GOVERNOR AND THE LEGISLATURE 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
STATE CAPITOL
HONOLULU, HAWAII 96813**

**FINANCIAL AUDIT OF THE
DEPARTMENT OF REGULATORY AGENCIES
STATE OF HAWAII
FISCAL YEAR ENDED JUNE 30, 1973**

Conducted by
Main Lafrentz & Co.
Certified Public Accountants

A Report to the Governor and the Legislature of the
State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii

Audit Report No. 74-1
March 1974

FOREWORD

This financial audit report is the result of the examination of the financial statements and records of the State department of regulatory agencies for the fiscal year ended June 30, 1973. The audit was conducted by Main Lafrentz & Co., certified public accountants.

The audit was performed in accordance with the generally accepted auditing standards adopted by the membership of the American Institute of Certified Public Accountants. In addition, the audit was governed by the "Specifications for the Financial Audit of the State Department of Regulatory Agencies and Instructions for the Submission of a Proposal" issued by this office.

This report is divided into four parts. Part I contains a description of the department's organizational history and functions. Part II, "Report on Internal and Operational Controls, Accounting Systems and Procedures," includes the auditors' evaluation of the adequacy and effectiveness of the system of internal control and the adequacy of the financial records, financial reporting, and budgetary controls. In addition, the policies and practices in certain areas were examined. These included the reasonableness of the assessment of fees and charges on regulated activities, the fairness of the fee and license structure, and the practices relating to the assessment of penalties and fines.

Part III, "Financial Statements," displays the financial statements of the department and includes the auditors' opinion as to the reasonable accuracy of the financial statements.

It is our practice to request each of the agencies affected by the audit to submit in writing its comments on the findings and recommendations and to indicate what action has been or will be taken. The agencies' responses are included in Part IV of this report titled, "Comments by Affected Agencies."

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the departments contacted during the audit.

Clinton T. Tanimura
Legislative Auditor

MAIN LAFRENTZ & Co.

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March 15, 1974

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

Dear Mr. Tanimura:

We are pleased to submit herewith our report on the financial audit of the Department of Regulatory Agencies of the State of Hawaii for the year ended June 30, 1973.

The Directors and the staff of the various agencies affected by the audit were most cooperative during the conduct of the audit. We gratefully acknowledge their assistance. We are also pleased to note that our recommendations were accepted by them in the constructive spirit in which they were made.

The following independent certified public accountants participated in the audit and made valuable contributions to the successful completion of the report:

Inagaki, Mukai, Fo and Morikawa
Ishimoto, Imamoto & Company
Herman G.P. Lemke, C.P.A.

Finally, we wish to thank Mr. Wilbert Sakamoto, who served as project liason to our staff, and other members of your staff who assisted us in various ways.

We appreciate the opportunity to participate in the efforts of your office to achieve more effective and efficient government operations.

Very truly yours,

Main Lafrentz & Co.

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INTRODUCTION

This is a report on the post-audit of the financial transactions, books, and accounts of the department of regulatory agencies covering the period from July 1, 1972 to June 30, 1973 and an examination of the systems and procedures of accounting, reporting, and operational and internal controls of the Department. The audit was conducted by Main Lafrentz & Co., an independent certified public accounting firm, under a contract with the State auditor. It was performed pursuant to section 23-4 of the Hawaii Revised Statutes, which requires the State auditor to conduct post-audits of all transactions and of all books and accounts kept by or for all departments, offices, and agencies of the State and its political subdivisions.

Audit Objectives

The objectives of the examination were:

1. To provide a basis for an opinion as to the reasonable accuracy of the financial statements of the State department of regulatory agencies.
2. To ascertain whether or not expenditures and other disbursements have been made and all revenues and other receipts to which the State is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government (where applicable).
3. To ascertain the adequacy of the financial and other management information reports in providing officials at the different levels of the department with the proper information to plan, evaluate, control, and correct program activities.
4. To evaluate the adequacy, effectiveness, and efficiency of the systems and

procedures for financial accounting, internal and operational controls, and recommend improvements to such systems and procedures.

Audit Scope

The scope of the examination included the following:

1. A limited general audit of the financial transactions and accounting records of the State department of regulatory agencies embracing the transactions and records for the fiscal year July 1, 1972 to June 30, 1973, including tests of the financial data to provide the auditor with a basis to report on the fairness of the financial statements, the legality and propriety of the expenditures and other disbursements, and the accounting for all revenues and other receipts.
2. An examination of the existing systems and procedures of accounting, reporting, and operational and internal controls. This examination was intended to identify the weaknesses in the systems and procedures, and to formulate appropriate recommendations for improvements, including, but not limited to, the design or revision of forms and records, management information system, and accounting and operating procedures.
3. An analysis of all fees and charges to determine (a) the reasonableness of the amounts assessed in light of the purposes for which the fees and charges are levied and the cost of the services rendered and (b) the fairness of the fee and license structure, especially with respect to the fee and license charges of boards or commissions which are in similar groupings and which provide similar services. The examination also ascertained and identified the fees which have not been reviewed or revised for an extended period of time.

4. An examination of the laws, policies, procedures, and practices relating to fines and penalties, including an assessment of the consistency of the laws, policies, and procedures in the treatment of fines and penalties associated with the various fees and charges assessed, the adherence by the department to prescribed policies and legal requirements in the application of fines and penalties, and the fairness of the penalties in light of the fees being assessed and the seriousness of the violations.

Report Organization

This report is presented in three parts:

Part I describes the department of regulatory agencies, including its establishment, administration, organization, and functions;

Part II presents the audit findings and recommendations regarding the accounting systems, the systems of internal control, and specific areas of concern; and

Part III sets forth the financial statements of the department and a report on the statements.

PART I

SOME BACKGROUND

Organizational History

The department of regulatory agencies (formerly the department of treasury and regulations) was created by Section 15 of Act 1 (the Hawaii State Government Reorganization Act of 1959), Second Special Session Laws of Hawaii, 1959.

Under the act, the responsibility for protecting the interests of consumers, depositors, and investors throughout the State is placed within the department. The department is vested with the duty to set standards and to enforce all laws and rules and regulations governing the licensing, registration, and operations of trades, businesses, and professions, including banks, insurance companies, brokerage firms, and other financial institutions.

Within the department for administrative purposes are the: board of examiners of abstract makers; board of accountants; board of barbers; board of cosmetology; boxing commission; board of chiropractic examiners; collection agencies advisory board; contractors license board; board of dental examiners; board of registration for professional engineers, architects, and surveyors; board of massage; board of medical examiners; board of examiners in naturopathy; board of nursing; board of examiners of nursing home administrators; board of dispensing opticians; board of examiners in optometry; board of osteopathic examiners; board of pharmacy; board of photography; board of detectives and guards; public utilities commission; real estate commission; board of veterinary examiners; cemetery board; and motor vehicle industry licensing board.

In 1972 the Hawaii public broadcasting authority was created by the legislature and placed within the department for administrative

purposes. However, the transfer of real and personal property and personnel from the university of Hawaii was not effected until July 1, 1973.

The director of regulatory agencies is also the bank examiner, insurance commissioner, commissioner of securities, mortgage commissioner, and the fire marshal of the State.

Departmental Organization and Activities

1. *General administration.* The director of regulatory agencies is responsible for the general administration of the department. Included in general administration are the establishment, subject to the approval of the governor, of departmental policies and organizational plans and the implementation of such policies and plans and all administrative rules, regulations, and procedures. Also included are the maintenance of program planning, the general management and evaluation of departmental activities, and the rendering of fiscal, personnel, and other administrative services to the various divisions of the department.

2. *Bank examination division.* The bank examination division administers the State laws concerning the chartering, licensing, examination, supervision, and regulation of banks, trust companies, savings and loan associations, industrial loan companies, small loan companies, and business development corporations.

3. *Business registration division.* This division, which includes the office of the commissioner of securities, is charged with the responsibility of administering the State laws relating to corporations, partnerships, agricultural and fishing cooperatives, and the

sales of securities. In addition, this division maintains the State registry for trademarks, trade names, prints, and labels, and regulates the public solicitation of funds by charitable organizations. Administration activities include the examination, registration, supervision, and regulation of the foregoing activities.

4. *Fire marshal division.* The fire marshal division directs and coordinates the statewide fire protection program which includes the maintenance of records of all fires occurring within the State; investigation into the causes, origins, and circumstances of fires; maintenance of a fire inspection program and establishment and enforcement of regulations on fire prevention and fire safety, combustibles and explosives, fire alarm systems, and fire extinguishing equipment and fire escapes.

5. *Insurance division.* This division is responsible for the licensing, supervision, and regulation of all insurance companies, insurance agents, and non-profit corporations and associations engaged in insurance transactions. Specific activities include analyzing, reviewing, and taking action, as required, on insurance company reports, premium rates, insurance contracts, agency operations, and certificates of authority; performing field examinations of domestic insurers and rating bureaus; and investigating, examining, and licensing all classes of insurance agents.

6. *Public utilities division.* This division regulates and establishes the rates, charges, fares, and the classes and conditions of service of all franchised and certificated public service companies and motor carriers. Regulatory activities include the evaluation of utility properties to determine the appropriate base from which the allowable rate of earnings to the utilities may be ascertained; the adoption, promulgation, and enforcement of rules and regulations pertaining to standards of efficient and reasonable service, safety of operations, adequacy of facilities, accounting methods and records, accounting and statistical reports and practices and procedures before the public utilities commission; control over the acquisition and disposition of utility properties, including mergers; control over issuance of securities and long-term debt; issuance of certificates of public

convenience and necessity; and investigation of complaints.

7. *Regulatory boards and commissions.* The 26 regulatory boards and commissions, other than the public utilities commission, are responsible for the protection of the public by enforcing the laws which regulate the practice of certain professions and occupations through the adoption and enforcement of rules and regulations concerning these laws. Their responsibilities include establishing standards for qualifying examinations; determining and approving the content of these examinations; granting or denying licenses; directing investigations; and holding hearings in connection with the suspension, revocation, and reinstatement of licenses.

8. *Professional and vocational licensing division.* Administrative and office services are provided the 26 regulatory boards and commissions by the professional and vocational licensing division. Stenographic, clerical, examination, licensing, record keeping, and investigatory services are provided in cooperation with seven executive secretaries serving the regulatory boards and commissions.

9. *CATV division.* The CATV division is responsible for administering the State laws relating to cable television systems (also described as community antenna television systems), including receiving applications and granting permits to cable television companies to operate their systems in designated geographic service areas and establishing and enforcing rules, regulations, and fee schedules necessary for the regulation of the industry.

10. *Hawaii public broadcasting authority.* In 1972, the legislature created the Hawaii public broadcasting authority. The authority's duties and responsibilities are to establish, manage, control, and operate public broadcasting facilities; and to produce or otherwise obtain for broadcast programs intended to enlighten the people of the State and to air such programs to the citizens of Hawaii. The legislature placed the authority, which is under the control of a board of 11 members, within the department of regulatory agencies for administrative purposes. The

authority's duties and responsibilities were formerly with the university of Hawaii. Their

transfer to the authority from the university was effected on July 1, 1973.

PART II

REPORT ON INTERNAL AND OPERATIONAL CONTROLS ACCOUNTING SYSTEMS, AND PROCEDURES

Introduction

As a part of the examination of the financial statements of the department of regulatory agencies for the year ended June 30, 1973, the department's system of internal accounting control was reviewed and tested to the extent considered necessary. Under generally accepted auditing standards, such review is required to determine the degree to which the system may be relied upon. The system's reliability determines the nature, timing, and extent of other auditing procedures that must be employed to enable the auditor to express an opinion on the financial statements. It should be noted that such an evaluation of the department's system of internal accounting control does not necessarily disclose all of the weaknesses that may exist in the system.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and the financial records are reliable for preparing financial statements and for maintaining accountability for assets.¹ The concept of reasonable assurance recognizes that the cost of a system of internal accounting

¹There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

In addition to a review of the internal accounting controls described above, the management information systems, administrative procedures, and organizational structure were reviewed to determine whether the department, in certain selected areas, was complying with applicable laws and regulations and managing or utilizing its resources in an economical and efficient manner and whether the department was collecting all the revenues it was entitled to.

The financial transactions and operations of the Hawaii public broadcasting authority were not examined since, during fiscal year 1972-73 (the year subject to the audit), the functions of the authority were under the administrative control of the university of Hawaii. Also not examined were the financial transactions and operations of the public utilities division, except to the extent necessary to express an independent accountant's opinion on the financial statements presented in Part III.

This part of the report includes a summary of findings and a detailed discussion of the findings in the following sections:

- . Billings for reimbursable costs
- . Adequacy of licensing and regulatory fees
- . Collection of revenues
- . Business registration record keeping system and practices

- . Systems, procedures, and controls in the expenditure process
- . Other operational deficiencies
- . Computer controls

Summary of Findings

The review and evaluation of the adequacy, effectiveness, and efficiency of the systems and procedures of financial accounting and internal and operational controls disclosed areas in which definite improvements can be achieved. Instances were also found in which the statutes, rules, and regulations were not being complied with. The findings and recommendations are summarized below.

1. Internal and operational controls. The most significant weaknesses in internal and operational controls are in the procedures for collecting, accounting, and maintaining custody of departmental collections. Proper instructions and computerization of the process of recording cash collections can strengthen these controls.

Other opportunities for improvement in controls include better surveillance over the issuance of purchase orders to prevent overencumbrance of allotments, staggering of license renewal dates to even out work loads, and establishing policies regarding the acceptance of post-dated checks.

2. Systems and procedures. The department has begun computerizing the relicensing functions in the professional and vocational licensing division. Computerization should be expanded to include the business registration division to aid it in maintaining its records on a current basis. It should also be expanded to include the billing and collection functions to provide better control over delinquencies.

Other improvements can be achieved in the design of departmental appropriation, allotment, encumbrance, and expenditure records and the procedures for billing for costs incurred in examining banks and insurance companies.

3. Compliance with statutes, rules, and regulations. The bank examination division has not fully complied with the statutory requirement that it recover the costs of examining financial institutions. The result has been a loss of substantial revenues to the State. Non-compliance with statute is twofold. *First*, the rates at which the financial institutions are charged for the costs of examination are insufficient to recover all of the costs specified by statute. *Second*, the costs of certain investigatory examinations are not now being charged the examinee.

Additional revenue losses are being experienced by the penalty assessment procedures of the business registration division which are contrary to regulations.

4. Adequacy of fees assessed. The fees assessed by some divisions are inadequate to cover the cost of operating the divisions. Many of the fee rates have not changed for many years. Moreover, the fees assessed the various professions and occupations are not comparable in amounts. In addition, some of the penalties are inadequate in relation to the fee or tax assessed.

An additional opportunity to increase revenues exists by changing the insurance premium tax payments from annual to monthly payments.

5. Computer controls. A substantial part of the expenditures of the department are payroll costs which are computed and recorded by computer centers 1 and 3 of the statewide information system. There are several control problems at these computer centers which require correction. There is a need for (a) an organizational separation of duties and responsibilities at center 1; (b) additional backup of the system analyst's knowledge of the new payroll system; (c) improvements in security, organizational controls, and overall organization and maintenance of premises and records at center 1; and (d) documentation of the backup and recovery procedures and strengthening of the backup and recovery capabilities at center 1 and center 3.

Billings for Reimbursable Costs

Whenever a bank or insurance company is examined, the Hawaii Revised Statutes requires the department of regulatory agencies to recover from the examinee the costs of conducting that examination. A review of the rates at which banks and insurance companies are charged for such examinations and the procedures followed in billing disclosed the following:

- . The current billing rates for bank examinations are inadequate to recover costs, resulting in a substantial loss to the State.
- . Insurance companies are not being charged at a uniform rate, and all costs are not being included in the rates used.
- . The billing procedures have resulted in incorrect charges to examinees.
- . The banks are not being billed for examination services in a timely manner.
- . The banks are not being billed for the costs of certain investigatory examinations.

1. *Billing rates for bank examinations.*

Section 401-8, Hawaii Revised Statutes, requires that banks be charged for examinations of the banks "based on cost per hour per examiner plus travel, per diem and other related expenses." The hourly rate per examiner currently charged in the routine, annual examination of banks is \$3.25 when bank examiners I are utilized, \$3.50 when bank examiners II are employed, and \$4.50 when bank examiners III are used. The amount charged for overhead expenses is 25 percent of the hourly rates. This fee schedule has remained unchanged since 1964.

Both the hourly rate charged for the use of each of the three classes of examiners and the overhead rate are grossly insufficient to recover the costs of bank examinations. For the year ended June 30, 1973, this insufficiency resulted in the non-recovery of costs of approximately

\$180,000. That the rates are inadequate is evident from the following.

The actual hourly cost of providing bank examination services, when based on salary rates in effect on July 1, 1973, is as follows:

<i>Staff classification</i>	<i>Total working hours*</i>	<i>Estimated total compensation</i>	<i>Hourly rate</i>
Bank examiner I (3)	5,448	\$ 32,340	\$5.94
Bank examiner II (6)	10,896	88,380	8.11
Bank examiner III (6)	10,896	<u>103,020</u>	9.45
		<u>\$223,740</u>	

*Based on 227 working days per year after allowance for holidays and vacations.

The above calculation does not include the cost of any salary increments after July 1, 1973. Also excluded are the costs incurred when the bank examiners attend training sessions or staff meetings, or take sick leave, etc. If these costs are considered, the hourly rates will be higher.² The difference between these rates and the rates currently charged is as follows:

<i>Staff classification</i>	<i>Re-calculated rates</i>	<i>Rates currently charged</i>	<i>Difference</i>
Bank examiner I	\$5.94	\$3.25	\$2.69
Bank examiner II	8.11	3.50	4.61
Bank examiner III	9.45	4.50	4.95

With respect to overhead, the cost of the executive bank examiner and the bank examiner IV, who supervise and review the work of the examiners; the cost of clerical and secretarial support; and the cost of fringe benefits enjoyed by the bank examiners and support personnel

²The increase in the hourly rates will come about as follows. The examiners' total working hours will be reduced by the hours spent by them at training sessions and staff meetings, on sick leave, etc., to yield the actual hours spent examining banks. However, the banks will still be charged the total salaries paid to the examiners on the assumption that the training, etc., all relate to the task of bank examination. The actual bank examining hours divided into the total compensation will then yield higher hourly rates.

are all part of overhead. The actual overhead cost anticipated during 1973-74 is as follows:

Administrative salaries	\$ 51,936
Fringe benefit costs estimated at 20% of salary cost	55,135
Other current, budgeted expenses	<u>3,348</u>
	<u>\$110,419</u>

On this computation, the overhead rate should be 49 percent of the hourly rates, rather than 25 percent. The 49 percent is derived by dividing the overhead cost (\$110,419) by the bank examiners' total compensation (\$223,740). The rate would be higher if the following costs were also included in the overhead cost: the costs of departmental administration (which includes the cost of the office of the director of regulatory agencies and the administrative services of the department such as fiscal and personnel); the costs of State central services provided by the department of accounting and general services, the department of personnel services, the department of budget and finance, and others; and the cost of the space used by the bank examination division in the Kamamalu Building.

It is estimated that if the hourly and overhead rates remain unchanged revenue losses for the fiscal year ending June 30, 1974 will exceed \$182,000 according to the following computation:

Total estimated costs:	
Bank examiners' total compensation	\$223,740
Overhead	<u>110,419</u>
	334,159
Less estimated cost of unbilled investigations	<u>33,416</u>
Estimated costs to be recovered	300,743
Estimated revenues based on current billing rates including overhead	<u>117,982</u>
Excess of estimated costs over estimated revenues	<u>\$182,761</u>

The need to revise the hourly and overhead rates has been one of long standing. The office of the legislative auditor in its audit report for the year ended June 30, 1967 noted that the rates even then were too low. It is estimated that, in the period 1967 to 1973, the unrecovered costs (including the cost of employee fringe benefits) exceeded \$600,000.

Recommendation. To comply with the law covering bank examination fees and to prevent further losses of revenue, we recommend that the bank examination division revise its hourly rates and overhead rate immediately, and in doing so, to recover all costs related to bank examinations, include the costs of training, sick leave, etc., in the hourly rate and the costs of departmental administration, central services, and occupancy in the overhead rate.

2. Billing rates for insurance examinations. Section 431-59 of the Hawaii Revised Statutes requires that the insurance commissioner charge an insurer the costs of the examination of the insurer. Included among the costs to be charged the insurer is "per diem compensation at a reasonable rate." Examination of billings during the fiscal year disclosed that examinees are not being billed at uniform per diem rates and that the rates charged are inadequate to recover the costs of fringe benefits and other overhead expenses.

Examinations of insurance companies are performed by the State's single insurance examiner. The per diem compensation of this examiner that is charged an insurer is calculated by dividing the examiner's monthly compensation by the number of working days in the month in which the examination is conducted. Where the examination stretches over several months, the insurer is charged a different rate for each of the months, since the number of working days differs from month to month. To illustrate, in 1973, an insurer was charged the following daily rates for the services of an examiner who required 37 days to complete the examination, from January 29 to April 12, 1973:

Month	No. of days spent examining insurer during the mo.	Daily rate charged	Method of computation	
			Monthly salary	No. of working days in the mo.
January	3	\$55.05	(\$1,211 ÷ 22 w.d.)	
February	19	63.74	(1,211 ÷ 19 w.d.)	
March	14	57.67	(1,211 ÷ 21 w.d.)	
April	1	60.55	(1,211 ÷ 20 w.d.)	

This method of computing the daily rate is unfair. An insurer unfortunate enough to be examined during the month of February will always pay the highest daily rate (\$63.74) and the insurer examined during a month with the most working days (23) will always pay the least (\$53.05). The difference is \$10.69 per day. This unfairness is compounded when, through errors in calculation or otherwise, various companies examined during the same month are charged at different rates. In March, April, and July of 1973, the actual rates charged three different companies, although examined in the same month, were as follows:

Month	Company		
	1	2	3
March	\$57.67	\$55.92	
April	60.55	55.92	
July		67.43	\$65.36

Not only is the per diem rate unfairly computed, but it is also inadequate in that it does not reflect all costs of the examiner. The State's share of payroll taxes and fringe benefit costs, including medical and dental plan coverages, life insurance, retirement plan contributions, etc., are not included in the examiner's compensation in calculating the per diem rate. These costs are estimated to be approximately 20 percent of gross wages. Further, the cost of the examiner's sick leaves, vacations, training, administrative time, and other hours not spent in actual examination but related to the examination of insurers are currently not included.

In addition, there are other direct and indirect costs incurred in the examination program which should be recovered by the State. These include time spent by clerks and secretaries in preparing examination reports and otherwise assisting the examiner, time spent by the insurance administrator and other departmental personnel in supervising the insurance examination activities and otherwise providing administrative support, the cost of State central services, and the rental cost of the premises occupied by the insurance division.

Recommendation. A uniform rate for the services of the insurance examiner should be developed to be applicable to all examinees regardless of the month in which the service is provided, and an overhead rate should be developed to cover the cost of employee fringe benefits and other direct and indirect costs of administering the examination program.

3. Accounting for time spent in bank examinations. The procedure followed in billing banks for the costs of examinations is as follows.

Upon completion of an examination, each auditor involved submits to the examiner-in-charge a report which notes the dates and number of hours he spent and travel or mileage costs he incurred in the examination. The examiner-in-charge prepares a summary of the time and costs incurred by all auditors in the engagement and computes the total bill. The executive bank examiner then verifies the footings and extensions and reviews the bill. The bill is then transmitted to the examinee.

Nowhere in this procedure is the amount of time spent by the auditors in the examination as noted in the bill reconciled with that shown in the weekly time report which each auditor is required to prepare and submit to account for all of his time during the week. Such reconciliation should be made to avoid over- or underbilling for the auditors' time. Our examination of the bills sent and the auditors' weekly time sheets for the period January 1 to January 26, 1973 disclosed that 12 hours were underbilled and four hours were overbilled.

Recommendation. To insure that the banks are properly charged for the bank examiners' time spent in examinations, we recommend that the billings be reconciled with the auditors' weekly time reports before the billings are sent to the banks.

4. Frequency of billings in bank examinations. Where the scope of a bank examination includes the various bank branches, it is the policy of the bank examination division to bill the bank concerned for the costs of the examination only after all offices and branches within the scope of the examination have been

examined and a copy of the examination report has been transmitted to the head office. This means that the billing for and recovery of those costs clearly associated with the examination of the first branch are delayed until the last branch or office has been examined. This delay has sometimes been as long as eight months, as shown in the following example.

The Bank of Hawaii was examined in 1971-72. The Aiea Branch was the first branch examined. That examination was completed on December 15, 1971. The Head Office was the last to be examined. Its examination was completed on May 9, 1972, or 145 days after the examination of the Aiea Branch was finished. A bill for the costs of examining the Head Office and all branches was sent to the Bank of Hawaii on August 28, 1972, or 256 days after the examination of the Aiea Branch had been completed.

This delay in billing and collection unnecessarily postpones the availability of money to the State for its use. Furthermore, since the accounting system of the State of Hawaii does not recognize revenue until it is collected, this delay could cause the collection of bank examination fees to be reflected in a fiscal year other than that in which the costs of the examination are incurred. For example, in the Bank of Hawaii case cited above, the amount billed the bank was not included in the revenues of the State until the fiscal year ended June 30, 1973, although the costs of the examination were recognized substantially as expenditures during the year ended June 30, 1972.

Recommendation. We recommend that the bank examination division bill banks for examination costs on a monthly basis as the costs are incurred. Such a practice will allow the costs to be recovered sooner to permit a closer matching of costs and revenues under the existing accounting system.

5. *Costs of investigatory examinations.*

In addition to annual, routine examinations, the bank examination division from time to time conducts investigatory examinations of financial institutions. Such investigatory examinations include those conducted when a complaint is filed with the bank examination division by a

member of the public against a bank, those made when an application to engage in the business of a financial institution is filed, and those conducted when a financial institution relocates its office.

For some of these kinds of investigatory examinations, the statute specifically prescribes the amount of fee that the bank examination division should charge the examinee. For example, the statute provides that a fee of \$75 shall be charged in investigating a new industrial loan applicant and \$40 in investigating an applicant who wishes to engage in the business of an escrow depository. In other cases, however, the statute is silent as to the fee to be charged. This is particularly true with respect to investigating complaints of private citizens. In these cases, the bank examination division does not now charge the examinee for such investigations. The division feels that the practice of charging examinees in these cases would not gain the acceptance of the financial community.

It appears that section 401-7, Hawaii Revised Statutes, requires the bank examination division to charge the examinees for all such investigatory examinations at a fee (if not otherwise specifically prescribed by other sections of the statute) based on "the actual per diem cost and expenses" of each man engaged in the investigation.³

Recommendation. We recommend that the bank examination division, in compliance with HRS, section 401-7, bill the financial institutions for the costs of special investigations, including investigations of

³HRS, section 401-7, reads as follows:

"Whenever, in the judgment of the bank examiner, the condition of any bank, trust company, building and loan association, fiduciary company, industrial loan and investment company, or licensee under chapter 409 renders it necessary or expedient to make an extra examination or to devote any extraordinary attention to its or his affairs, the bank examiner may make any and all extra or necessary examinations and devote any necessary extra attention to the conduct of its or his affairs, and the bank, company, association, or licensee shall pay for all extra services rendered by the bank examiner at the actual per diem cost and expenses of each man who may be engaged in the special service at the direction of the bank examiner."

consumer complaints. If there is any doubt as to the applicability of this section, an opinion should be sought from the office of the attorney general.

Adequacy of Licensing and Regulatory Fees

The specific amounts of the licensing and regulatory fees (other than fees for investigations and examinations of financial institutions and insurance companies) that the various divisions of the department of regulatory agencies may assess are generally prescribed by statute. Under section 92-28, Hawaii Revised Statutes, any of these statutorily prescribed amounts may be increased or reduced by the department, with the approval of the governor. Such an increase or decrease may be made to maintain a reasonable relation between the revenues derived from the fee and the cost or value of services rendered, or to preserve comparability among the fees imposed by the State, or for "any other purpose which [the department] may deem necessary and reasonable."

Implied in section 92-28 is the notion that the fees should at least recover the costs of the services rendered. Implied also are that the fees should be reasonable, that there should be some comparability and equity among the various fees charged by the State and that the amount of the fees should be set in the light of all circumstances.

Over the years, the department has utilized this section of the statute and administratively increased some fees by as much as 50 percent. However, an analysis of the fees and charges revealed that there is a need for further examination of some of the fee amounts. Some fees were last adjusted many years ago. For example, the amount of the annual license fee for foreign corporations was last adjusted some fifty years ago, and the amounts of the license renewal fees for securities dealers and salesmen were last amended more than forty years ago. The fact that the amount of any fee has not been adjusted for many years in and of itself says nothing about the continuing reasonableness or unreasonableness of the amount. However, our analysis noted that the fee amounts:

are insufficient in some cases to cover the costs of the services performed;

vary widely among similar occupations and professions; and

are inequitable within particular occupational and professional groups.

Tables I and II summarize some of the various fees charged by the department.

1. Insufficiency of fees. All fees should at least recover the costs of the department's activities undertaken in connection with the purposes for which the fees are assessed. The following are examples where the fees are currently insufficient to recover such costs.

a. The department's insurance division is involved in the regulation of two groups—one, the insurers, and the other, the general agents, subagents, and solicitors. It is estimated that approximately 80 percent of the cost of operating the insurance division is attributable to the regulation of insurers. The remaining 20 percent is attributable to the regulation of general agents, subagents, and solicitors. The regulation of insurers includes activities and services such as insurance policy and rate analysis, review of applications for certificates of authority, review of annual statements and tax reports, collection of statistical data on insurance companies licensed to do business in the State, and conducting examinations.

The fees assessed general agents, subagents, and solicitors are more than enough to cover the costs of the insurance division attributable to the regulation of these agents, subagents, and solicitors. However, the fees charged the insurers (including the fees assessed for the issuance of certificates of authority to engage in the business of insurance and the annual service fees) are not sufficient to cover the costs of the division attributable to the regulation of insurers. In fiscal year ended June 30, 1973, the insurance division collected \$144,183 in fees.⁴

⁴The total revenues of the insurance division was \$9,294,595. Of this, \$9,150,412 constituted premium taxes, leaving \$144,183 as revenue from fees. The cost of collecting premium taxes is minimal and thus does not substantially affect the 80-20 ratio of the division's costs in regulating insurers and costs in regulating agents, subagents, and solicitors.

Table 1
 Department of Regulatory Agencies Boards and Commissions
 Comparison of Professional Licensing Fees
 June 30, 1973

	Examination and initial licensing	Re- examination	Licensing through reciprocity or endorsement	Renewal	Late renewal penalty
Accountants	\$ 45.00	\$ 35.00	\$ 45.00	\$15.00	\$10.00
Chiropractors	50.00	25.00	50.00	7.50	25.00
Dentists	60.00	60.00	60.00	10.50	14.50
Engineers, architects, and surveyors:					
Application	30.00		30.00		
Examination	15.00	15.00	15.00		
Registration	15.00		15.00	15.00	15.00
Medical	125.00	125.00	125.00	7.50	17.50
Naturopaths	75.00	75.00		7.50	50.00
Nurses, registered	30.00	5.00	30.00	3.00	5.00
Optometrists	30.00	30.00		7.50	17.50
Osteopathic physicians	50.00	50.00	100.00	7.50	5.00
Pharmacists	37.50	37.50		10.00	15.00
Psychologists:					
Application	10.00		10.00		
Examination	25.00	25.00			
Certificate	15.00		15.00	15.00	None
Veterinarians	100.00	100.00		15.00	25.00

Table II
 Department of Regulatory Agencies Boards and Commissions
 Comparison of Occupational Licensing Fees
 June 30, 1973

	Application, examination, and initial licensing	Re- examination	Renewal	Late renewal penalty	
Abstract makers:					
Application	\$ 5.00	\$ 5.00			
License	10.00		\$10.00	\$ 5.00	
Barbers	15.00	15.00	5.00	5.00	
Cemetery salesmen:	(no exam)				
Application	10.00				
License	25.00		15.00	10.00	
Contractors:					
General engineer and building—RME	200.00		25.00	2.50	10% of fee
Specialty—RME	100.00		25.00	2.50	10% of fee
Application	25.00	25.00			
Cosmetology	20.00	10.00	4.00	10.00	
Dispensing opticians	50.00	50.00	15.00	10.00	
Electricians and plumbers	25.00	25.00	10.00	1.00	10% of fee
Application	15.00				
Elevator mechanics	5.00	5.00	10.00		
Application	10.00				
Hearing aid dealers and fitters	5.00	5.00	5.00	5.00	30 days
By endorsement	5.00			10.00	over 30 days
Masseurs	15.00	5.00	7.50	5.00	
Motor vehicle salesmen:	(no exam)				
Oahu	15.00		15.00	3.75	25% of fee
Other islands	5.00		5.00	1.25	25% of fee
Application	5.00				Refundable
Nursing home administrators	40.00	20.00	25.00	10.00	
Private detectives and guards	37.50	37.50	37.50	37.50	
Real estate salesmen:	25.00	15.00			
License	50.00		25.00	12.50	
Real estate recovery	50.00				

Of this amount, about \$52,000 was on account of fees assessed agents, subagents, and solicitors, and \$92,000 on account of fees assessed the insurers. The cost of the insurance division totaled \$191,114, calculated as follows:

Expenditures against division appropriations . . .	\$161,328
Cost of employee fringe benefits not included above estimated at 20% of salary cost	<u>29,786</u>
	<u>\$191,114</u>

Of the total \$191,114, \$38,222 was attributable to the regulation of agents, subagents, and solicitors, and \$152,800 was attributable to the regulation of insurers. The amount of the fees collected from insurers was thus short by about \$60,800, and the amount of the fees collected from agents, subagents, and solicitors was about \$13,800 more than necessary to cover the cost of regulating them. The surplus in fees collected from agents, subagents, and solicitors reduced the shortage in fees collected from insurers to \$47,000. Nevertheless, the costs of the insurance division are not now being recovered because the fees charged to insurers are too low in comparison to those charged agents, subagents, and solicitors.

b. The licensing examinations for registered nurses are prepared and graded by a national examining organization. The national organization charges the State, per examinee, \$4 for each of the five parts of the examination. The State in turn charges each applicant a fee of \$30 on initial application to take the exam. This fee is, of course, sufficient to cover the costs of the services of the national examining organization. However, the State charges only \$5 for re-examination, even though the re-examination may be on two or more parts. Clearly, this re-examination fee is not enough to cover the costs of the examination. The insufficiency of the re-examination fee is even more obvious when one considers the cost of the department in renting the facilities necessary to administer the examination.

2. Disparities in fees among occupational and professional fields. As implied in section 92-28, the various fees charged in the several occupational and professional fields should, to the extent possible, be comparable in amount. This is particularly so where the occupations and

professions are somewhat similar in the kind of work performed. There are, however, some doubts about the comparability in fee amounts currently being charged.

a. The fees charged agents, brokers, and salesmen in the various sales occupations are as follows:

	<u>Initial license fee</u>		<u>Renewal fee</u>	
	<i>Solicitor or salesman</i>	<i>General agent, subagent, dealer or broker</i>	<i>Solicitor or salesman</i>	<i>General agent, subagent, dealer or broker</i>
Insurance	\$20.00	\$ 22.50	\$ 5.00	\$ 7.50
Real estate	50.00	50.00	25.00	50.00
Motor vehicle				
Oahu	15.00		15.00	
New		375.00		375.00
Used		150.00		150.00
Other	5.00		5.00	
New		60.00		60.00
Used		30.00		30.00
Cemetery	25.00		15.00	
Securities	5.00	25.00	5.00	25.00

Conceivably, some of the wide disparities among the various occupations occur because of the differences in the costs of regulating the occupations. For example, supervision of the securities industry is the concern not only of the State but also of the National Association of Securities Dealers (NASD) and the federal Securities and Exchange Commission (SEC). The NASD and the SEC are quite active in performing this supervisory function. To the extent that they are, the State is relieved of the necessity of expending that time and effort which it otherwise would in supervising the industry. It is probably for this reason that the fees charged securities salesmen and agents are much lower than those charged salesmen and agents in the other occupations.

However, not all of the differences in the fee amounts among the various occupations can be explained on this ground. Note, for example, the initial license fees assessed cemetery and motor vehicle salesmen. They are nearly equal to or higher than the fees charged salesmen in the other occupations. Yet, neither the cemetery salesmen nor the motor vehicle salesmen are

required to take examinations to qualify for licenses, while the salesmen in the other occupations must.

b. For some occupations and professions, the fee for re-examination is the same as the fee for initial examination; for others, the re-examination fee is substantially less. There is a question as to why this is so. While there may be a need to update the application on a re-examination in some cases, it would appear that, generally, the cost of reviewing and verifying the application would be substantially less in re-examinations than in initial examinations in virtually every occupation and profession.

c. The renewal fee for almost every occupation and profession is low in comparison to the initial examination and licensing fee. However, the amount of the renewal fees ranges widely from \$3 to \$15 in the professions and from \$4 to \$37.50 in the occupations. Further, the amount by which the renewal fee is less than the initial examination and license fee differs widely from occupation to occupation and from profession to profession. In the professional area, the differences range from \$27.50 (pharmacists) to \$117.50 (medicine), and in the occupations from \$0 (hearing aid dealers, motor vehicle salesmen, and private detectives and guards) to \$200 (general contractors). To note the disparity among occupations and professions in another way, the renewal fees for professionals range from 6 percent (medicine) to 33-1/3 percent (accountants) of the initial examination and license fees. In the occupations, the renewal fees range from 0 percent to 66-2/3 percent (abstract makers and elevator mechanics) of the initial examination and licensing fees.

The renewal fees, of course, should be in amounts sufficient to cover the costs of maintaining licensing records, issuing renewal licenses, investigating complaints, etc., but exclusive of the costs of reviewing initial applications and conducting licensing examinations. The latter two activities are not performed in license renewals. Except for the task of investigating complaints, the other tasks are generally clerical in nature. Thus, if there is any justification for the differences among the

occupations or professions in the amounts of the renewal fees or in the proportions of renewal fees to initial examination and licensing fees, it would appear that that justification probably lies in the differences in the number of complaints received and investigated by the department in the various occupational and professional fields. However, the following tabulation for the professions for the year ended June 30, 1973 suggests that this explanation does not hold up in all cases.

<i>Professions</i>	<i>No. of Renewal licensees</i>	<i>No. of Com- plaints</i>	<i>Ratio of com- plaints to licensees</i>	<i>Re- newal fee</i>
Accountants	1067	6	.56%	\$15.00
Chiropractors	34			7.50
Dentists	677	2	.30	10.50
Engineers, architects and surveyors	2645	1	.03	15.00
Medical	2148	5	.23	7.50
Naturopaths	11			7.50
Nurses, registered	4295	1	.02	3.00
Optometrists	91	1	1.10	7.50
Osteopaths	222			7.50
Pharmacists	340	4	1.18	10.00
Psychologists	74	10	13.51	15.00
Veterinarians	57	1	1.75	15.00

For example, in fiscal year 1973, as the above tabulation shows, the renewal fee was \$15 for each of the following four groups: accountants, engineers, architects and surveyors, and psychologists and veterinarians. This suggests that the ratio of complaints to licensees should have been fairly close among these groups. However, this was not the case. The ratio for the engineer group was .03 percent as compared to a high of 13.51 percent for psychologists.

d. The penalties for late renewal of licenses differ among the professions from a low of \$5 to a high of \$50, and among the occupations from a low of \$1 to a high of \$37.50. As a percentage of the renewal fee, they vary from zero to over six times the amount of the renewal fee. Penalties are presumably assessed to encourage timely compliance with

the renewal requirement; their primary purpose is not to recover costs of services rendered. Hence, it would appear that there should be some consistency in the rate (set high enough to encourage compliance) at which the various penalties are assessed. Such, of course, is not now the case. Note, that the personnel in the professional and vocational licensing division cannot recall an instance where it became necessary to assess the high penalty of \$50 in the case of naturopaths.

3. Disparities in fees within an occupational or professional field. Not only should fees be comparable from one field of occupation or profession to another, but the fees within an occupational or professional field should be equitable. That there is inequity within a field has already been demonstrated in some of the illustrations given above. Thus, for example, the inequity in the fees charged insurers vis a vis the fees charged insurance agents, subagents, and solicitors was noted. Also, the identical amounts assessed for initial application and examination and for re-examination in some professional fields was observed.

One other example of this inequity in fees within an occupational field is that fee charged for licensing by reciprocity. Licensing by reciprocity means that an applicant who possesses a license to practice in another state may acquire a Hawaii license without examination, provided he meets Hawaii's educational experience and other requirements. As table I shows, for nearly every profession where licensing by reciprocity is permitted, the fee for such licensing is equal to or higher than the fee for licensing by examination. It would appear that, since no examination is required to qualify for a license under reciprocity, the cost of examination is saved and thus the fee for licensing by reciprocity should be lower.

Recommendation. *We recommend that the department of regulatory agencies re-examine its fee schedules to insure adequacy in terms of recovering the costs of the services provided by the department and to foster equity within and among the various occupations and the various professions. Where statutory amendments are required, the department should formulate*

appropriate recommendations to the legislature.

Collection of Revenues

A review of the department of regulatory agencies' systems and procedures for the collection, handling, and disposition of revenues disclosed that:

- . There are serious security problems.
- . The effectiveness of accounting for the revenues collected is jeopardized by inadequate filing and documentation of receipts, inadequate equipment, lack of internal checks, and uneven work loads.
- . The once a year payment of insurance premium taxes is denying the State the prompt use of the moneys due it and costing the State as much as \$350,000 annually.

1. Inadequate security over cash receipts.

The department's administrative services division employs two cashiers who are responsible for receiving and validating for all divisions within the department all payments made through the mail or in person. Upon receipt, the cashiers validate the document accompanying the payment or prepare a receipt for the payment if there is no document. At the close of each day or the following morning the cashiers reconcile the validated documents and receipts with the tape produced by the validating machine. They then transmit the validated documents to the divisions concerned. For each day's collection, the cashiers prepare a summary of collections, a Form B-13 for transmission to the department of accounting and general services, and a bank deposit slip for transmission to the bank via the armored car service.

There are a number of operational deficiencies in this process which unless corrected could lead to losses from theft, robbery, or embezzlement. They are as follows.

- a. The two cashiers are stationed in enclosures which are less than four feet high, adjacent to a customer service counter. The

doors to the enclosures have no locks, although the enclosures are frequently left unattended. The low wall enables anyone to easily reach over the counter, and the lack of locks permits easy entrance into the enclosures. Any unauthorized person thus can have easy access to the cashiers' confines.

b. One cashier keeps the collected cash in a drawer which can be locked but which the cashier never locks. Indeed, when interviewed, the cashier could not recall where the key was located. The second cashier keeps her collections in a metal box next to the customer service counter where it is easily accessible. She further keeps the moneys to be picked up by the armored car service for deposit in money bags on her desk until the pickup is made and frequently leaves checks and documents not processed on the customer service counter. These practices are an open invitation to misappropriation.

c. Checks are not stamped "for deposit only" immediately upon receipt to prevent their further negotiability. The stamp is affixed when the cashier prepares the deposit slip at the end of the day or the following morning. Under this practice, checks made out to "cash" or endorsed in blank are particularly vulnerable to losses in case of theft or robbery.

d. The cashiers have ready access to the audit tape produced by the validation machine. It would be a simple matter for a cashier, whenever he chooses to do so, to remove the audit tape, validate a series of documents or receipts, clear the machine, re-register on the machine those items appearing on the audit tape, replace the audit tape, and misappropriate moneys equivalent to the total of the validated documents or receipts not appearing on the audit tape.

e. Collections validated during the day and checks and documents not processed on the day of receipt are placed in wire baskets in a walk-in vault. Also placed in the vault in a safe which is never locked are securities which the commissioner of securities is holding for safekeeping. The vault is locked only at night and is also used as a storage room. Persons other than those who have custodial responsibilities

over cash and securities have access to the vault and could easily misappropriate the moneys (which can amount to a substantial sum during peak collection periods) and the securities kept therein.

Recommendations. We recommend that:

a. *The walls of the cashiers' enclosures be raised, locks be provided for the enclosure doors, and that the doors be kept locked at all times.*

b. *The cashiers keep the collections, both processed and unprocessed, including those awaiting pickup by the armored car service, within the cashiers' enclosures under lock and key.*

c. *Checks be stamped "for deposit only to the credit of the State of Hawaii Director of Finance" immediately upon their receipt to prevent further negotiability.*

d. *The audit tapes be locked in the validation machines, with the keys in the custody of someone other than the cashiers. This holder of the keys should remove the tapes at the end of each day when the machine is cleared.*

e. *Access to the walk-in vault be limited to those persons who are responsible for the custody of cash and securities, or if access to the vault is necessary by persons other than those having custody of cash and securities, such access be under strict supervision; lock boxes be provided within the vault for undeposited cash, with the cashiers having custody of the keys to these boxes; and the safe containing the securities be kept locked at all times.*

2. Effectiveness of accounting for revenues collected. Accounting by the department for the revenues collected is made difficult by the following practices.

a. The copies of the receipts issued by the cashiers for moneys received are not filed in a numerical sequence. This causes extreme difficulty in applying that procedure which is ordinarily followed in verifying cash receipts. That procedure calls for tracing items on the

audit tape produced by the validation machine to the copies of the receipts retained by the cashier. This tracing is performed to determine whether the validation numbers and amounts shown on the audit tape and those on the receipts are in agreement. We attempted this procedure in the audit but found it very difficult to find the appropriate receipts for the randomly selected items in the absence of such numerical filing. A good systems design for departmental internal control requires a clear audit trail which can easily be followed.

Not only are the receipts not filed in a numerical sequence, but the cashier's description on the receipts of the purposes for which payments are made is often unclear. This is particularly true in cases when a single payment is made for two or more purposes, for example for license and penalty. In order to properly account for revenues for different purposes, in every case of a single payment for multiple purposes, the receipt should state clearly each purpose and the amount to be credited to each.

b. One of the two validation machines in use by the cashiers has the capacity to register only three digits. On days when the number of collections is large and the number of items registered on the machine exceeds 999, the validation numbers are repeated, thereby assigning the same validation number to two different items. Validation should make it possible to identify each document validated with the amount and number shown on the audit tape. But, since many of the items collected are for identical amounts, the use of identical validation numbers for two items makes it impossible to distinguish which entry on the audit tape is for which validated document.

c. Some of the divisions within the department do not maintain separate, independent records for licenses issued, penalties collected, etc. In the absence of such records, these divisions determine the number of licenses issued, documents registered, etc., by dividing the total sums reported by the fiscal section as having been collected for each such category by the standard fee per license, per document, etc. This results in an inaccurate count because sometimes only a partial amount of the total fee

to cover only a part of the year is paid. An accurate count is important for budgetary purposes.

Aside from providing an accurate count for budget purposes, the maintenance of independent records by the divisions is necessary to check on the accuracy of the statistical and collection reports furnished by the fiscal section. A comparison of these two sources of information and reconciliation of any differences provide that internal check.

d. There is some time lag between collection and deposit of money. As a part of our audit, we selected 97 receipts at random to ascertain the time period from receipt to deposit into the State treasury. We found that most of the receipts were deposited within two days from the date of receipt. However, we noted that 12 of the receipts showed a time lag of two to 18 days before being deposited as shown below.

<i>No. of receipts</i>	<i>Time lag in working days</i>	<i>Month of receipt</i>
3	2- 3	July
2	7	April
7	10-18	December-January
<u>12</u>		

Any delay in depositing receipts has at least two immediate effects. *First*, it increases the risk of misappropriation, theft, or loss, and *second*, the funds are not immediately made available for use by the State.

As evident from the above, the delay in depositing receipts is experienced at certain times during the year, especially in December and January. This is primarily due to the fact that the renewal dates for a large number of the licenses issued by the department fall on December 31 or January 1. The following schedule shows the renewal dates for licenses and the number of licenses that fall due on each date during fiscal year 1973.

<i>Renewal dates</i>	<i>No. of licenses</i>	<i>Percent</i>
December 31 or January 1	16,504	41.5%
January 31	1,965	5.0
April 30	7,283	18.3
June 30 or July 1	13,980	35.2
	<u>39,732</u>	<u>100.0%</u>

The license renewal dates for the various professions and occupations are generally specified by statute. In most instances, these renewal dates were established many years ago when the number of licensees was small and the issuance of license renewals did not present much of a clerical problem. However, today the rapid increase in the number of licensees is resulting in the clerical problems described above. To illustrate this increase, during the year ended June 30, 1968 the division issued 24,371 licenses. For the year ended June 30, 1973 this number increased to 39,732.

The department is attempting to cope with this increased volume of work through the use of an electronic data processing system for the licenses issued by the professional and vocational licensing division. Implementation of the system began during the latter part of the current fiscal year.

Recommendations. *We recommend as follows:*

a. *To provide a clear audit trail, receipts be filed in a numerical sequence and, where a payment is made for multiple purposes, the receipts clearly distinguish the purposes and record the amount for each.*

b. *The capacity of the validating machine which currently registers no more than 999 items be expanded.*

c. *The various divisions within the department of regulatory agencies maintain separate, independent records of licenses issued, documents filed, etc.*

d. *Every effort be made to deposit receipts promptly. Linking the cashiering operations to the data processing system*

currently being instituted for the professional and vocational licensing division might be of assistance in this regard. With the use of the cash register as the point of data input, the computerized system should eliminate the need for much of the manual sorting and tabulating that could be particularly time-consuming on peak license renewal dates. As necessary, the department should propose legislation which would change the license renewal dates so that work load in collection and deposit may be spread more evenly throughout the year.

3. Method of payment of insurance premium tax. Insurance companies which have been granted certificates of authority to do business in the State of Hawaii are subject to a tax on the gross insurance premiums collected and are exempt from the Hawaii general excise tax and the Hawaii income tax (except as to unrelated business taxable income).

This premium tax is payable once annually on March 15 following the year in which the gross insurance premiums, which are to be taxed, are collected. The Hawaii general excise tax, on the other hand, is payable by most other businesses in monthly installments on the last day of the month following the month in which the tax accrues. There is no real reason why the premium tax should not be payable monthly in the same fashion as the general excise tax. Both taxes are on the gross receipts.

For the fiscal year ended June 30, 1973, the State collected \$9,000,000 in premium taxes. If the premium tax had been payable in monthly installments in the same fashion as the general excise tax, then the \$9,000,000 could have been invested as it was collected throughout the year. At a 6 percent per annum interest rate, this would have meant additional revenues to the State from interest in excess of \$350,000.

Recommendation. *We recommend that the statute be amended to provide for the payment of the insurance premium tax in monthly installments. The department of regulatory agencies should prepare appropriate legislation for introduction in the legislature to accomplish this.*

Business Registration Record Keeping System and Practices

The Hawaii Revised Statutes requires that all corporations (and partnerships) formed in the State of Hawaii and all corporations (and partnerships) formed in other jurisdictions but doing business in the State, register with the business registration division of the department of regulatory agencies and file annual statements.

A review of the records maintained by the business registration division and the operating systems and procedures related to the filing of annual corporate exhibits disclosed the following:

The statutory requirement that corporations file annual exhibits on a timely basis is not being vigorously enforced. Indeed, certain practices and policies regarding the filing of these exhibits appear to be contrary to the intent of the statute.

The system of filing and recording annual corporate exhibits is cumbersome and inefficient and is causing a substantial backlog of work.

1. Non-enforcement of statutory requirement. Section 416-95 of the Hawaii Revised Statutes requires every corporation organized for profit under the State laws to file its annual corporate exhibit within 120 days after the end of its fiscal year. The statute authorizes the director of regulatory agencies to grant a reasonable extension of time for making and filing the annual exhibits, and it prescribes that a penalty shall be assessed for failing to comply with this filing requirement.

It appears that this statutory requirement for the annual filing of corporate exhibits is intended (a) to assist the State in the discharge of its regulatory functions over corporations and (b) to protect the interests of the corporations' creditors and stockholders. Thus, compliance by corporations with this statutory requirement is essential. However, the practices and policies of the business registration division indicate that this statutory requirement for filing corporate

exhibits is not being rigorously enforced. Indeed, the validity of certain practices and policies followed by the division is very questionable.

a. The division automatically grants to all corporations a grace period of 15 days beyond the statutorily prescribed 120 days. This practice is reflected in Part III, Section 3.1A of the division's rules and regulations which states that:

"Penalties shall be assessed commencing fifteen days after the due date of an exhibit, partnership statement or license fee."

This practice effectively changes the statutorily prescribed period of 120 days to 135 days. It is doubtful that the legislature intended to authorize such an amendment to the statute when it empowered the director of regulatory agencies to grant reasonable extensions of time. Rather, it appears that the legislature intended extensions to be granted on a case-by-case basis.

b. Written requests for extensions of time are granted without limitation. Part II, Section 2.1D of the division's rules and regulations states:

"Extensions not exceeding ninety days may be granted upon written request, which request must be received before the due date of the exhibit. If a corporation is still unable to file its exhibit within the extension, a further reasonable extension may be granted upon written request."
[Emphasis supplied.]

This rule seems to suggest that the maximum extension allowable is 180 days (or two 90-day periods). But the division in practice grants a multiple number of sequential extensions which when totaled exceed the 180 days prescribed by the rule. Such an unlimited number of extensions does not appear to have been contemplated by section 416-95.

c. The penalty provided by statute for failure to file annual corporate exhibits is not being imposed in the manner intended. Section

416-95 states that any corporation violating or neglecting or failing in any particular to conform to or comply with the requirements for filing corporate exhibits shall be subject to a penalty in an amount to be determined by the director of regulatory agencies not exceeding \$100 for every such violation, neglect, or failure. The section makes the continuance of a failure to file the required exhibit a separate offense for each 30 days of the continuance. The director may, for good cause shown, waive the penalty imposed by this section.

The practices of the business registration division are as follows. *First*, the penalty it assesses is a mere \$10, hardly a sufficient inducement for corporations to file. *Second*, the division assesses this \$10 penalty for the initial delinquency and \$10 for each year after the first year, rather than for each 30 days of delinquency. *Third*, penalties are waived without written justifications being filed. A review of 100 domestic and foreign annual corporate exhibits on file disclosed that 19 of them were filed after the statutorily prescribed 120 days and the administratively allowed grace period of 15 days, without the payment of any penalty, but for which documentations justifying the non-payment or waiver of penalty were not on file with the corporate exhibits.

Recommendations. We recommend that the division of business registration:

a. Cease the practice of granting a blanket automatic grace period of 15 days to all corporations for the filing of annual corporate exhibits.

b. Adhere to its own regulation of granting no more than two extensions of 90 days each.

c. File with the corporate exhibit all documentations relating to extensions and justifications for the waiver of penalty for late filing of the exhibit.

d. Review the adequacy of the penalty amount and adhere to the statutory definition that continuance of a failure to file the required annual exhibit for each 30 days of the continuance is a separate offense in assessing the penalty.

2. *Manual record keeping system.* The procedure prescribed in the filing of corporate exhibits is as follows. The exhibit is filed together with the filing fee and penalty, if any. The amount of the fee and penalty is validated by the cashier on the annual corporate exhibit form. The exhibit form is then numbered, and the number is manually posted on the card maintained for the corporation on which is kept a running record of all annual exhibits filed by the corporation. The annual corporate exhibit itself is filed away with the exhibits of other corporations. The exhibits of all corporations are filed in a numerical order by validation numbers.

When a corporate exhibit cannot be filed within the time prescribed by statute, a request for an extension of time for filing is submitted in triplicate. If the request is approved, the approval is indicated on the request form and two copies are returned to the corporation. The corporation is supposed to retain one copy and attach the other to the annual corporate exhibit when it is filed. A piece of adding machine tape is inserted in the running record card file where the corporation's card is located. No notation is made on the card or the tape itself. The copy of the extension request is filed in a chronological order by date of receipt.

When an annual corporate exhibit is received after the statutory due date, the corporation's running record of corporate exhibits filed is consulted and the adding machine tape, if any, is removed. If there is no tape and a copy of an approved extension request is not attached to the exhibit, no attempt is made to consult the file of the copies of the extension requests retained by the division to determine whether an extension had been granted. Rather, the corporation is requested to produce a copy of an approved extension form or pay a penalty.

This system is cumbersome and inefficient. *First*, the practice of inserting slips of adding machine tapes in the running record card file is a poor way of maintaining a record of corporations which have been granted extensions. Chances of errors are great. The slips may be misplaced in or inadvertently removed from the card file. *Second*, the manner in which

the division's copy of the approved extension forms are filed makes it difficult, if not impossible, to locate the copy of the form for a particular corporation. It is probably for this reason that no effort is expended to locate the form when a corporation files its exhibit late with no copy of the approved extension form attached. *Third*, the manual logging of corporate exhibits filed on the running record cards is time-consuming. Indeed, the division has not been able to keep up with the work load in posting the filings to the cards. It appears that there is a backlog of about three months.

Recommendation. *We recommend that the entire record-keeping system for annual corporate exhibits be computerized. The computerized system should include the following:*

a. Each corporation should be assigned an account number. It may be desirable to utilize the corporation's general excise tax license number as its account number to permit cross-checks between the records maintained by the department of taxation and those maintained by the business regulation division of the department of regulatory agencies.

b. The extension request forms should be numbered. In addition to assisting in computer operations, the numbering of the extension forms would permit their easy location when needed.

c. The due date for filing the corporate exhibit, the extended due date, the date of actual filing, and the exhibit number for each corporation should be entered by its account number into the computer.

d. The computer should produce a list, by account numbers, of the extensions filed. This print-out should serve as the reference source when the annual corporate exhibits are filed. The computer could automatically remove any extension from the list when data that the corporation concerned has actually filed its exhibit is entered into the computer. The input source of exhibit filings could be the cash register described earlier in the section on collection of revenues.

e. The computer should also print out a running record of all corporate exhibits filed by each corporation. This print-out will replace the running record cards now being posted manually.

The recommendation made here is equally applicable to the filing of annual partnership statements.

Systems, Procedures, and Controls in the Expenditure Process

A review of the accounting systems, operating procedures, and internal controls of the department of regulatory agencies for purchases of goods and services and expenditures of departmental appropriations disclosed the following weaknesses:

- . The department is not exercising sufficient control over requisition and purchase order forms to minimize the possibility of unauthorized use.
- . Quarterly allotments are being overexpended contrary to law.
- . There are duplications of accounting records, resulting in unnecessary work.

1. Control over purchase order forms.
The department uses the standard form provided by the department of accounting and general services (Requisition and Purchase Order — Form C-03) to make purchases of goods and services. A supply of these forms is provided to each division where purchase requisitions originate. The security measures used by the divisions to control access to these blank purchase order forms are minimal, thereby making it possible for unauthorized persons to gain access to them to make unauthorized purchases.

First, the forms are not kept in storage areas which could be secured, or if in areas which could be secured (such as in a desk) the areas are not secured. *Second*, the forms are not prenumbered. They are numbered as they are used. While prenumbering will not prevent

unauthorized use, it can aid in the discovery of misappropriation of the forms, and, once used, the form can be traced to the supply from which the form was taken to aid in the investigation of any unauthorized use.

Recommendation. We recommend that the requisition and purchase order blank forms received by the department be either prenumbered or numbered immediately upon receipt, and all unused supplies be kept under lock and key.

2. Overencumbrance of allotments.

Chapter 37, Hawaii Revised Statutes, provides that appropriated funds shall be allotted for use on a quarterly basis as a means of controlling the rate of expenditures during the fiscal year. It prohibits the encumbrance or expenditure of funds in any quarter beyond the amount allotted for that quarter. The department engages in a practice which violates this prohibition.

This practice consists of recording in a subsequent quarter the purchase orders issued in a previous quarter to avoid showing an overencumbrance for the quarter in which the purchase orders were issued. Although we found only two instances in our examination of 97 items where this practice was followed, and although the amounts involved were not significant, it should be noted that the items we examined were selected at random from approximately 2000 purchase orders issued throughout the year and the selection was not confined to periods close to the end of each quarter. Indeed, from all indications, it appears that this practice occurs with some frequency.

Recommendation. We recommend that the department cease issuing purchase orders which cause funds to be overencumbered in a given quarter. If the situation requires that a purchase order be issued when the allotment for the quarter has been used up, the department should apply to the director of finance for an amendment to the allotment as provided by statute.

3. Duplication of accounting records.

The departmental fiscal office maintains the following records to account for appropriations, encumbrances, and expenditures:

Requisition control detail ledger — record of allotment, encumbrances, and expenditures by object symbol;

Requisition control summary ledger — record of allotment, encumbrances, and expenditures by division;

Departmental appropriation ledger (Form D20) — record of appropriation, allotment, and expenditures (summarized by months) by division; and

Departmental detail ledger (Form D21A) — list of summary warrant vouchers and expenditures reported thereon by character of expenditures classified by division.

The first two forms are forms designed by the department for its own use and the last two are forms provided by the department of accounting and general services for departmental use. The forms designed by departmental personnel were initially prepared to satisfy certain requirements for information which could not be readily provided or provided at all by the forms furnished by DAGS.

A review of the recorded information revealed that the requisition control detail ledger and the requisition control summary ledger contain the same detailed information. Furthermore, the departmental detail ledger and the departmental appropriation ledger consist of information available in the first two forms. While the information may be arranged differently, the basic data are essentially the same. Information on the forms is recorded either in handwriting or by typing.

The department was originally scheduled to be a part of the statewide accounting system (SWAS) as of July 1, 1973, which presumably would have eliminated the need for some of these accounting records presently being maintained. However, the department is not yet a part of SWAS and we were unable to get a current estimate of the new implementation date.

Recommendation. To eliminate this apparent duplication of work, we recommend that the department determine what its needs really are, review the forms currently in use, and redesign them to reduce the number of forms and the amount of information being recorded after giving due consideration to the impending implementation of the statewide accounting system.

Other Operational Deficiencies

Some miscellaneous findings of our audit are, in summary, as follows.

- . The audit administration and examination procedures and techniques used by the bank examination division require upgrading if the division is to achieve maximum effectiveness.
- . There have been undue delays in processing and approving employee position reallocation requests, to the detriment of the employees concerned.
- . The practice of accepting post-dated checks in lieu of performance bonds provides the State with little, if any, protection against defaults in performance.

1. Bank audit administration and examination procedures. Under section 401-3, Hawaii Revised Statutes, the State bank examiner of the bank examination division is required to inspect annually every bank, trust company, building and loan association, fiduciary company, industrial loan and investment company, and small loan company, except the national banks. The scope of the examination required under the statute includes a complete and careful examination of the bank's, company's, association's, or licensee's

- . condition and resources;
- . mode of managing business and conducting affairs;

- . actions in the investment, management, and disposition of its funds and the funds and securities entrusted to it by others;
- . safety and prudence in management;
- . policy of transacting business;
- . security afforded to persons dealing with it; and
- . compliance with the laws of the State.

The bank examination division attempts to comply with this wide scope of requirements under the law by making arrangements with federal examiners to participate in joint examinations of banks and building and loan associations which are subject to examination by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. In cases where such participation is secured, the federal examiners review the financial condition of the financial institution, the safety and prudence of its management policies, its practices in transacting business, the effectiveness of its system of internal control and internal check, and its compliance with federal statutes and regulations; and the department's bank examiners limit their activities in these instances to a review of the institution's compliance with State laws.

In the examination of industrial loan and trust companies, the bank examination division itself must review all aspects of each company's management records and practices, since these companies are not subject to federal supervision and examination.

A review of some of the files on the examinations conducted by the bank examination division disclosed the following shortcomings in the performance of these examinations.

- a. The bank examination division does not have a manual of instructions to guide staff examiners—a manual which explains the operations of the various kinds of financial institutions, sets forth the criteria by which to evaluate operations and legal compliance,

clarifies the objectives of the examinations and examination standards, and suggests or prescribes the manner of preparing reports on the examinations conducted to maximize their effectiveness.

b. Audit programs are not prepared for each examination to outline the work to be performed on each examination.

c. The audit workpapers often fail to specify the transactions examined and the examination procedures followed. This was the case in 60 percent of the examination files we reviewed. Without such detail, there would be no way to show that the examination was conducted adequately or that an examination was even made in certain areas. The audit workpapers also often fail to note the examiner's conclusions concerning the items examined.

d. The sparsity in documentation of findings and conclusions with respect to the conditions and resources of the financial institutions and the safety and prudence of their management policies and practices seemingly indicates that very little effort is directed toward examining these aspects of financial institutions.

Recommendations. We recommend that:

a. *The bank examination division develop a manual of instructions for staff examiners. The manual should include, among other things, an explanation of the operations of the various kinds of financial institutions which are subject to audit, standard internal control questionnaires to serve as guides for an examiner to gain an understanding of a particular institution's system of internal controls and checks, standard audit programs to serve as guides in preparing for a particular audit, management and operational review questionnaires to be used in the assessment of the effectiveness of management operations, and instructions on the use of the manual.*

b. *Staff examiners fully document in the audit workpapers their findings, conclusions, and procedures used. Documentation is essential to provide a basis for review and evaluation of audit reports and to support the work*

performed and the conclusions stated in the reports issued.

2. *Delays in personnel action.* On November 26, 1969, the department of regulatory agencies submitted to the department of personnel services requests for the reallocation⁵ of two positions in the business registration division. The department of personnel services took no action on these requests until two years later, on November 12, 1971, when it denied the two requests. The business registration division subsequently resubmitted the requests on November 30, 1971. The department of personnel services again delayed in taking action on the requests, this time for 19 months. On July 18, 1973, it approved the requests, retroactive to December 1, 1969. The whole process took over three and one-half years. The only reason given for the delays was that the department of personnel services had a backlog of work. Indeed, the department of personnel services noted in its acknowledgement of receipt of the requests, both when the requests were first submitted and when they were resubmitted, that action would be delayed because of a backlog of work.

Delays of two, three, and four years in taking action on personnel matters are unreasonable. They are unfair to the employees concerned.

In 1969, in his report on the audit of the department of personnel services,⁶ the legislative auditor noted that the department was inordinately slow in taking reallocation actions. It appears that the situation has not improved over the years.

Recommendation. We recommend that the department of personnel services review its operating procedures and practices to speed up actions on requests for position reallocations.

⁵Reallocation is defined by the *State of Hawaii Personnel Rules and Regulations*, January 1972, Section 7.101(n) as "The assignment of a specific position or group of positions from one class to another on the basis of analysis and identification of new or different tasks, usually as the outcome of a period and process of normal changes or to correct a previous action."

⁶Legislative auditor, audit report no. 69-4, February 1969.

3. *Acceptance of post-dated checks in lieu of performance bonds.* Section 440G-6b(5), Hawaii Revised Statutes, requires that "before commencing construction of an increment of a CATV system, the applicant . . . submit to the Director a performance bond, with corporate surety satisfactory to the Director." The bond is required to be in an amount not less than 50 percent of the cost of construction. It must be maintained until the satisfactory completion of the installation in accordance with the schedule proposed in the application. The purpose of the performance bond is to provide the State with some financial security and protection should the applicant default on the work to be performed.

On occasions, the CATV division has accepted post-dated checks in lieu of performance bonds. For instance, during November 1972, it accepted two post-dated checks in the amounts of \$2,563 and \$2,442 as security for the construction of increments of a CATV system. The checks were post-dated to May 5, 1973.

Post-dated checks do not provide the State with the protection contemplated by the law since such checks cannot be "cashed" until the due date and, even then, there is no assurance that the checks would be backed by sufficient funds. Indeed, in the case of the two checks in the example cited, when they were eventually deposited on or about May 5, 1973, they were returned by the bank because of insufficient funds in the bank. Fortunately in that case, the construction was satisfactorily completed and the State did not need to rely on these checks for financial restitution.

Recommendation. We recommend that the department discontinue the practice of accepting post-dated checks in lieu of performance bonds.

Computer Controls

The department's payroll is processed through and the payroll records are maintained by the State's electronic data processing system. To satisfy ourselves that during the year under

review the payroll of the department, which represented 81 percent of departmental general fund expenditures, was properly computed and recorded, we reviewed the systems and the related controls in operation at computer center 1 (located in the basement of the State Office Building) and computer center 3 (located in the basement of the Queen Liliuokalani Building) which the statewide information system uses for payroll and record keeping.

Our review encompassed the following areas:

- . Organizational, procedural controls;
- . Computer processing controls;
- . Input/output controls;
- . Documentation;
- . Security, backup, and recovery

In this review we noted no unusual problems in the computation and recording of the payroll of the department of regulatory agencies' employees. However, the review disclosed certain weaknesses in the electronic data processing system, which although not directly related to the department of regulatory agencies' payroll are nevertheless of sufficient importance to be reported.

The statewide information system began implementation of a new payroll processing and record keeping system during the latter part of the 1972-73 fiscal year. Because during the period under review the old system was in use, our comments must necessarily encompass the old system as well as the new system. However, the corrective measures we suggest are applicable to the new system.

In summary, our findings are:

- . The physical separation of duties and responsibilities to protect against misuse of the system spelled out in the system's plan is not being strictly observed.
- . The system is exposed to the danger of disruption since there is no backup personnel to the payroll project manager with sufficient knowledge of the payroll system.

Security over the premises and facilities from unauthorized entry is minimal.

Backup and recovery provisions to prevent total disruption in the event of vandalism or catastrophe are insufficient.

1. Inadequate segregation of duties. The proper segregation of duties is just as important, if not more so, in an electronic data processing system as it is in a conventional accounting system. There is generally a greater concentration of responsibility lodged in the EDP department than in any other single unit. It is important that this department be so designed as to permit maximum cooperation between its work units, yet provide for physical and organizational separation among the various functional areas.

In January 1972, the State of Hawaii computer functions were restructured. The plans included placing all computer centers under the electronic data processing division in the department of budget and finance. They also provided for a physical and organizational separation of the functions of input/output control, operations, and systems/programming. To effectuate this separation, the EDP personnel have been instructed that systems and programming personnel are not to have access to the computer operations rooms and are not to operate the computer and that operators are not to have access to the programs and related files and documentation. Interviews with EDP personnel verified that these instructions are understood.

Actual tours and reviews at computer centers 1 and 3 disclosed that, despite a common understanding of the instructions, they are not always followed. On our tours we observed:

At center 3, a programmer was in the operations room while delivering a tape for a payroll program under test. The chief of the EDP division challenged the programmer's presence and, after reviewing the tape being delivered, advised the programmer

that his presence in the operations room was contrary to policy.

At center 1, the systems/programming staff has full access to the operations area and to operators.

A principal reason why there is this breakdown in observing this physical and organizational separation rule is that the new payroll system was in the developmental stage for an exceptionally long time—over five years. During systems/programming development, it is difficult to maintain strict organizational separation, for the programmers, operators, and users necessarily must work together to some degree. Control procedures cannot be observed fully until programming is completed and the system is operational. The breaches in observing the separation policy which currently occur are a fall-out of this long, diverse association of the EDP personnel with one another.

Recommendation. We recommend that the physical and organizational separation of functions be strictly observed by all EDP personnel at centers 1 and 3.

2. Lack of backup to the system project manager. The payroll system project manager is apparently the only person who knows the new payroll system and all its aspects fully. Serious difficulties are likely to arise should he become incapacitated or seek employment elsewhere.

The EDP division chief indicated that this weakness is recognized and that efforts are being made to provide a backup to the project manager.

Recommendation. We recommend that the EDP division provide backup to the system project manager with deliberate speed. Steps should be taken through proper planning to avoid problems of this nature in the future.

3. Inadequate security over premises and facilities at computer centers.

a. Security at computer center 1 is minimal. Inadequacies exist with respect to both the premises and the procedure. Security problems with respect to the premises include the following:

The doors to the computer facilities are standard doors that can be easily opened or broken down.

Entrance to the computer facilities, located in the basement, is through long, covered passageways which are not readily observable from within the facilities.

The rear door to the electrical accounting machine (EAM) room is in an out-of-the-way corner and opens down a long corridor. (Incidentally, this door was not latched at the time of our inspection.)

Entry is easily achieved to the computer area through a third entry through the vault area.

The metal door at the rear of the vault area where all unused warrant stocks, signed bonds ready for delivery, and important accounting records including warrant registers are stored, can be readily opened from the outside by a person with a small arm or by using a short metal rod. Two other similar doors opening into the vault area have metal screening which can be removed with little difficulty. The large metal door at the other end opens into the computer operations room and is apparently left open continuously during operating shifts.

Entry to the thin metal cabinet in which bonds are stored can be easily forced.

With respect to procedure, it appears that responsibility for inventorying and storing unused warrants and bonds is not sufficiently defined. The function of control over these warrants and bonds should be clearly separated from the function of computer operation. Not only is the responsibility for unused warrants and bonds not clearly defined, but the warrants as well as punched cards, etc., are so easily accessible that any knowledgeable computer operator can readily misapply the payroll system. The security conditions over the unused

warrants at center 1 are the poorest we have ever encountered.

b. The security at center 3 is good. The operations room and file areas restrict access through special security lock doors. Procedures require any unauthorized personnel be pre-identified before entrance and then escorted by authorized personnel while on the premises. However, on the first day of our inspection of the premises, we noted that the lock on the main security door was inoperative. Operations management had requested immediate repairs. A few days later, the lock was still not repaired although EDP management made several requests daily. Apparently the delay occurred in going through the channels of various departments. The State needs to arrange for more rapid responses to problems of maintenance of vital security areas. The inoperative door lock negated otherwise effective security of the premises.

Recommendations. We recommend that

a. *The EDP division take immediate steps to secure the premises at computer center 1 and to strictly control access to unused warrants and bonds.*

b. *The department of accounting and general services provide for procedures which enable immediate responses to requests for repairs of security devices.*

4. *Deficiencies in backup and recovery provisions.* In all EDP systems, there should be backup and recovery procedures in the event of the failure of the normally used equipment or procedures due to vandalism, catastrophe, or otherwise. In other words, should anything happen to make the normal procedures inoperable, there should be sufficient capability to perform that which should be performed through other means.

A way in which such capability may be assured is to maintain duplicate copies of programs and systems pack. At computer center 3, such duplicates exist. However, the procedures governing their use are not documented. Further, the backup copies are stored on premises which are not theft- and

fire-proof, and no provision has been made to rotate their locations as is usually done. Then, the copies are kept in a small theft-proof/fire-proof safe or vault which is not large enough to accommodate all storage needs. The payroll project manager, without the knowledge of the operations management, had arranged to store backup copies of the payroll programs in the safe. When this fact was made known to the operations management, it questioned the correctness of this information since it thought that the safe was already filled with other files. This indicates that the placement of the payroll files in the safe is probably only temporary and that a new place will need to be found to place the payroll files, since the safe will soon be used to store other files.

Storage of backup copies is then a problem at computer center 3 which must soon be resolved. The lack of adequate file/program backup storage facilities presents a potentially

serious exposure condition in this highly important computer center.

At computer center 1, copies of files and programs are nonexistent. Indeed, even the status of its original files is undeterminable. For instance, it is difficult to tell which files are kept on a cycle generation basis and which files on a date of retention basis. The situation at computer center 1 is so deplorably weak that it could be summarized as one of having no backup and recovery capability of any kind.

Recommendation. We recommend that the statewide information system produce backup copies of files and programs where such copies are not now available and make immediate provisions for storage of all backup copies of files and programs in separate fire-proof facilities away from the computer centers using these files to prevent total disruption in the event of vandalism or catastrophe.

PART III
FINANCIAL STATEMENTS

Introduction

The department of regulatory agencies is responsible for the collection of all revenues the department is entitled to receive under the law; the expending of amounts appropriated for its operations by the State legislature in the manner prescribed by the statutes and regulations; the safeguarding of all funds and property entrusted to its custody and use from loss through waste, extravagance, and misappropriation; the maintenance of records which accurately reflect all of its financial transactions; and the preparation of financial reports which accurately summarize its financial transactions for the fiscal year and the status of its accounts.

This part of the report consists of the financial statements of the department of regulatory agencies for the year ended June 30, 1973.

The financial statements of the general fund in that section of this part titled, "Opinion of Certified Public Accountants," are presented on the "cash basis," the method of accounting used by the department of regulatory agencies. The financial statements of the general fund and other statements in the later section titled, "Accountants' Opinion on Supplementary Information," are presented in accordance with the recommendations of the proposed guide on "Audits of State and Local Governmental Units," issued by the Committee on Governmental Accounting and Auditing of the American Institute of Certified Public Accountants.

Description of Financial Statements

The following is a brief description of the financial statements included in this part.

1. *Accountants' Opinion on Financial Statements* discloses the scope of the examination of the financial statements and is the independent certified public accountants' opinion on whether these financial statements present fairly the financial position and results of operations of the department of regulatory agencies in accordance with generally accepted accounting principles.

2. *Notes to Financial Statements* are disclosures which provide the reader with a better understanding of the financial statements.

3. *Balance Sheet* presents the assets, liabilities, reserves, and fund balances of the department's various funds at June 30, 1973.

4. *Statement of Revenues (Cash Basis)* presents the revenue collections for the year.

5. *Statement of Appropriations, Expenditures and Encumbrances (Cash Basis)* reflects the appropriations for the fiscal year ended June 30, 1973 and the unpaid obligations at June 30, 1972, the cash expenditures against these appropriations and obligations, the unpaid obligations at June 30, 1973 and the unobligated balance at the end of the fiscal year.

6. *Statement of Cash Receipts and Disbursements* presents the cash transactions during the year.

7. *Accountants' Opinion on Supplementary Information* discloses the scope of the examination of the supplementary information presented and presents the independent certified public accountants' opinion on such supplementary information.

8. *Statement of Revenues* shows the revenues which have been collected in cash and available revenues, such as reimbursable costs,

which should be accrued to reflect properly the revenues earned.

9. Statement of Appropriations, Expenditures and Encumbrances reflects the appropriations for the fiscal year ended June 30, 1973 and the unexpended obligations at June 30, 1972, the accrued expenditures for the period, including the increase in the accrued vacation pay during the year and the retroactive pay increase which were not appropriated for during the current fiscal year, the unexpended obligations at June 30, 1973, and the unobligated balances at the end of the fiscal year.

10. Statement of Revenues of Boards and Commissions shows the revenues collected by the boards and commissions receiving administrative support from the professional and vocational licensing division.

Opinion of Certified Public Accountants

1. The opinion. Filed with the legislative auditor is the following opinion on the department's financial statements (tables III to X):

"To the Auditor
State of Hawaii

We have examined the following balance sheets of the State of Hawaii, department of regulatory agencies, as of June 30, 1973:

Trust Funds
Public Broadcasting Revolving Fund
Temporary Deposit Funds

and the following related statements for the year then ended:

General Fund — Statement of Revenues
(Cash Basis)

General Fund — Statement of
Appropriations, Expenditures and
Encumbrances (Cash Basis)

Trust Funds — Combined Statement of
Revenues, Expenditures and Fund Balances

Public Broadcasting Revolving Fund —
Statement of Revenues, Expenditures and Fund
Balance

Temporary Deposit Funds — Combined
Statement of Cash Receipts and Disbursements

In accordance with the terms of our engagement, the scope of our examination did not include the audit of the balance sheet of the general fund which includes the assets and liabilities of other departments of the State government. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The appropriations and expenditures of the department for personnel services do not include the cost of employee fringe benefits which are estimated to be 20 percent for the year ended June 30, 1973.

In our opinion, the accompanying financial statements present fairly the financial position of the funds of the State of Hawaii, department of regulatory agencies (except the balance sheet of the general fund which is not included), the general fund cash revenues of the department, the general fund cash expenditures against appropriations of the department, the results of operations of the trust funds and revolving fund and the cash receipts and disbursements of the temporary deposit funds for the year then ended in conformity with generally accepted accounting principles except as disclosed in the note to the financial statements on accounting policies.

Main Lafrentz & Co.
Certified Public Accountants

Honolulu, Hawaii
October 16, 1973"

2. General notes to financial statements

a. Accounting policies

(1) Method of accounting. The State of Hawaii maintains its books on a cash basis of

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND

STATEMENT OF REVENUES (CASH BASIS)

YEAR ENDED JUNE 30, 1973

	Estimated revenues	Actual revenues	Actual over (under) estimate
Administrative Division			
Sale of publications	\$ 4,520	\$ 4,576	\$ 56
Bank Examination Division			
Examinations	157,600	126,343	(31,257)
Licenses and fees	22,739	24,263	1,524
	<u>180,339</u>	<u>150,606</u>	<u>(29,733)</u>
Business Registration Division			
Corporations	381,940	395,044	13,104
Partnerships	11,906	13,090	1,184
Securities registrations	40,790	32,113	(8,677)
Securities dealers and salesmen	21,350	20,650	(700)
Trademarks, trade names and others	20,014	21,374	1,360
	<u>476,000</u>	<u>482,271</u>	<u>6,271</u>
Fire Marshal Division			
Tank installation permits	5,000	9,240	4,240
Insurance Division			
Premium tax	9,306,954	9,150,413	(156,541)
Examinations of insurers, etc.	11,000	11,743	743
Licenses and fees	115,091	129,910	14,819
	<u>9,433,045</u>	<u>9,292,066</u>	<u>(140,979)</u>
Boards and Commissions			
Examination and licensing fees	837,524	928,959	91,435
Public Utilities Division			
Motor carriers	143,575	155,528	11,953
Public utilities	513,405	525,279	11,874
	<u>656,980</u>	<u>680,807</u>	<u>23,827</u>
Professional and Vocational Licensing Division			
Subdivisions	4,175	4,000	(175)
Condominiums	4,800	13,125	8,325
Cemetery and pre-need funeral authority	5,140	4,420	(720)
	<u>14,115</u>	<u>21,545</u>	<u>7,430</u>
CATV Division			
Permit fees and publications	97,678	84,271	(13,407)
Total	<u>\$11,705,201</u>	<u>\$11,654,341</u>	<u>\$ (50,860)</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND
STATEMENT OF APPROPRIATIONS, EXPENDITURES AND ENCUMBRANCES
(Cash Basis)
YEAR ENDED JUNE 30, 1973

	AUTHORIZATIONS				EXPENDITURES			June 30, 1973 Encumbrances	Unencumbered Balance
	June 30, 1972 Encumbrances Forwarded	Original Appropriations	Restrictions and reclas- sifications	Total	June 30, 1972 Encumbrances	Appropriations	Total		
Administration Division									
Personnel services	\$ 479	\$ 182,045	\$(19,321)	\$ 163,203	\$ 479	\$ 162,534	\$ 163,013	\$ 191	\$ (1)
Current expenses	861	83,643	(51,623)	32,881	853	31,888	32,741	57	83
Equipment	948	100		1,048	948	151	1,099		(51)
Total Administration Division	2,288	265,788	(70,944)	197,132	2,280	194,573	196,853	248	31
Travel	1,585		77,087	78,672	1,334	73,297	74,631	802	3,239
Bank Examination Division									
Personnel services		266,678	1,152	267,830		267,775	267,775	55	
Current expenses	70	28,793	(25,484)	3,379	70	3,290	3,360	19	
Equipment									
Total Bank Examination Division	70	295,471	(24,332)	271,209	70	271,065	271,135	74	
Business Registration Division									
Personnel services		87,478	5,035	92,513		88,411	88,411	4,101	1
Current expenses	248	9,522	(150)	9,620	236	9,356	9,592	5	23
Equipment	128			128	126		126		2
Total Business Registration Division	376	97,000	4,885	102,261	362	97,767	98,129	4,106	26
Fire Marshal Division									
Personnel services		42,601	445	43,046		43,046	43,046		
Current expenses	39	1,859		1,898	38	1,873	1,911	14	(27)
Equipment		50		50		22	22		28
Total Fire Marshal Division	39	44,510	445	44,994	38	44,941	44,979	14	1
Insurance Division									
Personnel services	2,454	141,064	1,923	145,441	2,454	141,483	143,937	1,504	
Current expenses	67	22,191	(4,103)	18,155	67	10,432	10,499	7,740	(84)
Equipment	25	100		125	25	9	34	7	84
Total Insurance Division	2,546	163,355	(2,180)	163,721	2,546	151,924	154,470	9,251	
Total carried forward	6,904	866,124	(15,039)	857,989	6,630	833,567	840,197	14,495	3,297

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND
STATEMENT OF APPROPRIATIONS, EXPENDITURES AND ENCUMBRANCES
(Cash Basis)
YEAR ENDED JUNE 30, 1973

	AUTHORIZATIONS				EXPENDITURES			June 30, 1973 Encumbrances	Unencumbered Balance
	June 30, 1972 Encumbrances Forwarded	Original Appropriations	Restrictions and reclas- sifications	Total	June 30, 1972 Encumbrances	Appropriations	Total		
Total brought forward	\$ 6,904	\$ 866,124	\$(15,039)	\$ 857,989	\$ 6,630	\$ 833,567	\$ 840,197	\$14,495	\$ 3,237
Boards and Commissions									
Personnel services	295	4,229	(319)	4,205	295	3,619	3,914	292	(1)
Current expenses		2,665	432	3,097		2,428	2,428	669	
Equipment									
Total Boards and Commissions	295	6,894	113	7,302	295	6,047	6,342	961	(1)
Public Utilities Division									
Personnel services	369	420,338	(12,532)	408,175	369	405,262	405,631	2,100	444
Current expenses	68,976	138,738	(32,745)	174,969	40,573	73,785	114,358	37,558	23,053
Equipment	116	200		316	116	189	305	646	(635)
Total Public Utilities Division	69,461	559,276	(45,277)	583,460	41,058	479,236	520,294	40,304	22,852
Professional and Vocational Licensing Division									
Personnel services	488	430,752	2,552	433,792	465	433,302	433,767		25
Current expenses	10,889	108,401	9,010	128,300	10,594	90,122	100,716	7,541	20,643
Equipment	159	1,300		1,459	178	1,006	1,184	42	233
Total Professional and Vocational Licensing Division	11,536	540,453	11,562	563,551	11,237	524,430	535,667	7,583	20,361
CATV Division									
Personnel services		77,194		77,194		62,534	62,534		14,660
Current expenses	939	23,862		24,801	878	12,802	13,680	1,063	10,058
Equipment	904	870		1,774	904	3,014	3,918	4,911	(7,055)
Total CATV Division	1,843	101,926		103,769	1,782	78,350	80,132	5,974	17,663
Public Employment Program									
	90,039	2,074,673	(48,641)	2,116,071	61,002	1,921,630	1,982,632	69,317	64,122
						21,404	21,404		(21,404)
Total	\$90,039	2,074,673	(48,641)	2,116,071	61,002	1,943,034	2,004,036	69,317	42,718

Note - Expenditures for the Public Employment Program were fully reimbursed by the Federal government. However, the Department does not receive the reimbursement, therefore, the reimbursement is not reflected as a deduction on this statement.

The accompanying notes are an integral part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TRUST FUNDS

COMBINED BALANCE SHEET

JUNE 30, 1973

Assets	<u>Total</u>	<u>Real Estate Recovery Fund</u>	<u>Real Estate Educational Fund</u>
Cash with treasury	\$ 27,718	\$ 23,482	\$ 4,236
Time certificates of deposit	<u>246,000</u>	<u>220,000</u>	<u>26,000</u>
	273,718	243,482	30,236
Accrued interest receivable	<u>4,958</u>	<u> </u>	<u>4,958</u>
Total assets	<u>\$278,676</u>	<u>\$243,482</u>	<u>\$35,194</u>
Fund Balances			
Fund balances	<u>\$278,676</u>	<u>\$243,482</u>	<u>\$35,194</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TRUST FUNDS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND FUND BALANCES
YEAR ENDED JUNE 30, 1973

	<u>Total</u>	<u>Real Estate Recovery Fund</u>	<u>Real Estate Educational Fund</u>
Revenues			
Fees	\$ 55,840	\$ 55,840	
Interest on time certificates of deposit	<u>11,308</u>	<u> </u>	<u>\$11,308</u>
Total revenues	<u>67,148</u>	<u>55,840</u>	<u>11,308</u>
Expenditures			
Claims	14,503	14,503	
Travel	1,713		1,713
Donation - University of Hawaii Foundation	<u>2,000</u>	<u> </u>	<u>2,000</u>
Total expenditures	<u>18,216</u>	<u>14,503</u>	<u>3,713</u>
Excess of revenues over expenditures	48,932	41,337	7,595
Fund balances			
Beginning of year	<u>229,744</u>	<u>202,145</u>	<u>27,599</u>
End of year	<u>\$278,676</u>	<u>\$243,482</u>	<u>\$35,194</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
PUBLIC BROADCASTING REVOLVING FUND
BALANCE SHEET
JUNE 30, 1973

Assets	
Cash with treasury	\$1,363
Due from temporary deposit fund	<u>675</u>
	<u>\$2,038</u>
Fund Balance	
Fund balance	<u>\$2,038</u>

Table VIII

STATEMENT OF REVENUES, EXPENDITURES AND FUND BALANCE
YEAR ENDED JUNE 30, 1973

Revenues	
Contribution for drag racing program production	\$ 707
Leasing of mobile T. V. unit	<u>1,180</u>
Total revenues	1,887
Expenditure	
Cost of production of drag racing program	<u>524</u>
Excess of revenues over expenditure	1,363
Fund balance	
Beginning of year	<u> </u>
End of year	<u>\$1,363</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TEMPORARY DEPOSIT FUNDS
COMBINED BALANCE SHEET
JUNE 30, 1973

	<u>Total</u>	<u>Business Registration Division</u>	<u>Professional and Vocational Licensing Division</u>	<u>Insurance Division</u>	<u>CATV Division</u>	<u>ETV Musical Encounter</u>	<u>Workmen's Compensation</u>	<u>PUC Bond Fund</u>
Assets								
Cash	\$19,203	\$1,039	\$8,707	\$4,193	\$4,339	\$675	\$ -	\$250
Accounts receivable	<u>230</u>	<u> </u>	<u> </u>	<u>230</u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$19,433</u>	<u>\$1,039</u>	<u>\$8,707</u>	<u>\$4,423</u>	<u>\$4,339</u>	<u>\$675</u>	<u>\$ -</u>	<u>\$250</u>
Liabilities								
Accounts payable	\$ 600			\$ 600			\$ -	
Deposits payable	10,450	\$1,039	\$4,701	121	\$4,339			\$250
Due to General Fund	7,708		4,006	3,702				
Due to other fund	<u>675</u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u>\$675</u>	<u> </u>	<u> </u>
Total liabilities	<u>\$19,433</u>	<u>\$1,039</u>	<u>\$8,707</u>	<u>\$4,423</u>	<u>\$4,339</u>	<u>\$675</u>	<u>\$ -</u>	<u>\$250</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TEMPORARY DEPOSIT FUNDS
COMBINED STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS
YEAR ENDED JUNE 30, 1973

	<u>Total</u>	<u>Business Registration Division</u>	<u>Professional and Vocational Licensing Division</u>	<u>Insurance Division</u>	<u>CATV Division</u>	<u>ETV Musical Encounter</u>	<u>Workmen's Compensation</u>	<u>PUC Bond Fund</u>
Cash balance								
June 30, 1972	\$ 28,294	\$1,039	\$ 4,231	\$ 3,038			\$ 18,736	\$1,250
Receipts								
Deposits	<u>685,181</u>		<u>11,985</u>	<u>31,500</u>	<u>\$4,339</u>	<u>\$2,175</u>	<u>635,182</u>	
Total	<u>713,475</u>	<u>1,039</u>	<u>16,216</u>	<u>34,538</u>	<u>4,339</u>	<u>2,175</u>	<u>653,918</u>	<u>1,250</u>
Disbursements								
Inspection costs	3,707		3,707					
Awards	1,500					1,500		
Contract examiners	18,150			18,150				
State examiner	12,135			12,135				
Workmen's compensation special compensation fund	653,918						653,918	
Refunds	<u>4,862</u>		<u>3,802</u>	<u>60</u>				<u>1,000</u>
	<u>694,272</u>		<u>7,509</u>	<u>30,345</u>		<u>1,500</u>	<u>653,918</u>	<u>1,000</u>
Cash balance								
June 30, 1973	<u>\$ 19,203</u>	<u>\$1,039</u>	<u>\$ 8,707</u>	<u>\$ 4,193</u>	<u>\$4,339</u>	<u>\$ 675</u>	<u>\$ -</u>	<u>\$ 250</u>

The accompanying notes are an integral
part of these financial statements.

accounting. Accordingly, the increase in accrued vacation pay during the year of \$33,468, the pay increase retroactive to January 1, 1973 totaling \$37,957, which was appropriated for the year ending June 30, 1974, and other accrued expenses which were not paid as of June 30, 1973 are not recorded as expenditures. In addition, revenues earned but not collected for services rendered are not recognized. Financial statements for the general fund have been prepared in accordance with the method of accounting followed by the State of Hawaii in order that comparisons may be made with appropriated amounts. Under this method, reported revenues and expenditures are less than revenues and expenditures under the accrual method by \$16,932 and \$41,614, respectively.

All other statements, except the combined statement of cash receipts and disbursements, have been prepared on the accrual method of accounting in accordance with generally accepted accounting principles. General fund statements prepared on the accrual method are presented as supplementary information.

(2) *Encumbrances.* The department's accounting procedures provide for the recording of commitments at the time contracts are awarded and orders are placed for equipment, services, and supplies. These commitments are represented as encumbrances in the accompanying financial statements and are necessary to reflect obligations against appropriations.

b. Description of funds

(1) *General fund.* The general fund accounts for all revenues and expenditures of the State of Hawaii not accounted for by other funds. The financial activities of the department of regulatory agencies not accounted for by other funds under the supervision and control of the department are reflected in the accompanying general fund statements.

However, these statements do not include the cost of employee fringe benefits which are carried as separate items in the general fund covering all employees paid out of the general fund.

(2) *Trust funds.* The real estate recovery fund was established by chapter 467-16 of the Hawaii Revised Statutes and is maintained by the real estate commission. The fund is used to pay damages ordered by the courts to persons aggrieved by an act or conduct of a licensed real estate broker or salesman which is in violation of the statutes. Receipts of the fund are from a \$25 fee charged to each new licensee. If, on December 31 of any year, the balance of the fund is less than \$150,000, then, a fee is charged to every broker (\$25) and salesman (\$15) renewing his license during the following calendar year.

The real estate educational fund was established by chapter 467-19 of the Hawaii Revised Statutes. This fund is credited with the interest from investments made by the real estate recovery fund. The money is available to the real estate commission for educational purposes.

(3) *Public broadcasting revolving fund.* The public broadcasting revolving fund was authorized by section 13 of Act 199 of the 1972 State legislature which established the Hawaii public broadcasting authority. This fund was established to receive State funds specifically appropriated and funds derived from private sources and to expend such funds for services and air time.

(4) *Temporary deposit funds.* The business registration division deposit fund is used to disburse proceeds of bonds posted where the corporations, partnerships, or individuals posting the bonds have not complied with the terms of their licenses, and parties, having been damaged as a result, seek redress.

Subdivision inspection fee deposits are collected by the professional and vocational licensing division to defray the cost of inspecting subdivisions being sold in the State of Hawaii but which are located elsewhere; and examination fee deposits are collected by the insurance division to pay for the cost of the services of the State insurance examiner and contract examiners engaged to examine insurance companies.

The CATV division deposit fund is used to hold cash bonds posted by licensees on proposed improvements. Bonds are returned when improvements are completed.

Prior to the establishment of the public broadcasting revolving fund, the ETV musical encounter fund was used to deposit and expend funds. The balance in this fund is due to the revolving fund.

Moneys collected for, and disbursed to, the workmen's compensation special compensation fund of the department of labor and industrial relations are accounted for in the workmen's compensation deposit fund.

The PUC bond fund is used to collect deposits from those filing appeals of decisions by the public utilities commission with the State supreme court. The deposit is refunded if the appeal is denied or judgment is rendered.

3. General fund: note to statement of appropriations, expenditures and encumbrances. The accumulated vacation pay as of June 30, 1973 was \$442,694. The increase in accrual of \$33,468 for the year ended June 30, 1973 is not reflected in the accompanying (cash basis) financial statements of the general fund but is reflected in the accrual basis statements presented in the supplementary information section.

4. Real estate recovery fund: note to financial statements. The department of the attorney general of the State of Hawaii has reported four suits or actions involving the real estate recovery fund totaling \$52,289, which may lead to payments from the fund if judgment is obtained against the defendant salesmen or brokers.

The State consumer protection office filed a suit against a corporation and judgment was rendered in its favor. There is now a good possibility that a class suit will be brought by all purchasers against the corporation and its salesmen and brokers, and if judgments are

rendered in their favor and they cannot be satisfied, there is a good possibility that the real estate recovery fund may be substantially depleted by these judgments. Such monetary liability cannot be estimated at this time.

Subsequent to June 30, 1973 but prior to the report by the office of the attorney general, claims totaling \$18,497 were paid by the real estate recovery fund.

The seven other suits involving the department of regulatory agencies have been filed, but in the opinion of the office of the attorney general none of them would result in any monetary claims against the department.

Accountants' Opinion on Supplementary Information

Filed with the legislative auditor is the following opinion on the department's supplemental financial statements (tables XI to XIII):

"To the Auditor
State of Hawaii

Our examination of the financial statements presented in the preceding section of this report was made primarily to form an opinion on such financial statements taken as a whole. Supplementary information, contained on the following pages, is not considered essential for the fair presentation of the financial position of the funds or the results of their operations in conformity with generally accepted accounting principles. However, the following data were subjected to the audit procedures applied in the examination of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Main Lafrentz & Co.

Honolulu, Hawaii
October 16, 1973"

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND

STATEMENT OF REVENUES
YEAR ENDED JUNE 30, 1973

	<u>Estimated revenues</u>	<u>Actual revenues</u>	<u>Actual over (under) estimate</u>
Administrative Division			
Sale of publications and copies of public documents	\$ 4,520	\$ 4,576	\$ 56
Bank Examination Division			
Examinations	157,600	144,429	(13,171)
Licenses and fees	22,739	24,263	1,524
	<u>180,339</u>	<u>168,692</u>	<u>(11,647)</u>
Business Registration Division			
Corporations	381,940	395,044	13,104
Partnerships	11,906	13,090	1,184
Securities registrations	40,790	32,113	(8,677)
Securities dealers and salesmen	21,350	20,650	(700)
Trademarks, trade names and others	20,014	21,374	1,360
	<u>476,000</u>	<u>482,271</u>	<u>6,271</u>
Fire Marshal Division			
Tank installation permits	5,000	9,240	4,240
Insurance Division			
Premium tax	9,306,954	9,150,413	(156,541)
Examinations of insurers, etc.	11,000	14,272	3,272
Licenses and fees	115,091	129,910	14,819
	<u>9,433,045</u>	<u>9,294,595</u>	<u>(138,450)</u>
Boards and Commissions			
Examination and licensing fees	837,524	928,959	91,435
Public Utilities Division			
Motor carriers	143,575	155,528	11,953
Public utilities	513,405	525,279	11,874
	<u>656,980</u>	<u>680,807</u>	<u>23,827</u>
Professional and Vocational Licensing Division			
Subdivisions	4,175	8,006	3,831
Condominiums	4,800	13,125	8,325
Cemetery and pre-need funeral authority	5,140	4,420	(720)
	<u>14,115</u>	<u>25,551</u>	<u>11,436</u>
CATV Division			
Permit fees and publications	97,678	76,582	(21,096)
Total	<u>\$11,705,201</u>	<u>\$11,671,273</u>	<u>\$ (33,928)</u>

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND
STATEMENT OF APPROPRIATIONS, EXPENDITURES AND ENCUMBRANCES
YEAR ENDED JUNE 30, 1973

	AUTHORIZATIONS				EXPENDITURES			June 30, 1973 Encumbrances	Unencumbered Balance
	June 30, 1972 Encumbrances Forwarded	Original Appropriations	Restrictions and reclas- sifications	Total	June 30, 1972 Encumbrances	Appropriations	Total		
Administration Division									
Personnel services		\$ 182,045	\$(19,321)	\$ 162,724		\$ 178,264	\$ 178,264		\$(15,540)
Current expenses	\$ 509	83,643	(51,623)	32,529	\$ 499	31,888	32,387	\$ 57	85
Equipment	948	100		1,048	948	151	1,099		(51)
Total Administration Division	1,457	265,788	(70,944)	196,301	1,447	210,303	211,750	57	(15,506)
Travel	135		77,087	77,222	128	73,820	73,948	245	3,029
Bank Examination Division									
Personnel services		266,678	1,152	267,830		279,678	279,678		(11,848)
Current expenses	33	28,793	(25,484)	3,342	34	3,302	3,336		6
Equipment									
Total Bank Examination Division	33	295,471	(24,332)	271,172	34	282,980	283,014		(11,842)
Business Registration Division									
Personnel services		87,478	5,035	92,513		94,024	94,024		(1,511)
Current expenses	226	9,522	(150)	9,598	214	9,356	9,570	5	23
Equipment	128			128	126		126		2
Total Business Registration Division	354	97,000	4,885	102,239	340	103,380	103,720	5	(1,486)
Fire Marshal Division									
Personnel services		42,601	445	43,046		45,026	45,026		(1,980)
Current expenses		1,859		1,859		1,883	1,883		(24)
Equipment		50		50		22	22		28
Total Fire Marshal Division		44,510	445	44,955		46,931	46,931		(1,976)
Insurance Division									
Personnel services		141,064	1,923	142,987		148,932	148,932		(5,945)
Current expenses	67	22,191	(4,103)	18,155	67	10,435	10,502	7,730	(77)
Equipment	25	100		125	25	9	34		91
Total Insurance Division	92	163,355	(2,180)	161,267	92	159,376	159,468	7,730	(5,931)
Total carried forward	2,071	866,124	(15,039)	853,156	2,041	876,790	878,831	7,980	(33,712)

The accompanying notes are an integral
part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND
STATEMENT OF APPROPRIATIONS, EXPENDITURES AND ENCUMBRANCES
YEAR ENDED JUNE 30, 1973

	AUTHORIZATIONS				EXPENDITURES			June 30, 1973 Encumbrances	Unencumbered Balance
	June 30, 1972 Encumbrances Forwarded	Original Appropriations	Restrictions and reclas- sifications	Total	June 30, 1972 Encumbrances	Appropriations	Total		
Total brought forward	\$ 2,071	\$ 866,124	\$(15,039)	\$ 853,156	\$ 2,041	\$ 876,790	\$ 878,831	\$ 7,980	\$(33,712)
Boards and Commissions									
Personnel services		4,229	(319)	3,910		3,619	3,619		291
Current expenses		2,665	432	3,097		3,027	3,027	70	
Equipment									
Total Boards and Commissions		6,894	113	7,007		6,646	6,646	70	291
Public Utilities Division									
Personnel services		420,338	(12,532)	407,806		416,371	416,371		(8,555)
Current expenses	45,624	138,738	(32,745)	151,617	17,306	75,885	93,191	31,987	26,439
Equipment	116	200		316	116	189	305	646	(533)
Total Public Utilities Division	45,740	559,276	(45,277)	559,739	17,422	492,445	509,867	32,633	17,239
Professional and Vocational Licensing Division									
Personnel services		430,752	2,552	433,304		469,458	469,458		(36,154)
Current expenses	454	108,401	9,010	117,865	164	96,073	96,237	838	20,790
Equipment	178	1,300		1,478	178	1,006	1,184		294
Total Professional and Vocational Licensing Division	632	540,453	11,562	552,647	342	566,537	566,879	838	(15,070)
CATV Division									
Personnel services		77,194		77,194		65,423	65,423		11,771
Current expenses	39	23,862		23,901	39	13,542	13,581	301	10,019
Equipment	887	870		1,757	887	3,536	4,423	4,372	(7,038)
Total CATV Division	926	101,926		102,852	926	82,501	83,427	4,673	14,752
Public Employment Program Reimbursements						(21,404)	(21,404)		21,404
Total	\$49,369	\$2,074,673	\$(48,641)	\$2,075,401	\$20,731	\$2,003,515	\$2,024,246	\$46,251	\$ 4,904

The accompanying notes are an integral part of these financial statements.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND

STATEMENT OF REVENUES OF BOARDS AND COMMISSIONS

YEAR ENDED JUNE 30, 1973

	<u>Estimated revenues</u>	<u>Actual revenues</u>	<u>Actual over (under) estimate</u>
Abstract makers	\$ 570	\$ 560	\$ (10)
Accountants	31,025	31,150	125
Barbers	11,891	11,464	(427)
Boxing	3,163	3,944	781
Cemetery board	5,105	4,260	(845)
Chiropractors	735	563	(172)
Collection agencies	2,310	1,942	(368)
Contractors	243,175	257,508	14,333
Cosmetology	25,635	26,494	859
Degree granting institutions	675		(675)
Dentists	13,136	15,376	2,240
Dispensing opticians	1,680	1,725	45
Electricians and plumbers	51,660	56,752	5,092
Elevator mechanics	1,680	1,395	(285)
Engineers, architects and surveyors	54,180	60,480	6,300
Hearing aid dealers and fitters	65	25	(40)
Masseurs	3,123	3,469	346
Medical	29,275	46,980	17,705
Motor vehicle industry	65,200	56,885	(8,315)
Naturopaths	173	83	(90)
Nurses	44,213	45,119	906
Nursing home administrators	520	915	395
Optometrists	1,125	1,083	(42)
Osteopathic physicians	2,780	3,430	650
Pharmacists	6,406	7,697	1,291
Private detectives and guards	3,358	3,750	392
Psychologists	1,000	1,746	746
Real estate	221,631	282,511	60,880
Escort agencies	25	18	(7)
Rental agencies	75	100	25
Pest control	10,925		(10,925)
Veterinarians	1,010	1,535	525
	<u>\$837,524</u>	<u>\$928,959</u>	<u>\$ 91,435</u>

The accompanying notes are an integral
part of these financial statements.

GLOSSARY

Accrued expenses — Expenses incurred during the current accounting period but not paid until a subsequent accounting period.

Allotment — Authorization from the director of finance to a State department or agency to incur obligations and make expenditures against appropriations of the State legislature. Allotments are usually made in quarterly installments.

Backup — Pertaining to computer equipment files, documentation, or procedures that are available for use in the event of failure or overloading of normally used equipment or procedures. Note: The provision of adequate backup facilities is an important factor in the design of all data processing systems, where a system failure may bring the total operations of an organization to a virtual standstill.

Cash basis — A basis of accounting under which revenues are recorded when received and expenditures recorded when paid.

Deck — A collection of punched cards, usually bearing data for a particular run.

Documentation — Preparation of documents during programming that describe the program and document—its preparation, its approval, and any subsequent changes; usually assembled in a run manual.

EAM (electrical accounting machine) — Pertaining to predominantly electro-mechanical data processing equipment, such as keypunches, collators, mechanical sorters, and tabulators. Note: EAM equipment is still widely used in lieu of, or in support of, electronic digital computers.

EDP (electronic data processing) — Data processing performed largely by automatic means; that is, by a system of electronic or electrical machines that require little human

assistance or intervention.

Encumbrances — Obligations in the form of purchase orders or contracts which are chargeable to an appropriation, the incurring of which sets aside the appropriation for the amount of the obligation.

Extension — Making an arithmetical computation or a series of arithmetical computations across a writing surface.

File — A collection of related records, usually (but not necessarily) arranged in sequence according to a key contained in each record. Note: A record, in turn, is a collection of related items; an item is an arbitrary quantity of data that is treated as a unit; in payroll processing, an employee's pay rate forms an item, a set of all items relating to a particular employee forms a record and the complete set of employee records forms a file.

Footing — Making an arithmetical computation or a series of arithmetical computations downward on a writing surface.

Fund — An independent fiscal and accounting entity with a self-balancing set of accounts, recording the financial transactions for the purpose of carrying out specific activities or attaining certain objectives in accordance with special regulations, limitations, or restrictions.

Generally accepted auditing standards — Standards for examination of financial statements by certified public accountants codified by the American Institute of Certified Public Accountants in its *Statement of Auditing Standards*, 1973.

Input/output — Refers to the points, locations, or activities where data are first entered into a computer and received from the computer system.

Master file — A file containing relatively permanent information which is used as a source of reference and is generally updated periodically.

Obligation — Amounts which a governmental unit may be required to pay out of its resources. These may be actual liabilities for goods and services received or commitments for goods and services to be received in the future.

Overhead — Costs of materials and services not directly adding to or readily identifiable with the product or service which constitutes the main object of the operation.

Programmer — A person who devises and writes or develops programs. Note: The term “programmer” is most suitably applied to a person who is mainly involved in formulating programs, particularly at the level of flowchart preparation; a person mainly involved in the definition of problems is called an analyst, while a person mainly involved in converting programs into coding suitable for entry into a computer system is called a coder; in many organizations, all three of these functions are performed by programmers.

Record — A collection of related items of data. Note: In payroll processing, for example, an employee’s pay rate forms an item, a set of

all the items relating to a particular employee forms a record, and a complete set of employee records forms a file.

Summary warrant voucher — A form used for departmental certification of claims for payment. Supporting documents such as expenditure vouchers, invoices, and the receiving copy of the purchase orders are usually attached.

System — A set (or arrangement) of entities that forms (or is considered) an organized whole. Note: This term is very general and is applied to both hardware and software entities; therefore, it is meaningful only when carefully qualified, as, for example, in the following: computer system, management information system, number system, operating system, etc.

System analysis — The examination of an activity procedure, method, technique, or business to determine what changes should be made and how they should be accomplished.

Tape — Refers to magnetic medium in tape form where data can be stored on the surface in form of electro magnetic marks.

Warrant — A draft for payment of money drawn upon the State treasury and payable on demand within a specified period of time.

PART IV
COMMENTS BY AFFECTED AGENCIES

**A MEMORANDUM ON THE
COMMENTS BY AFFECTED AGENCIES**

A preliminary copy of this financial audit report was distributed to the governor, the presiding officers of both houses of the legislature, and to the following departments affected by the audit:

Department of regulatory agencies
Department of accounting and general services
Department of budget and finance
Department of personnel services

A copy of the transmittal letter to the department of regulatory agencies is attached as attachment no. 2. The departments were requested to submit their comments on the recommendations contained in the report, including information as to the specific action they have taken or intend to take with respect to the recommendations.

The departments in their responses (see attachments 3 to 6) have expressed general agreement with the recommendations made by the contract auditors and have indicated that they are implementing or will implement most of the changes recommended.

The contract auditors were requested to submit their comments on the departments' responses. A copy of the contract auditors' reply is attached as attachment no. 1. The auditors limited their reply to those areas where the agencies did not understand or have taken issue with the recommendations.

MAIN LAFRENTZ & CO.

CERTIFIED PUBLIC ACCOUNTANTS

OFFICES OR ASSOCIATED FIRMS
U.S.A., CANADA, MEXICO, SOUTH AMERICA,
GREAT BRITAIN, EUROPE, MIDDLE EAST,
AUSTRALIA, AFRICA

ATTACHMENT NO. 1
1149 BETHEL STREET, SUITE 801
HONOLULU, HAWAII 96813
533-4466

March 15, 1974

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

Dear Mr. Tanimura:

We appreciate the opportunity to respond to the comments of the Directors of the Department of Regulatory Agencies, Department of Budget and Finance, Department of Accounting and General Services and the Department of Personnel Services made in response to the Report on Internal and Operational Controls, Accounting Systems and Procedures issued in connection with the financial audit of the Department of Regulatory Agencies for the year ended June 30, 1973.

The Departments concerned have concurred with substantially all of our findings. Therefore, we are limiting our responses to those areas where we feel further discussion is required.

BILLINGS FOR REIMBURSABLE COSTS

Accounting for time spent in bank examinations

Our reconciliation of the billings and the weekly time sheets covered only a four-week period out of the entire year. While it is possible that our findings are not indicative of a condition that occurs throughout the year, the Bank Examination Division has no assurance of this. Our recommendation, when implemented, will give reasonable assurance that all billable time charges are billed.

Costs of investigatory examinations

Apparently, the Bank Examination Division is interpreting the word "condition" to mean financial condition. We feel that the statute has a broader application. A financial institution can be in violation of the statutes in many ways without any adverse effect on its financial condition. In responding to consumer complaints, the Bank Examination Division has the responsibility to determine whether these financial institutions are in violation of the statutes and the extent to which such violations have occurred. The cost of such investigations should be billed, particularly if the complaint is the result of an actual violation of the statutes.

Mr. Clinton T. Tanimura
Auditor
State of Hawaii
Page 2
March 15, 1974

BILLINGS FOR REIMBURSABLE COSTS (Continued)

Costs of investigatory examinations (Continued)

Our recommendation that the Bank Examination Division seek the opinion of the Office of The Attorney General was made in recognition of the narrow interpretation of the statute currently being applied.

COLLECTION OF REVENUES

Effectiveness of accounting for revenues collected

While we recognize the probable difficulties to be encountered by the Department in filing receipts in numerical sequence, such filing is necessary. The computerization of the cashiering operation, however, should relieve the Department from its present practice of re-sorting the receipts from its numerical sequence to the type of revenue collected.

Method of payment of insurance premium tax

The cost of handling the additional workload which would result from changing the filing requirements from an annual to a monthly basis should not amount to ten percent of the estimated interest earnings. The additional costs to the Department resulting from this change would be the cost of printing and mailing the tax forms, the cost of collection which should be minimal if the cashiering operation is computerized, the cost of verifying the mathematical accuracy of the monthly returns and determining the timeliness of filing of such returns, the cost of reconciling the monthly returns to the annual returns, and the costs of file maintenance.

BUSINESS REGISTRATION RECORDKEEPING SYSTEM AND PRACTICES

Non-enforcement of statutory requirement

The Business Registration Division should clarify the language of Part II, Section 2.1D if the intent is to grant more than two extensions. However, before doing so, the Division should review the provisions of the Internal Revenue Code which provide for granting of extensions of time for filing U.S. Corporate Income Tax Returns. These extensions are limited to two 90-day periods. Furthermore, Section 235-98 of the Hawaii Revised Statutes limits the extensions of time for filing Hawaii Corporate Income Tax Returns to periods not exceeding six months. Therefore, corporations requesting more than two 90-day extensions probably do not have similar Federal and State income tax extensions.

Mr. Clinton T. Tanimura
Auditor
State of Hawaii
Page 3
March 15, 1974

SYSTEMS, PROCEDURES AND CONTROLS IN THE EXPENDITURE PROCESS

Control over purchase order forms

Our comments concerning purchase orders are directed at providing better security over these forms. This can be accomplished without centralizing the purchase order preparation process and hiring additional personnel.

OTHER OPERATIONAL DEFICIENCIES

Bank audit administration and examination procedures

We are unable to see the distinction that the Bank examination Division attempts to draw between the words "examination" and "audit". It would be impossible for the Bank Examiner to fulfill the requirements of Section 401-3 of Hawaii Revised Statutes to make "a complete and careful examination of the condition and resources of" any financial institution without performing certain auditing procedures.

As to the upgrading of procedures and techniques used, beyond what has already been described in the report, we refer the Bank Examination Division to the following publications of the American Institute of Certified Public Accountants:

Statement of Auditing Standards, 1973
Audits of Banks, 1968
Audits of Savings and Loan Associations, 1973
Audits of Finance Companies, 1973
An Auditor's Approach to Statistical Sampling, 1967

These are only a few of the many publications available.

As indicated in our report, we recognize the role of Federal examiners in the audits of banks and savings and loan associations, and the participation of Bank Examination Division personnel in such audits. The Division should concentrate its efforts in areas where Federal supervision is not provided, particularly if the financial institution has not been audited by independent certified public accountants, to ascertain whether these institutions are financially viable.

Additionally, we recommend that the Division utilize qualified persons from outside the Department on an annual basis to review the quality of performance of the Division. The introduction of external standards for comparison can do much to upgrade performance.

Mr. Clinton T. Tanimura
Auditor
State of Hawaii
Page 4
March 15, 1974

COMPUTER CONTROLS

Inadequate segregation of duties

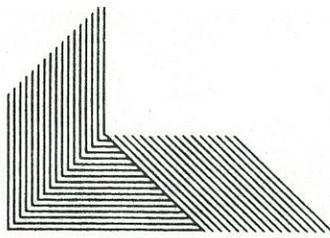
We agree that it would be inappropriate to prevent application systems/programming personnel from having access to the Center 1 computer operations room due to present circumstances. However, the potential exposure to misuse of the system will not have been resolved until the payroll/retirement systems are converted to the new payroll computer systems and this exposure will continue until the end of 1974. Accordingly, we recommend arrangements be made for recurring independent and unannounced audit checks by computer knowledgeable personnel until the problem can be resolved.

Finally, we recommend very strongly that the Department engage computer/audit personnel annually who are independent of the Department to review the system to detect control problems.

Very truly yours,

Main Rafrentz Ho.

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
STATE CAPITOL
HONOLULU, HAWAII 96813



ATTACHMENT NO. 2

CLINTON T. TANIMURA
AUDITOR

YUKIO NAITO
DEPUTY AUDITOR

March 4, 1974

C
O
P
Y

Honorable Edwin H. Honda, Director
Department of Regulatory Agencies
State of Hawaii
Honolulu, Hawaii

Dear Mr. Honda:

Enclosed are four copies of our preliminary report of the *Financial Audit of the Department of Regulatory Agencies*. 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, the presiding officers of both houses of the legislature, and other agencies affected by the audit.

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 11, 1974. 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 7, 1974. 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,

Clinton T. Tanimura
Legislative Auditor

Encls.

JOHN A. BURNS
GOVERNOR



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

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF REGULATORY AGENCIES
1010 RICHARDS STREET
P. O. BOX 541
HONOLULU, HAWAII 96809

HANNAH KELIHOOMALU
Deputy Director

RECEIVED

MAR 13 1974

OFFICE OF THE AUDITOR
HAWAII

March 13, 1974

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

Dear Mr. Tanimura:

SUBJECT: Comments on Recommendations Contained in Preliminary
Financial Audit of the Department of Regulatory Agencies
Conducted by Main Lafrentz & Co.

Thank you for your letter of March 4, 1974, wherein you invite our written comments on recommendations made by Main Lafrentz & Co. upon completion of their audit of our department, and the specific actions to be taken by our department with respect to the recommendations. Our comments follow the sequence presented in the report.

BILLINGS FOR REIMBURSABLE COSTS (Pages 8-11)

1. **Billing rates for bank examinations.**

Your recommendation concerning fee charged to institutions examined by the bank examiners is well conceived and merits a thorough evaluation of the fee schedule. We will discuss the legal ramifications with the Attorney General's Office and revise the current billing rates for bank examinations.

2. **Billing rates for insurance examinations.**

We have no objection to your recommendation. If the "overhead rate" approved by the Director will substantially increase the total rate to be charged over that presently charged, we will no doubt find it advisable to secure an Attorney General opinion that Sec. 431-59(b) will permit the revised approach.

3. Accounting for time spent in bank examinations.

Under our present billing procedures, we do feel that time spent in an examination is accounted for and verified when it is submitted to the examiner-in-charge of an examination. A review of the billing procedures will be made to prevent an underbilling or overbilling which, in our opinion, is an exception.

4. Frequency of billings in bank examinations.

The recommendation appears worthwhile. We will look into this matter and discuss with management as to whether there may be problems.

5. Costs of investigatory examinations.

We do not agree with the auditor's interpretation of the provisions of Section 401-7, HRS. We wish to point out that Section 401-7, HRS, relates to special examinations, and payment of costs of such special examination by the financial institution examined, whenever, in the judgment of the bank examiner, the condition (underscoring ours) requires such an examination. If this division conducts such an examination, the financial institution will be billed for such an examination. In our opinion, an investigation of a complaint by a consumer does not fall within the purview of Section 401-7, HRS. To date, oral or written complaints received by this office do not relate to the condition of the financial institution, therefore, no special examination was necessary.

ADEQUACY OF LICENSING AND REGULATORY FEES (Page 12-17)

- 1. Insufficiency of fees.**
- 2. Disparities in fees among occupational and professional fields.**
- 3. Disparities in fees within an occupational or professional field.**

We concur with your recommendation pertaining to insufficiency and disparities in fees. The department will endeavor to establish a more systematic, rational, and uniform basis of fee imposition. A legislative proposal will be submitted to assign responsibility for proposing fee schedule, and hold public hearing thereafter as required, to the Director of Regulatory Agencies. It would require approval by the Governor of the proposed schedules and would give the Legislature the opportunity of disapproving such fee schedules within a 30-day period after submission to it. In absence of the legislative disapproval, the proposed fee schedule would be sent to the Lieutenant Governor for promulgation.

It is our belief that the proposal will combine flexibility of establishment while still retaining legislative authority and control over the fee schedule to be promulgated.

Instead of the present total profession and board-by-board approach to fee setting which fails to take into account the unit cost per activity for each applicant or licensee, henceforth, in budget making fee setting and program planning, there will be cost allocation per applicant or licensee

within broad categories such as professional, vocational and business licensees. Mass confusion as to titles of the fees charged, the activities being performed and the charges imposed will be eliminated by creating a uniform system which would eliminate the inefficiencies and problems encountered by staff personnel.

COLLECTION OF REVENUES (Pages 17-20)

1. Inadequate security over cash receipts.

The urgent need to provide security in the Cashiers' area has prompted us to again write to the State Comptroller requesting priority pursuant to our letter dated June 22, 1971 for assistance in the planning and re-designing of the Lobby area. Until such time as renovation to this area is made, all collections, processed and unprocessed, including those awaiting pickup by the armored car service are being kept in the vault.

The recommendation, that checks be stamped "for deposit only to the credit of the State of Hawaii Director of Finance" immediately upon their receipt to prevent further negotiability, has already been put into effect.

We agree with your recommendation that audit tapes be locked in the validation machines, with keys in the custody of someone other than the cashiers, who will remove the tapes at the end of each day when the machines are cleared. However, our two validating machines are not designed nor equipped to lock audit tapes in the machines. The department is contemplating purchase of new validating machines to correct this situation.

The day-gate to the walk-in vault is being kept closed and locked to limit access to unauthorized persons; undeposited cash and checks are placed in the safe within the vault, which is kept locked at all times.

2. Effectiveness of accounting for revenues collected.

We believe that your recommendation to file receipts in numerical sequence is presently impractical. Until the present collection procedure and validating machines are changed, receipts must be broken down by types of payment for manual posting. At the time of collection, receipts are in numerical sequence and collections are reconciled by an account clerk as a check against the Cashier before receipts are broken down by types.

We agree with your recommendation that in order to properly account for revenues where single payment is for multiple purposes, the receipt should clearly state the purpose and amount credited to each. This practice has been put into effect.

As mentioned earlier, the department will be purchasing a new validating machine with the capacity of registering more than 999 items.

The various divisions within the department have been directed to maintain separate, independent records of licenses issued, documents filed, etc.

We agree with your recommendation to link cashiering operations to the data processing system. We plan to request purchase of validating machines which can tie-in with the data processing computerized system. Division Administrators will be directed to submit legislative proposals to change license renewal dates so that workload in collection and deposit will be spread more evenly throughout the year.

3. Method of payment of insurance premium tax.

There is no objection to your recommendation that the statute be amended to provide for the payment of the insurance premium tax in monthly installments. However, instead of 500 tax returns, we would have 6,000 to cope with. We need to review this matter completely to determine whether additional workload expenditures would exceed interest earnings.

BUSINESS REGISTRATION RECORD-KEEPING SYSTEM AND PRACTICES (Pages 21-23)

1. Non-enforcement of statutory requirement.

a. The granting of 15 days grace period to corporations for filing of annual corporation exhibits. The discontinuance of granting a blanket automatic grace period of 15 days to all corporations for the filing of annual corporate exhibits will be studied at the earliest date possible so that we may abide by the statute. This practice arose due to workload problems.

b. Granting not more than two extensions. Our Rule 2.2D does not limit extensions to 90 days each, nor does Section 416-95, HRS. It would be unreasonable on our part not to grant further extensions to corporations who have been granted further extensions by the Internal Revenue Service and the Hawaii State Tax Department. An exhibit cannot be completed until the tax return is filed.

c. Filing with the corporation exhibit all documents relating to extensions, etc. We concur with your recommendation and will comply. Lack of manpower contributed to the failure of filing with the corporate exhibit all documentations relating to extensions and justifications for the waiver of penalty for late filing of the exhibit.

d. Adequacy of the penalty on delinquency on filing the exhibit. The penalty being imposed on delinquency is \$10, which is 100% of the filing fee and is considered adequate. For the year 1973, \$102,629 was collected in filing fees on corporation exhibits, and \$8,277 was collected on penalties, or 8%, which is reasonable. However, the adequacy of the penalty will be reviewed.

2. Manual record-keeping system.

Technicians from the Electronic Data Processing Division have been studying the operations of the Business Registration Division since January 1974 to computerize their record-keeping system.

SYSTEMS, PROCEDURES, AND CONTROLS IN THE EXPENDITURE PROCESS (Pages 23-25)

1. Control over purchase order forms.

An alternative to your recommendation is to have each division prepare a requisition for goods or services and submit same to the Fiscal Office for review and approval. This system would entail the need for additional personnel to type the information contained in the requisition on to the purchase order form.

2. Overencumbrance of allotments.

We will comply with your recommendation pursuant to Chapter 37, Hawaii Revised Statutes.

3. Duplicating of accounting records.

Your recommendation concerning duplication of accounting records has been corrected and in effect since January 1974. Upon the implementation of the statewide accounting system, we will review and re-design forms currently in use to reduce the number of forms and amount of information being recorded.

OTHER OPERATIONAL DEFICIENCIES (Pages 25-27)

1. Bank audit administration and examination procedures.

We wish to point out that the Bank Examination Division conducts an examination of a financial institution as required by statutes and does not perform an audit of the financial institution examined.

Your report refers to upgrading of examination procedures and techniques used by the Bank Examination Division. We wish to seek further clarification as to which procedure or technique of the entire examination procedure needs upgrading, so that we may consider said procedure.

This division works closely with examiners of the Federal Deposit Insurance Corporation in the examinations of state-chartered banks and with examiners of the Federal Savings and Loan Insurance Corporation in the examinations of state-chartered savings and loan association.

The procedures of examination used by this division are constantly under review by this division and improvements made where deemed necessary.

A new examiner receives on-the-job training regarding the examination of each type of financial institution under our supervision. Preparation of a reference manual of instructions will begin as soon as manpower is available.

This division tries to upgrade the examining staff by enrolling examiners in schools or courses, within our budget restrictions, which are available for examiners.

2. Acceptance of post-dated checks in lieu of performance bonds.

This practice has been discontinued. The two checks cited by the auditors were the only two post-dated checks received by the CATV division in lieu of performance bonds. Both checks were submitted by Hawaiian Cable Vision Corporation on November 14, 1972 and post dated May 1, 1973. One for the Kelaweia Mauka increment (\$2,563.25) and the other for the Wahikuli Terrace increment (\$2,441.65).

We thank you for your observations and suggestions and will effectuate your recommendations which we find feasible. Please be assured that while the foregoing has been considered and reviewed within the short period permitted, we will devote more time and study on all of your findings and recommendations and will effect all changes necessary thereto.

Yours very truly,

A handwritten signature in cursive script, appearing to read "Edwin F. Haku".

JOHN A. BURNS
GOVERNOR



KENAM KIM
COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES
P. O. BOX 119
HONOLULU, HAWAII 96810

RECEIVED

MAR 11 1974

OFFICE OF THE AUDITOR
HAWAII

March 11, 1974

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

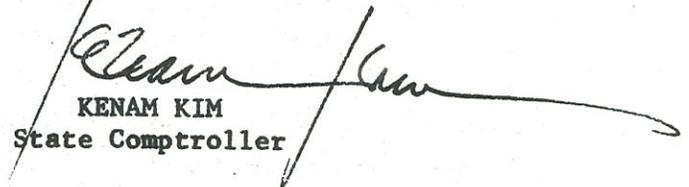
Dear Mr. Tanimura:

Thank you for your letter of March 4, 1974 allowing us the opportunity to review and comment on the preliminary draft of the report on "Financial Audit of the Department of Regulatory Agencies, State of Hawaii" as it affects the Department of Accounting and General Services.

The report, on page 29, recommends that "The Department of Accounting and General Services provide for procedures which enable immediate responses to requests for repairs of security devices".

Subsequent to receipt of your report, meetings were held with managers of Computer Center #1 and Computer Center #3 for the purpose of reviewing existing procedures for requesting repair services during normal working hours. In these meetings, EDP staff were assured that response to maintenance problems vital to security will be given emergency priorities. Additionally, home telephone numbers of key Central Services personnel were given to Computer Center supervisors for after hours contingencies. With respect to specific deficiencies in security devices for Computer Centers 1 and 3, corrective actions have been initiated and will be completed.

Very truly yours,


KENAM KIM
State Comptroller

JOHN A. BURNS
GOVERNOR

STATE FOUNDATION ON CULTURE AND THE ARTS
COMMISSION ON THE STATUS OF WOMEN
STATE COMMISSION ON AGING
EMPLOYEES' RETIREMENT SYSTEM
EMPLOYEES' GROUP MEDICAL AND
HOSPITAL CARE INSURANCE PLAN
STADIUM AUTHORITY



STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
STATE CAPITOL
P. O. BOX 150
HONOLULU, HAWAII 96810

HIRAM K. KAMAKA
DIRECTOR

SUSUMU ONO
DEPUTY DIRECTOR

DIVISIONS:
BUDGET PLANNING AND MANAGEMENT
ELECTRONIC DATA PROCESSING
FINANCE

RECEIVED

MAR 11 1974

OFFICE OF THE AUDITOR
HAWAII

March 8, 1974

The Honorable Clinton T. Tanimura
Legislative Auditor
State of Hawaii
Honolulu, Hawaii

Dear Mr. Tanimura:

Thank you for the opportunity to review your preliminary report on the Financial Audit of the Department of Regulatory Agencies dated March 1974, and to present our comments on that portion of the report affecting the Department of Budget and Finance. These comments are confined to the Computer Controls Section on pages 28 through 30.

We are aware of the problems mentioned in your report and we believe that much progress has already been made in resolving some of the problems brought out in the audit report. Although we will need the cooperation of other departments in implementing some of your recommendations, please be assured that we have considered these recommendations seriously and will make every effort to correct the deficiencies underlined in your report.

It should be mentioned that the EDP Division's move into the new State Office Building, scheduled for May 1975, should resolve the problems associated with Center #1.

Very truly yours,

HIRAM K. KAMAKA

Encl.

Recommend that the physical and organizational separation of functions be strictly observed by all EDP personnel at Centers #1 and #3.

Comment

Regarding Center #3, we agree with the recommendation that the application systems/programming staff not be allowed in the computer operations room. To reinforce this policy, application systems/programming personnel are now also excluded from the control room (adjacent to the computer room), thereby making it possible for entry into the computer room only after passing through two locked doors. It should be stated, however, that in special situations application systems programmers and analysts are sometimes allowed into the computer room with the approval of the operations supervisor. In these special situations, an identification badge is assigned to the individual before entering the computer room, and a log is kept showing the time of entering, the reason for entering, and the time the badge is returned.

The situation at Center #1 is a little different. The lack of documentation, procedural controls, and backup capability makes it unwise, at this time, to prevent programmer/analysts from having access to the computer operations room.

However, the separation problem at Center #1 should be gradually resolved as applications now running at Center #1 are converted to Center #3 operation. Major conversion efforts are now under way for the Payroll, Retirement, and Personnel Systems; the remaining applications are scheduled to be converted by the end of calendar year 1974, at which time Center #1 will be phased out in preparation for the Division's move to the new State Office Building in mid-1975.

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Recommend that the EDP Division provide backup to the system project manager with deliberate speed. Steps should be taken through proper planning to avoid problems of this nature in the future.

Comment

Since the interview, we have moved expeditiously into providing managerial backup for the Payroll System. This backup is provided by a member of the Payroll project team who has worked closely with the project manager since the inception of the Payroll System, and who is thoroughly knowledgeable with the system. He, in turn, is backed up by two programmers who have also been associated with the system since its early stages of development.

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Recommend that:

A. The EDP Division take immediate steps to secure the premises at Computer Center 1 and to strictly control access to unused warrants and bonds.

B. The Department of Accounting and General Services provide for procedures which enable immediate responses to requests for repairs of security devices.

Comment

A. Center #1 is located in a facility not designed for the level of security normally expected at an edp center. However, the security problem of this Center will be resolved when the Center is phased out by the end of 1974. To improve the physical security of this facility in the interim period, we will install, or replace, with the approval of the Department of Accounting and General Services, doors with locks leading to the computer facility and keep these doors locked at all times with entrance to be gained only by authorized personnel.

With respect to the thin metal cabinet and the control of access to unused warrants and bonds, the function of control over these materials (and other special forms) should be clearly separated from the functions of computer operations. Control over special forms should be lodged in

the user agency--in this case, the DAGS payroll control office as soon as possible. The EDP Division should be responsible for processing data and providing edp-related services--not for the actual handling and storage of the warrants or bonds themselves. Accordingly, we refer the matter of access to unused warrants and bonds to the Department of Accounting and General Services.

B. We refer this recommendation to the Department of Accounting and General Services. The Department of Budget and Finance will cooperate fully.

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Recommend that the statewide information system produce backup copies of files and programs where such copies are not now available and make immediate provisions for storage of all backup copies of files and programs in separate fire-proof facilities away from the computer centers using these files to prevent total disruption in the event of vandalism or catastrophe.

Comments

At the time of the audit, the new Payroll System was in the process of implementation at Center #3 and certain deficiencies, as mentioned in the report, did exist. Since the audit, however, many improvements have been made. In the area of the payroll files, backup tapes for both payroll data and computer programs are stored in a fire-proof triple-locked vault, such that in the event of vandalism or catastrophe, the payroll could be processed from these backup tapes. Furthermore, the entire computer center is protected by a highly efficient Halon gas fire protection system. Because of these protective measures, we believe that the remote storage of duplicate program and data files is unwarranted.

Systems documentation as well as program listings are stored at the Kamamalu Building where the analysts/programmers are located, away from the computing center. Operations documentation, including procedures governing the use of programs and system packs, are stored at Center #3.

In the case of Center #1, there is a problem of backup. However, the complete cutover of the Payroll System to Center #3 operations, scheduled for June 30, 1974, will resolve this problem. As for other programs currently running at this center, we will identify them and provide minimal interim backup until the center is phased out.

JOHN A. BURNS
GOVERNOR OF HAWAII



JAMES H. TAKUSHI
DIRECTOR

Henry H. C. Lau
DEPUTY DIRECTOR

STATE OF HAWAII
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OFFICE OF THE AUDITOR
HAWAII

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

Dear Mr. Tanimura:

Thank you for allowing us the opportunity to respond to a specific recommendation affecting the Department of Personnel Services as contained in your report of the Financial Audit of the Department of Regulatory Agencies.

The two positions referred to in your report were received for classification study on December 9, 1969. As your general audit of the Department of Personnel Services reported in 1969, there was at that time a sizeable backlog of classification requests. As of November 30, 1969 the backlog consisted of 1905 requests, not including 194 administrative review requests and 25 appeals.

Considerable efforts have been made to improve operations and to reduce the backlog. Despite these efforts, it was not possible to eliminate the backlog of requests immediately, as other new workload requirements were imposed on the department during the period of time cited in your report. In particular, the passage of the public employees collective bargaining law in 1970 resulted in a greatly increased workload for the Division of Classification and Pay relative to bargaining unit determinations, exclusion designations and hearings, representation elections and other related activities.

It would be erroneous to conclude that the situation has not improved over the years. Operational improvements have, in fact, been made, and the timelag involving the two positions is no longer typical of the several thousand classification actions taken in the course of a year. You may be interested to know that as of January 31, 1974 our backlog of classification requests was 406; as of February 28, 1974 that figure was reduced to 330. Of this latter number, 36 were requests received in February, 79 were requests received in January, and 42 in December.

Sincerely,

JAMES H. TAKUSHI
Director of Personnel Services

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