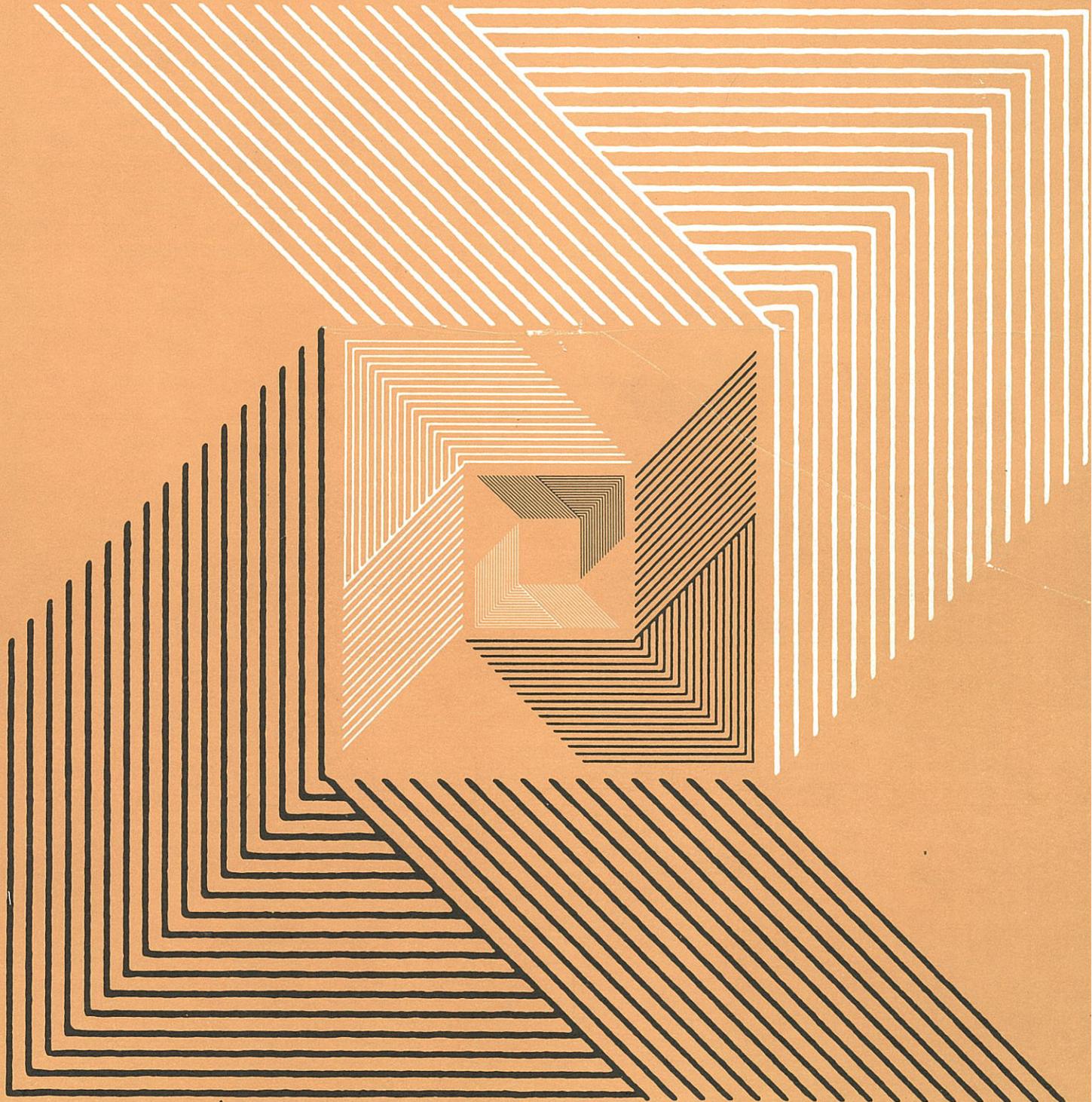


AUDIT REPORT NO. 75-5

AUGUST 1975

# FINANCIAL AUDIT OF THE DEPARTMENT OF TAXATION

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  
STATE DEPARTMENT OF TAXATION  
STATE OF HAWAII  
FISCAL YEAR ENDED JUNE 30, 1974**

**Conducted by the  
Office of the Legislative Auditor  
State of Hawaii**

**and**

**Coopers & Lybrand  
Certified Public Accountants**

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

**Submitted by the  
Legislative Auditor of the State Hawaii**

**Audit Report No. 75—5**

**August 1975**

## FOREWORD

This financial audit report is the result of an examination of the financial statements and records of the department of taxation for the fiscal year ended June 30, 1974. The audit was conducted by the office of the legislative auditor and the CPA firm of Coopers and Lybrand.

This report is divided into four parts. Part I contains introductory information and a brief description of the functions, organization, and activities of the department of taxation. Part II presents our findings, comments, and recommendations regarding the department's operations and practices in tax collections and real property and income tax administration. Part III displays the department's financial statements, including the audit opinion of the CPA firm on the accuracy of the financial statements.

There are a number of deficiencies in the financial accounting and internal control systems of the department of taxation. A number of these deficiencies stem from insufficient accounting controls and procedural inadequacies. Numerous other deficiencies, particularly with respect to real property and income tax administration, point to the need for computerization of out-dated and time-consuming manual systems now in use. Our findings and recommendations are contained in chapters 3 through 5 of part II of this report.

It is our practice to request the agency affected by the audit to submit in writing its comments on the findings and recommendations. The department of taxation's response is included in part IV of this report entitled, "Response of the Affected Agency."

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officials and staff of the department of taxation during the audit.

Clinton T. Tanimura  
Legislative Auditor  
State of Hawaii

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**PART I**

**INTRODUCTION AND BACKGROUND**

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## Chapter 1

### INTRODUCTION

This is a report on our financial audit of the transactions, books, and accounts of the department of taxation. The audit was conducted pursuant to Hawaii Revised Statutes, section 23-4, 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. The audit was conducted by the office of the legislative auditor and by Coopers and Lybrand, an independent certified public accounting (CPA) firm.

#### Objectives of the Audit

The objectives of the audit were:

1. To provide a basis for an opinion as to the reasonable accuracy of the financial statements of the department of taxation.
2. To ascertain whether expenditures and other disbursements were made and all revenues and other receipts, to which the State was entitled, had been collected and accounted for in accordance with state laws, rules and regulations, and policies and procedures.
3. To assess the adequacy, effectiveness, and efficiency of the systems and procedures for financial accounting and reporting and for internal and operational controls, and to

recommend improvements to such systems and procedures.

#### Scope of the Audit

The audit examined the financial statements of the department of taxation covering the fiscal year July 1, 1973 to June 30, 1974. It included tests of the financial and related records and an examination of the existing systems and procedures of accounting, reporting, and operational and internal controls.

#### Organization of the Report

This report is organized into four parts. Part I (chapters 1 and 2) presents this introduction and background information on the department of taxation.

Part II (chapters 3 through 5) presents our audit findings and recommendations regarding the financial, operational, and administrative practices of the department of taxation.

Part III (chapter 6) presents the financial statements of the department of taxation and the accountants' opinion on such statements.

Part IV contains the response of the department of taxation to the findings and recommendations of the audit. Our comments to the department's response are also included.

## Chapter 2

### BACKGROUND

In 1932, the territorial legislature, acting in special session, established a separate department called "the office of the tax commissioner" to administer the territorial tax laws. Before 1932, the tax assessment and collection functions were the responsibility of the bureau of taxes under the jurisdiction of the territorial treasurer. With statehood, the office of the tax commissioner was abolished and the functions and authority of tax administration were transferred to the department of taxation.<sup>1</sup>

#### Functions of the Department

By statute, the department of taxation is responsible for administering and enforcing the tax laws of the State. The general duties and powers of the department include assessing and collecting taxes, imposing penalties for late- and non-payment of taxes, prescribing tax return forms, inspecting and examining taxpayers' records, recommending legislation relating to taxes, and establishing rules and regulations to carry out the purposes for which the department is constituted.

#### Organization and Activities

The department of taxation is comprised of three basic organizational components—headquarters, operations, and tax appeals boards. A brief description of this organizational makeup follows.

**Headquarters.** Headquarters is the administrative center of the department. It provides overall direction and support services to the operational component of the department. Headquarters is divided into the following units:

1. *Office of the director.* This office includes the director of taxation. Under the general direction of the governor, it plans, directs, and coordinates the various activities of the department.

2. *Income technical office.* This office provides technical services in administering the income and miscellaneous tax laws. Specifically, this office interprets and formulates rules and regulations relating to income and miscellaneous taxes; studies the tax laws and recommends revisions and changes to the director; and acts as the principal source of information regarding technical income and miscellaneous tax matters for district offices, taxpayers, tax advisors, and the legislature.

3. *Property technical office.* This office is responsible for planning and developing real property tax standards, systems, and programs. Specific activities include directing and coordinating the operations of the State's tax map system, developing uniform classification and valuation systems and procedures for property assessments, developing land use

<sup>1</sup>Department of Taxation, State of Hawaii, *Annual Report 1972-1973*, p. 5.

classification systems and construction cost indexes for building classification purposes, advising and representing the director in real property tax appeal hearings, and acting as the principal source of information relating to real property tax matters.

**4. Administrative services and accounting office.** This office provides general internal management assistance to the director and accounts for and maintains control records of all tax collections. Specifically, this office initiates and prepares the department's annual operating budget, installs and maintains budgetary controls, performs purchasing activities for the department, prepares and maintains inventory records and reports, renders duplicating and reproduction services, maintains tax revenue accounting records, prepares refund vouchers and credit adjustment reports, maintains records of protested tax payments, provides taxpayers with informational services and tax clearances, and renders mail and messenger services for the department.

**5. Tax research and planning office.** This office provides the department with statistical information and projections as to tax yields, tax impact, and economic conditions affecting taxes. In addition, this office conducts research projects relating to taxes, supervises the preparation of the department's annual report and the compilation of various reports on tax revenues, assists the director in developing proposed changes in tax legislation, and acts as the department's principal tax planner.

**6. Systems and procedures office.** This office provides technical services and advice to the director on electronic data processing, coordinates data processing activities with the State's computer center, reviews and develops systems and procedures for the standardization and simplification of tax processing, and performs keypunching services for the department. In addition, this office performs management analysis and provides bookkeeping services in all tax program areas not presently automated.

**7. Personnel office.** This office handles all personnel matters for the department. Services are provided in the areas of job classification and evaluation, employee relations, employee training and development, and personnel transactions. This office also maintains all personnel records.

**Operations.** Operations includes those departmental units which carry out the tax programs of the department. These units and their activities are as follows:

**1. Office of the chief of operations.** This office provides direct supervision over all field operations in the four district offices. It also provides the necessary coordination between headquarters and district offices.

**2. Audit coordination office.** This office develops and coordinates the auditing programs of the district offices and supervises those audits which require interdistrict action. It also acts as the department's liaison with the internal revenue service on exchange of audit information.

**3. District offices.** District offices are located on Oahu, Maui, Hawaii, and Kauai. Each district office is responsible for the administration and enforcement of Hawaii tax laws in the district. Each district office is divided into the following divisions:

**a.** The property assessment division appraises all taxable real property, classifies land for tax assessment purposes, conducts sales and lease analysis to establish benchmark values, appraises new and remodeled buildings and revalues existing buildings, maintains appraisal records, and prepares input data for processing assessment notices and bills through the computer center.

**b.** The collections division is responsible for the collection of all tax payments and fees set forth by law. It also accounts for all taxes collected and deposits the receipts in designated banks. It is further responsible for the collection

of delinquent taxes through office and field contacts.

c. The income assessment and audit division is responsible for administering a comprehensive and uniform system of assessing all income and miscellaneous taxes. It conducts office and field examinations and audits of tax returns filed by taxpayers, provides individual assistance and information to taxpayers, and files and maintains tax returns and related records.

**Tax appeals boards.** There is a tax appeals board in each of the four taxation districts. Each board consists of five members appointed by the governor with the advice and consent of the senate. The boards hear appeals filed by aggrieved taxpayers against tax assessments made by the department of taxation. The boards are independent and impartial decision-rendering bodies. They are placed, by statute, within the department of taxation for administrative purposes only.

**Taxes Collected by the Department of Taxation**

The department of taxation is responsible for the collection of substantially all of the taxes imposed by law. The major taxes collected include the general excise tax on gross receipts arising from business activities, the income tax on the net taxable income of individuals and

corporations, and the real property tax on the value of land and buildings situated in each county. Other taxes collected by the department include fuel, employment security,<sup>2</sup> public service company, bank and other financial corporation, inheritance and estate, liquor, and tobacco. Tax collections by the department during the fiscal year 1973-74 were as follows.

<i>Taxes</i>	<i>Amount collected (in million dollars)</i>
General excise . . . .	\$244
Income . . . . .	170
Real property . . . . .	122
Others . . . . .	<u>102</u>
Total . . . . .	<u>\$638</u>

In addition to the above taxes, the department administers the conveyance tax which is imposed on all documents transferring ownership or interest in real property. Collection of this tax, however, is made by the bureau of conveyance, which is an operating unit of the department of land and natural resources.

<sup>2</sup>The Employment Security Law is administered by the department of labor and industrial relations. The tax, however, is collected by the department of taxation under a contractual agreement with the department of labor and industrial relations.

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**PART II**

**FINDINGS AND RECOMMENDATIONS**

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## Chapter 3

### INTERNAL AND OPERATIONAL CONTROLS

This chapter contains our findings and recommendations regarding the department of taxation's system of internal control<sup>1</sup> and the department's operational controls and practices in tax collection and related activities. This chapter is concerned with controls and practices generally. Those controls and practices which relate specifically to the administration of real property and income taxes are discussed in subsequent chapters.

#### Summary of Findings

In summary, our major findings are as follows:

1. Sufficient controls over tax payments made through the mail are lacking.
2. There are substantial delays in depositing tax receipts, particularly during peak collection periods. Procedural deficiencies contribute to the delays.
3. Tax return validation is inefficiently performed.
4. There is inadequate security to protect cash receipts.
5. Pursuit of delinquent taxes is unnecessarily slow.
6. Recordkeeping for general excise and withholding taxes is continuously backlogged.

7. The financial records of the Kauai district office are not being properly maintained.

8. Tax documents and files are inadequately secured.

#### Insufficient Controls over Mailed-In Receipts

The department handles millions of dollars annually as part of its tax collection responsibilities. For the year ended June 30, 1974, tax collections totaled over \$600 million. Because of the large sums of money and also the volume of transactions involved in the tax collection process, it is important that appropriate controls be established by the department to safeguard tax collections from loss, theft, burglary, or misappropriation. Such controls over tax payments sent to the department by mail are presently insufficient.

<sup>1</sup>The term, system of internal control, means the plan of organization and methods within the department to ensure the accuracy and reliability of accounting data; to promote operational efficiency; and to assure adherence to prescribed laws, policies, and rules and regulations of the State and the state department of taxation. A sound system of internal control includes two basic elements: First, the adoption of procedures requiring prior authorization for expenditures; prompt collection of revenues; accurate and timely recording of transactions and recording procedures to provide reasonable accounting control over assets and liabilities in accordance with generally accepted accounting principles, the laws, policies, and rules and regulations of the State and the department of taxation. The second is an appropriate segregation of duties assigned in a manner that no one individual controls all phases of a transaction without the interrelated function of a cross-check by some other individual.

**The mail-handling process, generally.** To appreciate the deficiencies in exercising control over tax payments received by mail, an understanding of how mail in general and mail relating to tax payments in particular are handled is necessary. This section outlines that process.

The department has a mailroom which serves as the central depository for all incoming and outgoing mail. Among the pieces of mail received are those addressed to the department in general and those addressed to specific individuals or offices. The latter are sent unopened by the mailroom directly to the individuals or offices concerned, even though they may contain tax payments. The rest of the mail is opened and sorted by the mailclerks. Pieces of mail relating to tax payments are sorted by specific kinds of taxes. They are then further segregated into those containing tax payments and those not containing tax payments. Those containing tax payments are then divided essentially into two groups. The first group is transmitted directly to the cashiers for processing and the second group is transmitted to appropriate divisions or branches for examination before being processed by the cashiers.

Mail routed to appropriate divisions or branches for examination includes: (1) mail which encloses a tax payment but does not contain an accompanying return or which contains a tax payment without identification of the specific tax being paid or the nature of the payment, (2) mail which encloses a payment which differs from the amount shown on the enclosed tax return, (3) mail which encloses a late payment of real property taxes, and (4) mail which encloses a payment of delinquent taxes.

**The deficiency.** Under the procedure outlined above, accounting control over mail receipts is not established until they are processed by the cashiers. There is no system to account for tax receipts while they are in the mailroom and when they are routed to the various divisions and branches. While in the mailroom or in the

various divisions and branches, the tax receipts could conceivably be misappropriated without detection.<sup>2</sup> A sound system of internal control dictates that accounting control be established at the point of initial receipt; that is, in the mailroom, to minimize the possibility of loss or misappropriation.

Ideally, a listing of all mail receipts should be prepared daily by mailroom personnel. The listing would show for each receipt, the date of receipt, receipt identification number, method of payment (i.e., check, money order, etc.), kind of remittance, and amount of payment. This list would be used to verify that all receipts have been deposited. However, due to the volume of mail receipts, especially around the major tax deadline dates, the preparation of such a listing would be time-consuming and impracticable. As an alternative, early control over mail receipts can be achieved through the "batching" process. Under this process, receipts and accompanying returns are sorted by type of return or any other appropriate grouping, and for each grouping or batch an adding machine tape of the tax payments in each batch is prepared. The total amount for each batch is recorded in a daily logbook. Each batch is kept intact as a unit throughout the collection process, including the cashiering process. This means that the mail receipts are transmitted to the cashiers in batches and the cashiers "punch-in" only the totals of each batch into the cash registers. In addition, only the batch totals are recorded on the deposit slips. We believe that this batch control process is appropriate for the department and thus should be adopted.

***Recommendations.** We recommend that the accounting controls over tax payments received through the mail be established in the mailroom through the use of a batch control process. In addition, we recommend that*

<sup>2</sup>This same finding and related recommendation was made in a previous report issued by this office entitled, *Financial Audit of the General Fund, State of Hawaii, for the Fiscal Year Ended June 30, 1968*, Audit Report No. 69-1, January 1969. In that report, the department concurred with the recommendation but has apparently done nothing to implement it.

*someone other than the cashier periodically compare the batch totals as shown in the daily logbook with the corresponding total shown on the deposit slip to ensure that all receipts are deposited intact and that no discrepancies exist between payments received and deposited.*

### **Delays in Depositing Receipts**

Since tax collections are not available for use by the State until they are deposited into the state treasury, any delay in depositing receipts prevents the State from utilizing the funds. It is essential, therefore, that the department process and deposit collections to the designated banks in a timely and efficient manner. It is not unusual, however, for several days and even weeks to elapse between the initial receipt of tax payments and their subsequent deposit. Delays occur particularly during peak periods when a large volume of tax payments is received. Peak periods occur around the major tax deadline dates which are: April 20th for individual income taxes, May 20th and 30th and November 20th and 30th for real property taxes, and at the end of each month for general excise taxes and income taxes withheld.<sup>3</sup> During these peak periods, a backlog occurs in both the mailroom and the cashiering branch. As a result of such a backlog, processing of receipts may be delayed anywhere from one to three weeks during the income and real property tax deadline dates and approximately one to one and one-half weeks at the end of each month.

An accurate determination of the fiscal impact of the delays during peak periods cannot be made since no accounting is made of the receipts until they are validated by the cashiers. The total amount of receipts in the unopened mail not processed by the cashiers is not known. However, the average daily bank deposits made during peak periods is an indicator. During peak periods, daily deposits average well in excess of \$3 million per day. It is conceivable, therefore, that the State's loss, measured in terms of interest that could be earned if not for the delay

in depositing, could easily amount to thousands of dollars annually.

Although delays in processing and depositing tax receipts are particularly acute during peak periods, they also occur during non-peak periods. There are several procedural deficiencies in the department's tax collection process, which if corrected could speed up the processing and depositing of tax receipts. These deficiencies include (1) the inefficient system to handle tax receipts during peak periods, (2) the practice of routing tax receipts to various other sections before being sent to the cashiers, and (3) the holding of receipts overnight before depositing.

**Inefficiency during peak periods.** During peak periods, the department hires part-time help and uses employees from other sections to assist in sorting and opening mail in the mailroom. It also employs part-time cashiers to process mail receipts. Part-time helpers are not totally familiar with the collection process. This, of course, tends to weaken internal controls. In addition, mail receipts are sorted at locations other than the mailroom. This destroys accountability over mail receipts. Finally, employees from other sections who are used to process mail are generally those whose rates of pay are higher than the pay of the mailroom clerks. Thus their use is not cost-effective.

We think that the department needs to explore alternative solutions to easing the backlog besides increasing or shifting personnel. In this regard, we discuss two alternatives. *First*, the department should consider instituting a lockbox system for tax collections. Under this system, an agreement is entered into between a bank (or banks) and the State to enable taxpayers to mail payments and accompanying documents directly to a post office box to which only the bank has access. In addition, arrangements could be made so that tax

<sup>3</sup>In addition to the collection of general excise taxes and income taxes withheld at the end of each month, the department also collects unemployment insurance taxes in the month following the end of each quarter.

payments may be made in person at the bank. This would be similar to the service presently offered by banks whereby consumers may pay their utility bills at the banks. This system would make it convenient for many taxpayers. The bank would in turn make the deposits and transmit any necessary information and documents to the department. The lockbox system would be suitable for handling real property tax payments. Property owners would be able to either mail their payments to the banks or pay their property tax in person.

A *second* possible alternative to reduce the backlog during peak periods is the bank depository system. The federal internal revenue service has been using a depository system for federal income and social security taxes for decades. Under this system, deposit forms are issued to each taxpayer. The forms would be prepunched (similar to utility bills) to facilitate processing by the electronic data processing equipment. This form would be in two parts, the remittance portion and a detachable stub which serves as the taxpayer's deposit record. Before making a deposit (tax payment), the taxpayer enters the amount of payment in the spaces provided on the form and records the check or money order number and date on the stub. The stub is detached, while the remittance portion of the form and the payment are mailed or delivered to the bank. The bank would deposit all tax collections to the credit of the State and would make an accounting to the department. The taxpayer when filing his tax return would indicate on such return the amount of deposits made. A depository system would be ideal for the collection of income taxes withheld and possibly for general excise taxes.

Besides reducing the volume of unprocessed receipts at the department, the institution of a depository system would make it possible for tax return forms to be filed less frequently than monthly as it is presently required for income taxes withheld and general excise taxes. Since the tax payments would be made directly to the bank monthly (or more frequently), there is no urgency for the tax

return forms to be filed. The forms would merely show the amounts upon which the tax payments were computed. The filing of returns, say quarterly, would reduce significantly the workload of processing returns.

The two alternatives discussed above would make moneys immediately available for use by the State and reduce some of the workload burden during peak periods of the mailroom personnel and cashiers and other sections of the department. Further, they would eliminate the need to handle most tax collections, thereby reducing the risk of loss and misappropriation inherent in handling receipts. We believe that the two alternatives merit serious consideration by the department. The department should weigh the costs and benefits of the alternatives discussed as well as other alternatives before deciding on a course of action.

*Recommendation.* We recommend that the department take immediate steps to reduce delays in depositing tax receipts, including the study of the alternatives discussed in this section.

**Unnecessary routing of mail.** Two kinds of mail are routed by the mailroom to the department's other branches and sections rather than to the cashiering branch directly. The first kind includes mail which is addressed to a particular individual or office. This kind of mail is routed, unopened, to the individual or office concerned. If the mail contains a tax payment, it is then routed by the addressee to the cashiering branch.

The second kind of mail includes mail containing a tax payment which is routed to a branch or section, other than cashiering, for investigation or other processing. It is routed to cashiering after the investigation or processing is completed.

These indirect routings of tax payments to the cashiering branch are time-consuming and contribute to the delays in depositing receipts. Note the following timelags.

**1. Mail addressed to a particular individual or office.** The field audit branch is one of the more common offices to which mail is specifically addressed. It often is from a taxpayer whose return is being audited and frequently contains a tax payment. A payment enclosed in a mail addressed to the field audit branch (or a field auditor) may take up to five days before it is sent by the field audit branch to the cashiering branch. This delay occurs because the field audit branch finds it necessary to complete the report on the audit of the taxpayer concerned before sending the payment on to the cashiering branch. There is really no reason why the tax payment should be sent at all to the field audit branch. Mail, even though addressed to a specific addressee, should be opened by the mailroom personnel and the tax payment enclosed, if any, sent directly to the cashiering branch. The specific addressee, such as the field auditor, could at the same time be notified of the receipt of the tax payment.

*Recommendation.* We recommend that mailroom personnel open all mail, including those addressed to specific individuals or offices. When any such mail contains a tax payment, the mailroom should notify the addressee concerned that payment has been received, but transmit the payment directly to a cashier for processing.

**2. Routing for investigation, etc.** Mail routed to a section of the department for investigation, billing of penalty and interest, and recordation is sometimes held by the section for several days or, as is sometimes the case, for many weeks before being forwarded to the cashiering branch. For example, on July 31, 1974, 35 checks totaling over \$10,000, which had been received through the mail without accompanying documents, were being held by the accounting branch for identification of the taxpayers' accounts before being sent to the cashiers. These checks had been in the branch for up to eight weeks. Then, on September 5, 1974, the delinquent enforcement section had 126 checks totaling over \$166,000. These receipts had been in the delinquent enforcement section for periods ranging from two days to

three weeks and were being retained until the section's collectors updated their delinquency records, including computations of penalty and interest.

There is no real reason why these mail receipts could not be routed directly to the cashiers for processing. Routing mail receipts (checks) and the related documents to other sections for billing of penalty and interest and recordation is unnecessary since all information required by these sections for these purposes can be obtained from the validated documents (i.e., tax return, remittance advice, or letter which accompanies the payment). Further, routing receipts that are unaccompanied by documents to the accounting branch for investigation is not essential. The reproduction of these checks could be made and sent for investigation.

*Recommendation.* We recommend that all mail receipts and accompanying documents, including those requiring special attention, be transmitted directly from the mailroom to the cashiering branch. All tax payments should be processed for deposit, and only upon validation should the documents in question be transmitted to the appropriate section for disposition. In the case of a check unaccompanied by a document, we recommend that a reproduced copy of the check be transmitted to the accounting branch for investigation. Pending completion of the investigation, the payment represented by the check should be placed by the accounting branch in a suspense account. Once the receipt is properly identified, necessary adjustments can be made in the financial records.

**Holding receipts overnight.** Tax receipts (both mailed-in and over-the-counter) are processed by the cashiers as follows. For each tax receipt, the cashier first "validates" the accompanying tax return—that is, notes on the return the fact that tax payment has been made. The cashier then reviews the enclosed check for completeness and proper execution. He routes to the accounting branch for investigation and disposition all postdated and stale checks (i.e.,

checks more than six months old) and checks from taxpayers whose names are on the worthless check list. All other checks are prepared for deposit in the following manner.

At the close of each day, to ensure accuracy, each cashier tallies on a separate adding machine the amounts shown on the returns he validated that day and compares or cross-checks the total with the total registered on the cash register tape. He then prepares a cash register reading report (Form A-3) and a cash register detail report (Form A-4) for transmission to the department's accounting branch. He places the day's receipts, together with the cash register tape and the adding machine tape, in a cashbox, locks it, and sends the cashbox to the assistant supervisor of the cashiering branch. The assistant supervisor places all locked cashboxes, as he receives them from the various cashiers, in a safe which is located in a walk-in vault. The cashier routes all validated returns to the respective divisions or branches (e.g., the individual income tax returns are transmitted to the income tax division, the general excise tax returns are sent to the general excise branch, etc.), for recordation and filing.

On the following day, the assistant supervisor reviews the contents of each cashier's cashbox to ensure that the proper cross-check was performed by the cashier. He then prepares a summary of all of the previous day's collections (Form B-13) and sends a copy of the summary to each of the following: the department of accounting and general services, the department of budget and finance, and the department of taxation's administrative services and accounting office. Bank deposit slips are also prepared at this time. The receipts and the accompanying deposit slips are placed in the safe until they are picked up by the armored car service.

Under the above-described procedure, it is evident that depositing of receipts is delayed for at least one day during a normal workweek and for more than one day on a weekend or a holiday. Where the dollar amounts involved are

not significant, this delay would be of little consequence. However, the tax department handles on the average approximately \$2.3 million daily. Thus, a delay of even one day in depositing receipts is costly to the State. It denies the State a substantial amount of interest. Assuming an annual interest rate of 6 percent a year, the interest lost to the State by a delay of just one day is approximately \$138,000 annually.

To enable the department to deposit tax collections on the same day they are processed, all cash registers should be cleared at a designated time each day, say at 2:00 p.m., to allow sufficient time to prepare for deposit. All receipts processed after the designated hour would be deposited on the following day. This practice would not only increase the daily cash flow of the State but it would also minimize the risks associated with keeping large amounts of funds overnight in the vault.

*Recommendation.* We recommend that the department take the steps necessary to enable receipts to be deposited on the same day that they are processed.

### **Inefficient Method of Validating Returns**

Validation of a tax return is performed on the cash register. The cash register imprints simultaneously on the return the date, the symbol of the specific tax being paid, and the amount of payment.

Validating returns on the cash registers is cumbersome and inefficient. The cash registers are unable to take bulky returns. These returns must therefore be taken apart before they can be validated. This practice of taking the returns apart is a poor method of receipting. *First*, portions of the returns can be misplaced or inadvertently lost. *Second*, the entire process of unstapling, validating, and restapling is time-consuming, especially during peak periods.

We believe validation can be more efficiently accomplished manually with a hand stamp. In using a hand stamp, the actual amount received should be recorded on the return only when the amount received differs from the amount shown as payable on the return.

*Recommendation.* We recommend that the validation of returns be performed manually with a hand stamp in order to eliminate the time-consuming task of separating and reassembling returns.

### Poor Security over Cash Receipts

The department handles a large sum of money daily. As noted earlier, the average sum processed each day is about \$2.3 million. Yet, security to safeguard such a large sum of receipts against losses from theft, robbery, or embezzlement is woefully lacking. The principal security deficiencies are as follows.

**Inadequate safekeeping of receipts.** Receipts, both processed and unprocessed for deposit, are not kept under lock and key. Money to be deposited, for example, which includes on the average approximately \$6500 in currency, is kept in an unlocked safe in an unlocked walk-in vault until pickup is made by armored car service. Change fund money of at least \$400 held in reserve is also kept in this unlocked safe. Checks and related documents received on any given day that cannot be processed on that day are placed in baskets and stored in the walk-in vault until the cashiers are ready to process them. Under "normal" conditions, unprocessed receipts remain in the vault but overnight; however, around tax deadline dates, they remain in the vault for days and sometimes even weeks before being processed. The vault is locked only at night. During the day, all employees have fairly easy access to the vault. Entrance is not restricted to specific employees. Then, the vault is used also as a storage room for office supplies.

**Unsecured cashiering area.** The door to the cashiering area has no lock. The area is thus

exposed to the public and extremely vulnerable to robbery.

*Recommendations.* We recommend that the department take steps necessary to ensure adequate security over cash receipts. The security measures should include the following:

1. The safe containing receipts and other cash items should be kept locked at all times. In addition, access to the walk-in vault should be limited to designated personnel, or if access to the vault is necessary by persons other than those designated, such access should be under strict supervision.

2. A lock should be installed on the door to the cashiering area and only authorized personnel should be allowed entry to the area.

### Slowness in Processing and Pursuing Delinquent Taxes

Any tax which is due is a debt owed to the State. If unpaid after the statutory deadline for payment, it constitutes a delinquent tax. At the end of fiscal year 1969-70, delinquent taxes outstanding totaled \$7.5 million. Since 1969-70, the amount of delinquent taxes outstanding has continually increased. At June 30, 1974, it totaled \$13.4 million. This sum represents the total assessed and unpaid, exclusive of penalty and interest due on such unpaid taxes. A summary of delinquent taxes outstanding (by type of tax) at June 30, 1974 is shown below.

Type of tax	Total in million \$
General excise .....	\$ 6.1
Net income—individual ..	2.7
Real property .....	1.9
Withholding .....	1.5
Others .....	1.2
Total .....	<u>\$13.4</u>

Approximately 20 percent or \$2.7 million of the above total were, at June 30, 1974, past due for about one to two years, and 30 percent or \$4 million for about three to four years. The remaining 50 percent or \$6.7 million were past due for about five or more years.

A part of the department's responsibility is to ensure that appropriate actions are taken against taxpayers who are delinquent in tax payments. Our examination of the department's administration of delinquent accounts revealed several processing deficiencies which probably contribute to the increasing amount of delinquent taxes and the unreasonably long periods that delinquent taxes remain unpaid. The deficiencies are discussed below.

**Untimely transmittal of delinquent accounts to the delinquent enforcement branch.** Whenever a taxpayer files a return but fails to make full payment by the statutory due date or if he files a late return, he is billed for any unpaid tax plus penalty and interest as applicable. In the case of delinquent general excise taxes, the general excise tax branch bills the delinquent taxpayer for the delinquent amount and informs him that payment is due within ten days of the billing date. In effect, the branch grants the delinquent taxpayer a grace period of about ten days.

The general excise tax branch is extremely slow in transmitting to the delinquent enforcement branch any account which remains delinquent after the ten-day grace period. It is not until 50 days after the ten-day grace period that the branch transmits the account to the enforcement branch. There is no reason why the department should wait any longer than the ten-day grace period to transmit the account.

*Recommendation. We recommend that a delinquent account be immediately turned over to the delinquent enforcement branch whenever the delinquent taxpayer fails to make payment within the grace period allowed.*

**Untimely processing of delinquent tax notices.** The practice of the delinquent enforcement branch (for any delinquent tax account referred to it by the various offices and branches within the department) is to send two delinquency notices before initiating legal action against a delinquent taxpayer. The first notice allows the taxpayer anywhere from 7 to 15 days from the date of the notice to either remit payment or communicate with the department and arrange for settlement of the account. If the taxpayer fails to respond to the first notice, a second notice is sent informing the taxpayer that failure to respond to the second notice will compel the department to take whatever legal action is necessary to satisfy the amount of the delinquency.

There is an unnecessarily long timelag between the first and second notices. In some cases, four to eight months elapse before the second notice is actually prepared and mailed. The department's manual of operating procedures on delinquent accounts is silent as to when a second notice should be sent. Thus, it appears that the timing of the second notice is left essentially to the discretion of the individual tax collectors. We believe that the second notice should be mailed on the day immediately following the deadline contained in the first notice.

*Recommendation. We recommend that the department send the second delinquent tax notice immediately after the deadline set in the first delinquent tax notice.*

#### **Recordkeeping Backlog for General Excise and Withholding Taxes**

The systems and procedures office is responsible for maintaining the accounting records for general excise and withholding taxes received or due from taxpayers (essentially business firms). It maintains a ledger card for each taxpayer who files returns and remits the taxes. On the ledger card is kept a running record of the taxes due from and the amounts

paid by the taxpayer. As each return is filed and remittance made (usually on a monthly basis), the tax liability as shown on the return and the amount received in payment of the liability are posted to the card. After posting to the ledger card, the return is transmitted to the general excise tax branch for filing.

The systems and procedures office maintains approximately 73,200 ledger cards, and transactions are posted to these ledger cards through the use of bookkeeping machines. A large number of postings are required to be made monthly, and the office is not able to keep up with the flow of transactions. Postings are usually backlogged four to six weeks. We understand that this continuous backlog has been a problem for several years.

This posting backlog hampers and affects various departmental operations such as the handling of inquiries by taxpayers regarding the current status of their accounts and the timely identification of delinquent amounts and late filings. The department has recently initiated plans to mechanize the recordkeeping process through the use of electronic data processing (EDP) equipment. We understand that implementation of the plans is scheduled for fiscal year 1975-76.

*Recommendation.* We recommend that the department complete and implement as quickly as possible its plans to apply the EDP system in maintaining general excise and withholding tax records.

### **Poor Maintenance of Financial Records**

Each neighbor island district office maintains a general ledger. This general ledger is the basic financial record for each district. It serves as the basic source from which financial statements are prepared. In it is recorded for each month by specific kind of tax, the total amount of billings, collections made, and the uncollected balances due as of the end of the

month. When properly maintained, the general ledger should also account for the financial assets, such as change funds and petty cash funds, which are under the custody and control of the district office.

In addition to the general ledger, each district office maintains a ledger account for each taxpayer (residing in the district) from whom taxes are due. These individual ledger accounts are termed subsidiary ledger accounts. The financial activities in the subsidiary ledger account when totaled should agree with the summary or total noted in the general ledger. The general ledger thus serves as a control account and ensures the accuracy of the subsidiary ledger accounts.

Our examination of the general ledger maintained by the Kauai district office revealed the following deficiencies: (1) The amounts in the general ledger account were not in balance or agreement with the subsidiary ledgers. To illustrate, the subsidiary accounts for real property taxes receivable did not agree with the general ledger by \$67,240. We understand that the general ledger account has not been in balance with the subsidiary ledgers for several years. (2) Since November 1973, no transaction had been posted to the general ledger for real property tax payments made under protest. (3) Several financial items, such as the amount of the cashier's change fund, imprest funds, and deposits in transit at the end of a month, were not recorded in the general ledger.

It should be noted that during our field work the department's administrative services and accounting office had just begun to assist the Kauai district office in correcting deficiencies in the district's accounting system.

*Recommendation.* We recommend that corrective measures, currently being undertaken by the department, be accomplished as quickly as possible, and necessary steps be taken to prevent any recurrence of improper maintenance of financial records at the Kauai district office.

## **Inadequate Security over Tax Documents and Files**

Numerous documents and files in the department's central office are critical to the operations of the department. They are, however, exposed to potential destruction by fire. Of particular concern are the real property field history books which are the primary source documents for valuing real property and the

more recently filed income tax returns. They are both stored on open shelves. Once destroyed, reconstruction of these documents would be difficult, if not almost impossible, to accomplish.

*Recommendation. We recommend that the department review security measures for safeguarding valuable tax records, documents, and files and provide suitable means by which they may be protected from destruction by fire.*

## Chapter 4

### REAL PROPERTY TAX ADMINISTRATION

This chapter contains our findings regarding the administration of real property taxes. It is primarily concerned with real property assessment and billing practices of the department.

#### Summary of Findings

In summary, our findings are as follows:

1. There are inequities in real property tax assessment arising from the use of faulty assessment techniques and practices. Buildings are not being depreciated properly, unimproved lands are being undervalued, benchmark values are being established and applied inconsistently, lands not devoted to agricultural production are being assessed as agricultural lands, and parcels are being selected for reappraisal in an unsystematic and on a nonrational basis. A large part of the problem stems from inadequate policies and guidelines on assessments and the tedious, manual assessment procedures.

2. The EDP operations in support of real property tax administration are faulty. The EDP printouts are so inaccurate as to make reliance on them impossible. Also, maximum use of EDP is not now being made.

3. Although the statutes require it, the full costs of administering real property taxes are not being recovered by the State.

4. There is confusion in the manner in which real property tax bills are being transmitted to property owners.

#### The Real Property Tax Law, in General

Under the Hawaii Revised Statutes, the State is responsible for valuing all real property in the State which are subject to the payment of real property taxes and for imposing or levying and for collecting all such taxes. The specific tax rate to be applied (expressed in terms of dollars per \$1000 of assessed value of property) in each county is established by the county council concerned. All revenues derived from the tax, less the cost incurred by the State in administering property assessments and collections, are remitted by the State to the counties for their use.

**Assessment.** Section 246-10, HRS, requires the director of taxation to determine the fair market value of all taxable real property and annually to assess a tax on the property. It requires a separate valuation and assessment of (1) the land and (2) the buildings, structures, fences, and other improvements. The statute provides that all property shall be valued "by appropriate systematic methods so selected and applied as to obtain, as far as possible, uniform and equalized assessments throughout the State." For valuation and assessment purposes, the statute establishes seven general classes and requires that each taxable parcel of land be

placed in one of these classes in accordance with its highest and best use, except that it permits land dedicated for ranching or other agricultural use, although classified as other than agricultural, to be valued and assessed as if it were classified as agricultural. The seven classes of land are: improved residential, agriculture, conservation, unimproved residential, hotel and apartment, commercial, and industrial. The statute directs that buildings be valued each year upon the basis of the cost of replacement less depreciation due to age, condition, or obsolescence.

Although all taxable real property is subject to a tax upon its fair market value, under section 246-2, HRS, the director of taxation is permitted to use a percentage of the property's fair market value as the tax base. This percentage has traditionally been set at 70 percent.<sup>1</sup> The assessment value of each class of real property and the amount of revenues required from each class to sustain its operations are used by each county as the basis for setting the tax rate applicable to each class of taxable real property.

**Geographic divisions for assessment purposes.** For the purposes of real property tax assessment, each *tax district* (county) is divided into *zones*. Each zone is in turn divided into *sections*, and each section into *plats*. Each plat consists of a number of individual *parcels* of land. Thus, for example, a reference to "2-9-048-005" means parcel 5 in plat 48 of section 9 in zone 2.

### Assessment Inequities

Although section 246-10, HRS, provides as a matter of policy that assessments be uniform and equal as possible, it does not appear that the State is anywhere near this goal.

**Inequities illustrated.** The wide disparity in the "assessment-sales ratios" of various taxable parcels of land and an extremely high "coefficient of dispersion" in the various

sections are indicators of the inequalities that exist in assessments.

**1. Assessment-sales ratios.** An "assessment-sales ratio" expresses the relationship between the assessed value of a parcel and its market value in the form of a percentage. It is derived by dividing the assessed value by the fair market value. The higher the ratio, the closer is the assessment to the fair market value. However, the fact that the assessment-sales ratios are low does not mean that there are inequities in assessment, provided the ratios are low uniformly throughout the State. But if the ratios vary widely from one area of the State to another, it is an indication that inequities exist. Those landowners whose parcels have high assessment-sales ratios would be paying real property taxes at values closer to the fair market value than owners whose parcels have low assessment-sales ratios.

That there are wide disparities in the assessment-sales ratios of various parcels of land in the State is illustrated in a report prepared by the department entitled, *Hawaii's Assessment-Sales Ratio Study, 1973*. For instance, as of July 1, 1973, in the Oahu tax district, the mean (average) assessment-sales ratios of residential property ranged from a low of 36 percent for parcels in the Hauula section to a high of 62 percent for parcels in the Honouliuli section. Stated differently, the residential parcels in the Honouliuli section were, on the average, assessed at a value 26 percent closer to their "true" value than the residential parcels in the Hauula section. When compared against the statewide mean assessment-sales ratio for residential parcels (46 percent), the parcels in the Honouliuli section were, on the average, assessed at a value 16 percent closer to their "true" value than the rest of the residential parcels in the State. This

<sup>1</sup>Section 248-2 of the Hawaii Revised Statutes stipulates, in part, that net taxable real property means "seventy percent or such other percentage of the fair market value of property as the director of taxation certifies as the tax base as provided by law less exemptions as provided by law . . . ."

means, of course, that in 1973-74, residential property owners in the Honouliuli section, on the average, paid more in real property taxes, relatively speaking, than the average residential property owner in the State.

Not only do the assessment-sales ratios vary widely among the various sections in the State, but they also vary widely among sections within a single zone. For instance, as of July 1, 1973, in zone 5 on Oahu (Kaaawa to Pupukea), the mean ratios of the sections included in the zone varied from a low of 36 percent for residential properties in Hauula (section 4) to a high of 52 percent for residential properties in Waialae (section 8). Given this range in ratios, it is evident that there was at least, as of July 1, 1973, a high degree of intrazone nonuniformity and inequity.

## 2. High coefficients of dispersion.

"Coefficient of dispersion" measures the scatter of the individual assessment-sales ratios from their mean (or their average). It is expressed as a percentage of the mean ratio and is obtained by dividing the amount of the deviation by the mean ratio. The higher the coefficient, the greater is the inequality in assessments in a given area. The department considers a 10 percent dispersion figure as being an acceptable margin, a 20 percent dispersion as constituting the upper limits of acceptability, and a dispersion of more than 30 percent as "indicative of inequitable assessment."

We examined the coefficients of dispersion in the various residential sections on Oahu as contained in the report cited above, *Hawaii Assessment-Sales Ratio Study, 1973*. On July 1, 1973, 18 of the 58 residential sections, or 31 percent, had coefficients of dispersion above 20 percent. Table 4.1 shows the coefficients and the mean ratios for these sections.

Table 4.1  
Coefficients of Dispersion and  
Mean Ratios by Sections

Tax key section	Location	Coefficient of dispersion	Mean ratio
1-4	Kalihi-uka	26.3	41%
1-6	Kapalama	21.1	38
2-2	Pacific Heights	22.8	43
2-4	Makiki	27.3	45
2-9	Manoa	22.9	52
3-3	Kaimuki (mauka)	21.3	46
4-7	Kahuluu	21.1	38
5-3	Punaluu	28.5	41
5-4	Hauula	22.2	36
5-5	Laie	20.5	43
5-6	Malaekahana	28.5	44
6-6	Haleiwa-Waialua	28.5	40
6-8	Mokuleia	37.8	37
7-5	Wahiawa (mauka)	20.8	40
8-4	Makaha	21.2	42
8-5	Waianae	24.3	37
9-8	Kalawao	21.1	45

As noted on the table, the coefficients of dispersion for the Makiki, Punaluu, Malaekahana, and Haleiwa-Waialua sections were very close to 30 percent, and the coefficient for the Mokuleia section exceeded 30 percent.

A number of factors contribute to the current inequities. They are discussed in the paragraphs which follow.

**Deficiencies in valuation methods.** In valuing real property for assessment purposes, the department utilizes a number of techniques, the validity of which is highly questionable. They are as follows.

1. **Arbitrarily depreciating buildings.** The method in which buildings are valued for assessment purposes appears to contribute to the widely differing assessment-sales ratios and high coefficients of dispersion in and among the various areas in the State.

A building, unlike land, declines in value over time as a result of physical deterioration and obsolescence. The department accounts for such a decline in value of a residential structure by applying an annual depreciation rate of approximately 2½ percent until the depreciated

value reaches 20 percent of the cost of the structure. Different parts of a building are depreciated separately depending on the age of each part and all separate buildings are treated individually regardless of the extent to which they are used as an integrated unit.

Sometimes adjustments are made which slow down the rate of depreciation or increase the value of the structure. Such adjustments are usually made to recognize improvements made to the structure (thereby increasing its value) or to recognize the maintenance efforts expended to keep the structure in a good condition. But such adjustments are not made often enough. As a result, there is a tendency to undervalue relatively old but well-maintained residential buildings and thus to cause wide differences in assessment-sales ratios and high coefficients of dispersion. Note the example shown in table 4.2. Two parcels of real property of about equal size in lower Manoa were sold in 1973 for the same price, \$85,000. However, one parcel had been assessed \$23,625 for the land and \$5,906 for the building which was constructed in 1939. The assessment-sales ratio of this parcel was 29 percent (\$29,531 divided by \$85,000). The second parcel had been assessed \$23,882 for the land and \$13,557 for the building constructed in 1950. The assessment-sales ratio for this parcel was 44 percent (\$37,439 divided by \$85,000).

Since the assessed value of the land in both cases was about the same, it is evident that the difference in the assessment-sales ratios of the two parcels is attributable to the differing assessed value of the structures. The assessed value of the structures differed because of the

automatic application of the depreciation rate. Understandably, the 1939 structure was depreciated in an amount greater than the later 1950 structure. Yet, in the market, the structures were worth about the same, most probably because the 1939 structure, although older, had been well-maintained.

This example demonstrates the fact that the department's practice of automatically depreciating residential buildings without giving consideration to condition and upkeep can result in varying assessment-sales ratios in a given area and in the lowering of the overall mean ratio and high coefficient of dispersion for the area. Lower Manoa, for example, was reappraised during 1973, yet the mean ratio was only 41 percent and the coefficient of dispersion was 19.3. The situation existing in lower Manoa is prevalent in other older, well-developed areas on Oahu, such as the Pacific Heights and Tantalus areas.

## 2. Undervaluing unimproved land.

Unimproved (vacant) land is generally assessed lower than improved land, much lower than appears justified. For example, in a sample of vacant land sales which occurred in the Kapalama section during FY 1973-74, the assessment to sales ratios of unimproved parcels ranged from a low of 20 percent to a high of 42 percent (see table 4.3).

Low assessments of unimproved land will, of course, lower the overall mean ratio and will increase the dispersion for the section in which the unimproved parcels are situated. For instance, Kapalama's overall mean assessment-

Table 4.2  
Comparison Between Two Parcels in Lower Manoa, 1973

Parcel	Land area	Assessed valuation			Age of building	Selling price	Assessment-sales ratio
		Land	Building	Total			
1	5,000	\$23,625	\$ 5,906	\$29,531	1939 (34)	\$85,000	29
2	5,109	23,882	13,557	37,439	1950 (23)	85,000	44

sales ratio for fiscal year 1973–74, which included the ratios of improved as well as unimproved property sales, was 41 percent and the coefficient of dispersion was 25.7 percent.

Table 4.3  
Sample of Unimproved Parcel Sales  
Which Occurred During FY 1973–74

Parcel	Land area	Assessed valuation land	Selling price	Assess.-sales ratio
1	2,987	\$11,500	\$ 32,000	36
2	9,512	27,265	93,000	29
3	5,360	13,647	53,000	26
4	5,610	15,783	60,000	26
5	8,548	25,729	128,220	20
6	8,000	25,200	60,000	42
Average assessment-sales ratio				29.83

3. *Compromising benchmark values.* The department utilizes the technique of “benchmark values” in computing the amount of the assessment of the various parcels of taxable real property. In essence, this technique calls for the establishment of the value of a “typical” parcel in a given neighborhood. From this benchmark figure, all parcels in the neighborhood are then valued, taking into account the differing characteristics of the various parcels. In establishing the value of a typical parcel, the sales of the most common lot size in the neighborhood are supposed to be examined—that is, the benchmark value is supposed to reflect the sales price of a typical parcel. This is a reasonable requirement, for the assessments are supposed to reflect fair market value.

However, in practice, the sales price of a typical lot is often ignored, and a benchmark value is derived arbitrarily. For example, in 1975, the analysis performed by the department of the real property sales in a neighborhood in the Kapalama section showed that the average sales price of a typical parcel (5000 square feet) was \$10 per square foot.<sup>2</sup> Thus, the benchmark

value for assessment purposes in the neighborhood should have been somewhere around \$7 per square foot (.70 x \$10). The department, however, used a benchmark figure of \$5.60 per square foot (that is, it assumed an average sales price of \$8 per square foot—.70 x \$8 = \$5.60). This \$5.60 per square foot was used because the appraisers felt that the \$7 a square foot value would have been “excessive” in light of the old assessed value of \$2.80 per square foot (\$4.00 x .70 = \$2.80). As a result, they “compromised” on \$5.60. Apparently a “general feeling” of excessiveness was deemed insufficient justification for this compromise, for the appraisers noted that this benchmark value (\$5.60) was comparable and in line with the values for the Pacific Heights, Aiea Heights, and Wilhelmina Rise areas, even though these other areas had not been reappraised for some four years. Thus, the appraisers compared the current value of property in one area with the value of property in other areas that were four years old. Of course, this compromise action worked to the disadvantage of real property owners in other areas of the State whose parcels were appraised in 1975 at the current market value.

One other aspect of establishing benchmark values is pertinent here. Where there has been little or no sales activity in a given neighborhood, the sales of parcels in adjoining neighborhoods or sales which occurred in the given neighborhood in years past are considered. How much consideration is to be given to these sales rests in the discretion and judgment of the appraiser concerned. The result is usually a gross undervaluation of the properties in the given neighborhood.

4. *Inconsistently adjusting benchmark values.* The benchmark value is supposed to reflect the value of a typical-sized parcel in the neighborhood. In the application of the value to the various parcels in the neighborhood, adjustments are made for the differing sizes of

<sup>2</sup>Sale prices for 5000 square foot lots ranged from a low of \$7.71 to a high of \$13.01 per square foot.

the parcels. The adjustments, however, are being made in an inconsistent fashion, causing some neighborhoods to be assessed disproportionately more than other neighborhoods. In some areas, the benchmark value is reduced by one-half for the land area in excess of the typical-sized lot. In other areas, the excess land area is assessed at one-fourth the benchmark value. For example, in zone 1, section 6, plat 16 (Kapalama), where the benchmark value is \$5.60, the area in excess of 5000 square feet (the typical-sized lot) is assessed at one-half the benchmark value. A parcel with 5570 square feet is thus assessed as follows:

<i>land area</i>		<i>unit value</i>		<i>assessed value</i>
5,000	x	\$5.60	=	\$28,000
570	x	2.80	=	<u>1,596</u>
				<u>\$29,596</u>

On the other hand, in zone 8, section 6, plat 7 (Lualualei), where the benchmark value is \$2.52, the area in excess of 5000 square feet (the typical-sized lot) is assessed at one-fourth the benchmark value. A parcel containing 5114 square feet in Lualualei is thus assessed as follows:

<i>land area</i>		<i>unit value</i>		<i>assessed value</i>
5,000	x	\$2.52	=	\$12,600
114	x	.63	=	<u>72</u>
				<u>\$12,672</u>

There are also variations throughout the State in how the benchmark values are adjusted for parcels which are subdividable into two or more typical- or minimum-sized lots. These variations occur even within the same area. For example, in Kapalama where the typical lot size and the minimum-sized lot for a single family dwelling is 5000 square feet, some parcels subdividable into two or more lots are being assessed as follows. The first 5000 square feet is assessed at the benchmark unit value, i.e., \$5.60 per square foot; the second 5000 square feet at 15 percent less than the benchmark value or \$4.76 per square foot; and any remaining area at

one-half the value of the second 5000 square feet, or \$2.38 per square foot. As an illustration, a parcel containing an area of 11,253 square feet is thus assessed as follows:

<i>land area</i>		<i>unit value</i>		<i>assessed value</i>
5,000	x	\$5.60	=	\$28,000
5,000	x	4.76	=	23,800
1,253	x	2.38	=	<u>2,982</u>
				<u>\$54,782</u>

For other parcels in this Kapalama district, the full benchmark value is being applied to each subdividable part. For example, in one case examined, each 5000 square feet of a parcel containing a total of 10,000 square feet was assessed at \$5.60. When the appraisers responsible for the reappraisal of this plat were queried as to the discrepancy, they conceded that the parcel had been incorrectly revalued and proceeded to revise the value of this particular parcel. If this discrepancy had been left unchanged, the property owner would have paid \$861 in property taxes as opposed to \$796. There are, however, other parcels being assessed at the full benchmark value.

5. *Using inappropriate construction cost index.* Section 246-10(g), HRS, provides as follows:

“Buildings shall be valued each year upon the basis of the cost of replacement less depreciation, if any. Age, condition, and utility or obsolescence shall be considered. The director shall determine and require the use of the average basic replacement cost factors.”<sup>3</sup>

The department uses a single “construction cost index” to determine the replacement cost of *all* buildings—single family residence, multifamily residence, low rise structure, high

<sup>3</sup>The economic value of a building declines as a result of age and use. Depreciation is the process of charging a portion of the loss in economic value of the asset over its economic life.

rise structure, apartment, hotel, commercial structure, industrial structure, etc. This index is a composite index derived as follows. *First*, the type and amount of materials and labor required to construct (1) a single-family *wood-frame dwelling* and (2) a single-family *masonry or concrete dwelling* are determined. *Second*, based on the type and amount of material and labor required, the current cost of constructing a single-family, wood-frame dwelling and the cost of constructing a single-family, masonry or concrete dwelling are ascertained. *Third*, for each kind of dwelling, the percentage increase or decrease in construction cost as compared to that of the previous year is calculated. *Fourth*, weights are assigned to each of these percentages, and a weighted average increase or decrease is derived. This weighted average constitutes the construction cost index.

The use of a single construction cost index to determine the replacement cost of all buildings is very inappropriate. It results in unfairness in valuation. *First*, the cost index is based on the cost of replacing a residence. Yet, it is applied to apartment, hotel, commercial, and industrial structures as well, even though in fact the cost of constructing a residence differs markedly from the cost of constructing other kinds of buildings.

*Second*, the index is based on the cost of replacing a single-family dwelling. Yet, it is also applied to multifamily dwellings. The per-unit cost of constructing a multifamily dwelling is usually lower than the cost of constructing a single-family dwelling. Thus, the application of the single index results in an overvaluation of multifamily structures. Note that construction of multifamily structures has been increasing over the years. In 1973, 77 percent of all permits issued for construction were for multifamily dwellings.

*Third*, the single index assumes that all buildings have the same composition of materials and labor when, in fact, they do not.

*Fourth*, the index is a weighted average increase or decrease in the cost of constructing two different kinds of structures—wood-frame and masonry. As such, even as applied to residences, the use of the index results in an overvaluation of one kind of structure and undervaluation of the other kind of structure. Which kind of structure is overvalued and which kind is undervalued depends on the relative percentage increase or decrease in the cost of constructing each kind of structure. In 1974, the cost of constructing a wood-frame structure, as determined by the department, increased 16.49 percent over 1973, while the cost of constructing a masonry/concrete structure increased by 12.50 percent. The weighted average derived by the department was 16 percent.

	<i>Actual % increase or decrease in cost of constructing</i>	<i>Weighted average index</i>	<i>Over- valuation [under- valuation]</i>
Single family wood structure	+16.49%	+16.00%	[.49%]
Single family masonry structure	+12.50%		3.50%

The application of this weighted average resulted, as shown above, in all single wood-frame family buildings being undervalued by .49 percent and in all masonry single-family dwellings being overvalued by 3.5 percent.

To achieve equity as nearly as possible, we believe that buildings should be classified into several groups. At a minimum, with respect to residential dwellings, there should be the following major classes of structures: residential single-family, multifamily low-rise, and multifamily high-rise. Each class should further be divided by kind of construction (e.g., wood-frame, masonry) and cost models (with various ingredients of cost components) be developed for each such subgroup. While it would be impractical to categorize structures into fine classes and subclasses and a cost model developed for each, some rational classification system would serve to revalue buildings as closely as possible to their true

replacement costs and thereby equalize the real property tax burdens among the taxpayers.

**6. Improperly assessing lands as agricultural.** HRS, section 246-10, provides that "the value of land classified *and used* for agriculture, whether such lands are dedicated pursuant to section 246-12 or not, shall, for real property tax purposes, be the value of such land for agricultural use without regard to any value that such land might have for other purposes or uses." The intent of the law is to encourage owners of agricultural lands to keep lands in agricultural production or to put back lands taken out of agricultural production into such production.<sup>4</sup>

It appears that there are parcels of land being valued as agricultural lands although they are not being used in agricultural production. The department itself identified six parcels in Lualualei (zone 8, section 6, plat 7) being assessed as agricultural lands although they should not be. As an illustration, included among the six parcels is one on which two chickens are being kept for personal use only.

**Deficiencies in assessment process.** In addition to using questionable valuation methods, the department engages in procedures which are inefficient and which detract from, rather than foster, uniformity and equity in assessments.

**1. Unsystematic selection of parcels for reappraisal.** Although the department reappraises the taxable real property in the State every year, not all of the property are reappraised each year. At present, under the existing mechanism, it is impossible to reappraise every parcel every year. Thus, there is bound to be some differences in the assessment-sales ratios. Under these circumstances, the department seeks to minimize the differences. However, the process it uses appears to detract, rather than foster, minimization of the differences.

At the outset it should be noted that, although the department represented to us during the audit that it reappraises parcels on a cyclical basis and that a cycle is approximately four to six years, this is not really the case. A "cycle" implies that every parcel is reappraised once every so often (in this case, once every four to six years). It suggests that there is a program whereby starting at some point in the State, island, zone, or even section, a set of parcels is reappraised one year, another set the next, still another the year following, etc., until all parcels are reappraised and a new cycle begins. This is not the way real property is reappraised. Indeed, there is some question whether it should be done in this fashion in light of the fact that the value of parcels in one area may be increasing at a more rapid rate than the value of parcels in another area. However, if there were indeed a cyclical pattern followed, it could at least be said that there is some order in the manner in which real property is appraised. But there is no such order at present.

In practice, the frequency with which parcels are reappraised varies greatly. It varies not only among zones but also among sections within a zone. Table 4.4 illustrates this difference in frequency within zone 1 (Moanalua to Dowsett).

**Table 4.4**  
Frequency of Reappraisals of Selected Parcels in  
Zone 1—Moanalua to Dowsett  
For Tax Years 1969 through 1974

Section	Year of Reappraisal					
	1969	1970	1971	1972	1973	1974
1 Moanalua	x		x			x
3 Kalihi	x			x		
6 Kapalama	x					
8 Nuuanu	x				x	

<sup>4</sup>Standing Committee Report No. 536, relating to S.B. No. 176, S.D. 1, April 3, 1973.

The table above shows that sections 1, 3, 6, and 8 in zone 1 (Moanalua to Dowsett) were reappraised in 1969. Since 1969, section 1 (Moanalua) has been reappraised two more times, once in 1971 and again in 1974, while sections 3 (Kalihi) and 8 (Nuuanu) were appraised one more time, in 1972 and 1973, respectively. On the other hand, section 6 (Kapalama) has not been reappraised in its entirety since 1969.<sup>5</sup>

This difference in the frequency of reappraisal is not in and of itself bad. What is important is how the parcels or areas are selected for reappraisal. When queried on the matter, the department represented that it selects for reappraisal in any given year those areas with the lowest assessment-sales ratio. In the zone 1 illustration above, it stated that Moanalua was reappraised more frequently than the other sections in the zone because the selling prices of properties in Moanalua indicated that the assessments (as shown by the assessment-sales ratios) of the parcels in Moanalua were low in comparison with those of parcels in the other sections. This representation is in accord with that noted in the department's *Multi-year Program and Financial Plan and Executive Budget for the Period 1975-1981*, where the department states, "priority of reappraisal [in any given year] is established on the basis of first priority to those areas or classes with the lowest indicated level of sales-assessment ratio."

There is some merit to approaching reappraisals in this fashion, for the objective is to bring the ratios up to par with that for the State as a whole. However, while the department does from time to time select for reappraisal those areas with exceptionally low assessment-sales ratios, this is not always the case. Indeed, a low assessment-sales ratio does not appear to be the predominant criterion followed in choosing the parcels for reappraisals. In the case of Moanalua, for instance, when the reappraisal in tax year 1973-74 was made, the mean assessment-sales ratio of the section was 51 percent, and the coefficient of dispersion was

12.9 percent, while in the neighboring Kapalama section the assessment-sales ratio was 38 percent and the coefficient of dispersion 21.1 percent (see table 4.5). Given this situation, if the department's practice were indeed to give first priority to areas where the assessment-sales ratios are the lowest, Kapalama, rather than Moanalua, should have been selected for reappraisal in 1974.

It appears that the real criterion for the selection of parcels for reappraisal is "high sales activity," that is, the practice is to reappraise those areas which have experienced or are experiencing a large number of sales transactions. This practice is followed because it is easier to reappraise real property in those areas with a large number of sales transactions than to reappraise property situated in areas with little or no sales. The sale prices provide a convenient base for placing a value on neighboring property.

It appears that, even if the department really wants to give priority to areas with low assessment-sales ratios, it is not in a position to do so.<sup>6</sup> The assessment-sales ratio study which the department issues for each taxable year is not published until a year and a half later. The latest study that it has is for the tax year 1972-1973. The next study, for the year 1973-74, will not be available until December 1975, and the study for the year 1974-75, until December 1976. Unless the study is issued promptly after the close of each year, the data contained in the study are of little use in determining the areas of low assessment-sales ratios.

That the practice is to select areas with high sales activity for reappraisal was confirmed

<sup>5</sup> Selected parcels were reappraised in 1971, however, the entire section has not been reappraised since 1969.

<sup>6</sup> While individual appraisers may compute the assessment-sales ratios for sold properties in the zones and/or sections which they are responsible for reappraising, there is no comprehensive statewide analysis of real property sales and current property assessments to determine statewide priorities for reappraising properties with low assessment-sales ratios.

by our examination of the records. Residential areas such as Tantalus and Kapalama Heights, where sales have been limited, have not been completely reappraised for years. Likewise, commercial areas such as Kakaako and downtown Honolulu which have also experienced few sales have not been reappraised for many years. On the other hand, areas with high sales transactions have been reappraised with some frequency.

The fact that only a limited number of sales have occurred in a given area does not mean that the fair market value of the parcels in the area has not fluctuated (indeed, increased) over the years. It has. The nonreappraisal of these parcels has contributed to the low assessment-sales ratios and to the high coefficients of dispersion in these areas.

**2. Varying practices in assignment of appraisers.** There is another reason why frequencies with which parcels are reappraised differ from one part of the State to another. This reason is the manner in which appraisers are assigned to different areas for appraisal purposes.

There are 18 appraisers in the Oahu district. These 18 appraisers are divided into three groups, with one supervisor assigned to each group. Some appraisers are assigned permanently to specific zones and appraise only those parcels in their zones. Other appraisers work in whatever sections or zones that are selected for reappraisal in any given year. The manner in which the appraisers are deployed is not set by policy, but instead depends on the individual preference of the group supervisor.

The stated advantages of assigning an appraiser permanently to an area are the reservoir of knowledge that would be developed by the appraiser about the characteristics that affect values in the area and the appraiser's ability to appraise a larger number of parcels within the period allotted for appraisal because of his familiarity with the area. It causes, however, a variation in the frequency with which parcels are reappraised. This is illustrated

thus. Zone 8 (Makaha, Nanakuli, and Maile) is a relatively small zone, with appraisers permanently assigned to it. Since zone 8 is small, the appraisers are able to reappraise the parcels in the zone more frequently than parcels in some other zones. For example, the entire zone was reappraised in 1971, and in 1972 approximately 400 oceanfront parcels were reappraised. Then, in 1973, 250 agricultural parcels in the zone were reappraised (pursuant to an amendment to the real property tax law which permitted all lands in agricultural zones and used for agriculture to be assessed at agricultural values). We understand that the entire zone was again reappraised in 1975-76. Other larger zones, of course, are not reappraised for as long as six or more years.

**3. Inefficient, time-consuming process.** Only a limited number of areas are selected for reappraisal each year. More areas are not subject to reappraisal in part because of the tedious, time-consuming nature of the task of reappraising. Reappraisals presently are conducted as follows.

In the fall of each year, the department compiles data on every arm's length real property sale<sup>7</sup> made during the previous tax year. The data include, among other things, the sales price, assessed valuation of the land and building, assessment-sales ratio (assessed value divided by the sales price), and value per square foot of the property sold. The sales data are extracted from the certificate of conveyance issued by the state bureau of conveyance to the department on each real estate transaction.<sup>8</sup> Other pertinent data relating to the property, such as the assessed valuation of the building and land, are obtained from the department's

<sup>7</sup>An "arm's length" real property sale is a bona fide sale where one party gives a valuable consideration (e.g., cash, property) in exchange for the real property. Excluded from an arm's length sale is a transfer of real property, for example from father to son, induced by love and affection.

<sup>8</sup>The conveyance tax certificate contains, among other things, sales price or such other consideration paid for the property, the tax key identification, and the name of buyer and seller.

field history book.<sup>9</sup> The data for each property are compiled manually. It takes approximately three months to complete the compilation of data on all property sold in the previous tax year.

The data compiled are recorded on a master sheet called "Sales Analysis." They are recorded on the sheet by classes of property (i.e., residential, commercial, etc.) and by zones and sections. This "Sales Analysis" sheet is the basic source data used to set assessed land values.

Each appraiser performs an analysis of the data contained on the sheet for the area he is responsible for reappraising. He reviews the sales data on a parcel-by-parcel, street-by-street, or block-by-block basis. His task is first to establish a benchmark, that is, the value of a typical parcel in the neighborhood. With that benchmark he then proceeds to assign varying values to the parcels in the area.

As evident, the foregoing reappraisal procedure is very time-consuming. Given that procedure, it is understandable why more parcels of real property are not reappraised each year. Reappraisals must be accomplished within a relatively short period of time, and on Oahu alone there are approximately 144,000 parcels.

We note in passing that even under this time-consuming process, because of the manual labor involved, numerous miscalculations are made. Our examination of the computations in a sampling of parcels disclosed these errors: In some cases, the unit value had been incorrectly recorded; in others, the square footage of the parcels was incorrect; and in still other cases, the calculations themselves were incorrect. The errors were due primarily to carelessness. However, errors such as these could result in either gross over- or under-assessments of property.

**Need for improvement.** There is obviously a need for improvement if the statutory goal of uniform and equitable assessment is to be

reached. There are at least two things which must be done if these improvements are to be made. They are as follows.

*1. Establish policies and guidelines.* A number of the problems discussed above exist because the department does not have policies and guidelines to assist its appraisers. The policies and guidelines that do exist are outmoded, unclear, or otherwise insufficient in detail.

Take, for example, the matter of depreciating buildings. There are no clear guidelines as to how the rate of depreciation should be adjusted to reflect good maintenance of the buildings, and the use of the single construction cost index to apply to all structures, whether commercial, residential, wood-frame, or concrete, is simply inadequate to the task. Then the policies are vague as to the adjustments to the benchmark values in assessing real property to take into account the differences in the sizes of the various parcels.

In the area of assessing lands used for agricultural purposes, although the law permitting assessment as agricultural land was enacted in 1973, the department has yet to formulate policies governing such matters as to how one is to determine whether the land is indeed being *used* for agricultural purposes. Thus there is no policy regarding the minimum acreage that must be devoted to agricultural production, etc. When the law was passed in 1973, some efforts were devoted to establishing policies in this area. However, the policies that have been drafted still remain in draft form "for discussion purposes only."<sup>10</sup>

Finally, in the assignment of appraisers, there appears to be a need for some policy which assigns appraisers on a more rational basis.

<sup>9</sup>The field history book is a historical record of ownership and assessed valuation (building and land) of each parcel of property.

<sup>10</sup>The draft does not address itself to one of the major concerns, namely the definition of agricultural lands in terms of the minimum acreage under production necessary to qualify for the agricultural use values.

2. *Computerize operations.* The laborious, tedious, time-consuming manual system now followed is outdated. It is time to computerize the whole process of assessment. A computerized system will not only eliminate the present time-consuming and manual process, but would probably make it possible to reappraise every parcel simultaneously, every year. The simultaneous reappraisals will, of course, greatly assist in minimizing differences in assessment-sales ratios, and the annual reappraisal of every parcel will assist in keeping the assessments of all property continuously in line with changing market values. Also, a computerized system, if properly designed, should minimize the chances of calculation errors. A further benefit of a computerized system would be the immediate publication of the assessment-sales ratio study at the end of each year, which would be useful in the selection of the areas for reappraisal, if the computerized system does not result in the annual reappraisal of every parcel.

The computerized system might operate as follows. The core of the computerized system would consist of (a) a benchmark value for each homogeneous area and (b) an index for each parcel in the area. The benchmark value would be established at a given point in time, taking into account such relatively constant factors (and the weight attached to each) as the average size and the general shape and topography of the lots in the area, the nearness of the lots to schools, parks, and shopping centers, the existence of access roads and the width of the streets in the area, and the availability of utilities. The value would be calculated by the computer, based on the data fed into it. Once the benchmark value is established, in each subsequent year, the increase or decrease in the value (i.e., the increase over or decrease from the initially established benchmark value on the revised benchmark value calculated in the previous year) would be determined by the computer, based on the current sales and other data fed into and analyzed by the computer.

A parcel index would be necessary, for no

two parcels, even in a homogeneous district, are the same in every respect. The parcel index would recognize those features of a parcel which are substantially different from the features of other parcels in the area, resulting in a markedly different valuation. An example is the size of the parcel. Although, on the average, the size of the parcels in a homogeneous area might be 7500 square feet, one (or several) parcel in the area might consist of 10,000 square feet, thus substantially differentiating the value of that parcel from the rest. Each year, the index would be applied to the benchmark value for the area to determine the value of the parcel. This calculation would also be done automatically by the computer.

A salient effect of this computerized system would be the elimination of concentration on manual calculation of value and the diversion of the appraiser's attention to a periodic review (say, every four years) of the continuing relevancy and applicability of the factors (and the weights attached to each factor) considered in the establishment of the initial benchmark value and parcel indices for each homogeneous area. Such review need not be concentrated within a short space in any given year but spread out over each fiscal year.

The installation of this computerized system need not be accomplished all at once. In the light of the feature of periodic review of the factors considered in establishing benchmarks and parcel indices, the system might be phased in over several years, such that once all areas in the State are placed within the system a review of the factors for those areas first placed in the computerized system might begin.

### *Recommendations*

*To assist in achieving the objective of uniform and equitable assessment of taxable real property, we recommend as follows:*

1. *The department of taxation review the assessment techniques it now uses and the*

*practices it follows and establish definitive policies and guidelines for assessment. In particular, we recommend that the department do the following:*

*a. Depreciate structures in a manner which systematically takes into account the condition of the structures.*

*b. Avoid the undervaluation of unimproved lands.*

*c. Establish benchmark values and adjustments thereto on a uniform and consistent basis.*

*d. Develop an appropriate construction cost index for each of the different major classes of structures for determining their replacement costs.*

*e. Define "agricultural production" for purposes of taxing land as agricultural land.*

*f. Develop a methodology for a systematic, yearly selection of parcels for reappraisals and deploy appraisers on a rational basis.*

*2. The department of taxation begin the development of a computerized assessment system which will permit assessments of all taxable property on a uniform, annual, and systematic basis.*

### **Inefficient Use of EDP Services**

The department of taxation utilizes the computer services of the electronic data processing division of the state department of budget and finance in some of the department's real property activities. Some problems in using the State's EDP system are described below.

**Inaccurate EDP data.** One of the services provided by the EDP division is processing property assessment notices. All information required to process each assessment notice, i.e.,

the tax key number, land area, land use code, assessed valuation of the building and land, amount of property exemption, and net taxable value, is supposedly contained in a computer master file. However, the tax department personnel find it necessary to examine each assessment notice and compare it with the information contained in the department's field history book before the notice is mailed out to the landowner. This is a time-consuming and costly operation.

The same time-consuming and costly examination is conducted by the department with respect to exemptions. Each homeowner is entitled to an exemption from real property taxes on a portion of the assessed value of his property. For such an exemption to be effective, the homeowner must file a claim for exemption. The claim, once allowed, remains continuously in effect until a change occurs affecting the exemption—e.g., change in ownership, a change from residential use to rental, and a change in the amount of the exemption due to the age of the owner. Once each year, the EDP system prepares a list of all exemptions, using the information stored in the computer master file. The department of taxation finds it necessary to compare each item on the list with the individual claims on file to determine the accuracy of the list.

That such time-consuming and costly examination of the assessment notices and the master exemption list is necessary bespeaks of deficiencies in data input. Obviously, little confidence is placed by the department of taxation on the accuracy of the data in the EDP master file. The exact nature of these deficiencies is difficult to pinpoint, but that they do exist is clear. Even such a simple computer operation as calculating the new value of existing buildings through the use of the construction cost index appears to result in erroneous building assessed valuation figures on the assessment notices outprinted by the EDP system.

A possible remedy to ensure the accuracy of the data in the EDP master file is for the department of taxation to institute controls over the data at the time of their input. One form of such controls is the "batch control" system. Under this form of control, batches of input data are selected and manually totaled before their input into the computer. After data input and completion of the EDP process, the batch totals computed by the EDP are compared with the department's pre-input totals to verify that they are the same. Batch totals may be calculated for the dollar amounts (e.g., assessed values, exemption amounts) and for the quantities (e.g., square footage) involved. They can be calculated for figures which may have no collective significance other than for data input control purposes (e.g., total tax key numbers).

*Recommendations.* We recommend that the department seek to identify the points at which errors in data input are being made and take corrective measures to ensure the accuracy of the data on the EDP master file. We further recommend that the department install data input controls, such as the batch control system, to assist in ensuring the accuracy of the data in the master file.

**Inefficient updating of the EDP master file for real property tax exemptions.** With regard to home exemptions, changes in the EDP master file are made once a year and not as those changes occur during the year. The changes in the master file are made over a two-month period, beginning in April or May.

One reason why the changes take so long to be made is, as pointed out above, the inaccuracy of the data in the master file. This requires the department of taxation to check each item in the file and compare it with the individual exemption claims on file with the department. If the department could be assured of the accuracy of the data in the master file, it could concentrate solely on those parcels of land involving changes in exemption status, rather than on all of the items on the master list.

Another reason why it takes so long to update the exemption data is that changes in the EDP master file are made once a year, rather than periodically as changes occur. Making changes in the master file as they occur would not only speed up the process but would also minimize the chances of error in data input and the chances of individual claims for exemption being misplaced or lost.<sup>11</sup>

Finally, updating the EDP master file on exemptions takes time because the department manually calculates for each change in exemption status the respective portions of the total exemption to be allocated to building and to land. The many hours spent on this task can easily be eliminated if the computer were programmed to automatically make the calculations.

*Recommendations.* We recommend that the department update the EDP master file on home exemptions as changes occur rather than once a year, and that calculation of the amount of each exemption to be allocated to building and the amount to be allocated to land be automated.

**Inefficient processing of real property tax bills.** Real property tax bills are prepared by the computer. Each time the bills are prepared, the computer generates a master list of the amount due from each taxpayer. As real property taxes are collected, data from the tax bills are entered into the computer to update the master receivable listing. For placement into the computer, the data are first keypunched from the bills onto cards. The cards are then placed into a card reader which transfers the information onto a magnetic tape or disk.

<sup>11</sup> This has occurred in the past. The state ombudsman, in his report, *Report of the Ombudsman, State of Hawaii, For the period July 1, 1973-June 30, 1974*, Report No. 5, pp. 109-110, states that a homeowner complained that, although he had filed a claim for exemption in 1969, he had not received the home exemption for four years (1970-71 to 1973-74). The department advised the homeowner that no claim was on file with the department. Upon intervention by the state ombudsman, a search was made of the files by the department and the claim was located. The department was required to refund the homeowner the real property tax he paid on the home exemption portion for the four years, plus interest.

Approximately 3000 manhours are spent annually in the keypunch operation. There are alternatives which make it unnecessary to perform this time-consuming keypunch operation. Two of these are described below.

**1. Prepunched billing system.** One alternative is the prepunched billing system. Under this system, all information necessary to be on the bill, i.e., the property owner's name and address, tax key number, land use code, district, and amount of the tax payable are not only printed but keypunched onto the bill by the computer. The bill (or a portion of it) is required to be returned with the tax payment. Upon receipt of the tax payment, the prepunched card is used to automatically update the receivable listing. The issuance of prepunched bills would by-pass the need to manually keypunch data at the time of collection.

**2. Optical character system.** Another alternative is the use of optical characters, i.e., codes in digit, letter, and symbol form (“\$,” “%,” etc.). Characters are developed for all items necessary to be on the tax bill. The processing procedures are similar to those for a prepunched system. A receivable listing and property tax bills bearing optical characters are generated by the computer. The taxpayer is required to return either the entire bill or a portion of the bill with his payment. Upon receipt of the payment, the returned bill is processed through the computer. The characters on the bill are interpreted by an optical reader (a computer input device) and converted into machine-readable form, and the real property receivable listing is automatically updated.

*Recommendation.* We recommend that the department explore the prepunched billing system and the use of optical characters as possible alternatives to eliminate the need for performing the time-consuming task of keypunching collection data.

## Problems in Recovering Costs of Administering the Real Property Tax Program

Real property taxes collected by the State are remitted to the counties for their use. However, the Hawaii Revised Statutes requires the department of taxation to recover from the counties all costs associated with administering the real property tax program. Section 246-50, HRS, states:

“The costs of assessment and collection of real property taxes for the preceding tax year shall be withheld from payment to the several counties by the State out of the real property taxes collected for the current tax year in reimbursement of the costs of the assessment and collection incurred by the State.”

Section 246-50 further states:

“ . . . the costs of assessment and collection of real property taxes shall include any and all costs, direct and indirect, which are deemed necessary and proper to administer this chapter [on real property taxes].”

In fiscal year 1972-73, the department charged the counties, in the aggregate, the sum of \$1,736,180 as costs for administering the real property tax program. Of this sum, \$1,074,707 was for direct costs and \$661,473, for indirect costs.

**Questionable allocation of indirect costs.** Indirect costs are costs which are not attributable to the real property tax program alone. An example is the salaries of cashiers in the collection division, who process not only real property tax receipts but other tax receipts as well. Another example is the cost of stationery and supplies which are available and are used for the various tax programs. Thus, unlike direct costs, only a portion of the costs is assignable to the real property tax program.

Under current practice, the department allocates to the real property tax program as indirect costs a portion of the costs of the following four organizational units:

- . *Headquarters and field administration*, which provides overall direction and support services in all departmental operations.
- . *Systems and procedures office*, which maintains the department's accounting records, calculates the taxes due, updates tax data, sends assessment notices, bills taxpayers, etc.
- . *Collections division*, which performs the cashiering function for the department and enforces payment of delinquent taxes.
- . *EDP division of the department of budget and finance*, which performs electronic data processing functions for the department.

Various formulas are used in allocating the costs of these units to the real property tax program. Among the formulas used are: ratio of positions, ratio of collections, and actual and estimated time devoted to the real property tax program, all expressed in terms of percentages. The percentage applicable is applied to the total expenditure of an operating unit to derive the amount of the costs of the unit to be assigned to the real property tax program. The formula applied to each operating unit is as follows:

- . *Headquarters*                      Ratio of the number of positions in the unit authorized exclusively for the real property tax program to the aggregate number of positions in the unit authorized for both the real property and income assessment and audit programs

- . *Systems and Procedures*                      Estimate of time devoted to the real property tax assessment function
- . *Collections*                              Ratio of real property taxes collected to all taxes collected
- . *Electronic Data Processing*                      Actual time devoted to the real property tax program

The above-described method of charging indirect costs is deficient in the following respects.

1. *Allocation of collections division's costs.* Allocating the costs of collections on the basis of the dollar amounts collected is inappropriate. There is no direct relationship between the dollars collected and the costs of such collection. It does not cost any more to receive or enforce payment of a large dollar amount than to receive or enforce payment of a small dollar amount. It would be more appropriate, we think, for the collection cost to be allocated on the basis of the volume of collection transactions—that is, on the basis of the ratio of the number of real property tax payments processed to the total number of all tax payments processed.

2. *Allocation of costs of systems and procedures office and EDP division.* Presently, 80 percent of the costs of the systems and procedures office and 75 percent of the charges made by the department of budget and finance's EDP division to the tax department as a whole are allocated to the real property tax program. These percentages have been in effect for many years and data to support these percentage allocations cannot be located. These percentages apparently have not been reviewed for many years to ascertain their continued applicability.

*Recommendation.* We recommend that the department review the formulas it currently uses in determining the indirect costs to be charged

*the counties for the State's administration of the real property taxes. The formulas used should be such as to recover, to the maximum extent possible, the costs actually incurred by the State in administering the real property tax program.*

**Nonallocation of employee fringe benefit costs.** No part of the costs of fringe benefits enjoyed by the department's personnel is presently charged to the counties. Employee fringe benefit costs include the State's contributions to the employees' retirement system, dental and health insurance program, and federal social security program. These costs are a part of personnel costs and therefore so much of them as are attributable should be allocated to the real property tax program. Apparently the reason why no part of these costs is allocated to the real property tax program and charged to the counties is that moneys for these expenditures are budgeted, appropriated, and expended centrally for all state agencies by the department of budget and finance. This should be no excuse.

***Recommendation.** We recommend that the department include the costs of employee fringe benefits in the costs to be charged the counties for administering the real property tax program.*

### **Tax Billing Confusion**

Section 246-47, HRS, states that

"... each tax collector shall mail, postage prepaid, or deliver, each year on or before the billing

dates... to all known persons assessed for real property taxes in his district for such year, respectively, tax bills demanding payment of taxes due from each of them respectively.... The bill, if mailed, shall be addressed to the person concerned at his last known address or place of residence..." [Emphasis supplied.]

Under section 246-3, HRS, real property is assessed only once as of July 1 (at the beginning) of the tax year. Since section 246-47 reads that tax bills shall be sent "to all known persons assessed," the department is sending all tax bills for the tax year to the persons who are assessed at July 1, notwithstanding any change in ownership of the property during the tax year, that is, tax bills are being sent to the new owner's address but with the former owner's name on the tax bill. This procedure has caused much confusion among the taxpayers. Numerous phone calls have been received by the department from taxpayers wanting to know why the previous owner's name is still on the tax bill.

***Recommendation.** We recommend that the department, with the assistance of the state attorney general, seek an appropriate solution to the confusion being created by mailing tax bills addressed to the owner as of July 1, even though ownership has changed during the tax year. If necessary, the department should prepare appropriate legislation allowing it to reflect on its tax bills changes in ownership that occur during the tax year.*

## Chapter 5

### INCOME TAX ADMINISTRATION

This chapter contains our findings and recommendations with respect to income taxes. It is primarily concerned with that aspect of the law and with the policies, practices, and controls relating to the administration of income taxes.

#### Summary of Findings

Our findings, in summary, are as follows:

1. There is inefficiency in refunding overpayments of income taxes to taxpayers.
2. Examination of income tax returns is time-consuming and inefficient.
3. Statutory penalty is not being imposed for underestimating actual estimated income tax liability.
4. The present schedule for payment over to the State of income taxes withheld by employers from the wages of employees is costly to the State.

#### Inefficient Tax Refund Process

The department subjects each individual income tax return which shows an overpayment of taxes to an examination before refunding the overpayment. It views a claim for refund as it would an invoice or a bill which demands payment by the State. The department rationalizes this practice on the ground that if

there is any error in the return which reduces the claim of overpayment it would be easier to adjust the refund amount before rather than after the refund is made.

We think that subjecting each return which shows an overpayment of taxes to an examination before actual refund is inefficient. Taxpayers who file returns showing tax liability are equally apt to make errors on their returns as those taxpayers who file returns showing refunds due. There is no reason to consider that all returns containing refund claims are more prone to error. Indeed, examining before payment every return which shows a refund due is costing the State interest on late payments of refunds. Section 231-23(e)(1) of the Hawaii Revised Statutes provides that:

“... interest shall be allowed and paid [on late refunds] at the rate of two-thirds of one per cent for each calendar month or fraction thereof, beginning with the first month after the due date of the return and continuing until the date that the director approves the refund voucher. If the director approves the refund voucher within ninety days from the due date or the date the return is received, whichever is later, and the comptroller of the State sends the taxpayer a refund warrant within forty-five days from the date of the director's approval, no interest on the overpayment will be allowed or paid.

However, if either the director or the comptroller exceeds the time allowed herein, interest will be computed from the due date of the return until the date that the comptroller sends the refund warrant to the taxpayer.”

As of August 20, 1974, approximately \$20,000 in interest was paid on refunds of 1973 individual income tax overpayments (the returns for which were required to be filed with the State by April 20, 1974). Interest on “late” refunds was also paid in previous years. This payment of interest can be avoided by refunding first, and then examining the return. Collection of a refund overpayment, if that should happen to be the case upon later examination of the return, should pose no particular difficulty to the department.

*Recommendation.* We recommend that the department discontinue its practice of subjecting each return which shows an overpayment of taxes, to an examination before refunding the overpayment to the taxpayer.

### Inefficient Tax Return Examinations

One of the functions performed by departmental personnel is the examination of tax returns. The returns are reviewed for mathematical accuracy, completeness, obvious or apparent errors in interpretation of the tax law, and questionable income reported or deductions claimed on the returns. This function is presently performed manually. In the light of the number of returns filed, departmental personnel expend many thousands of hours yearly in examining tax returns, including relatively simple returns.<sup>1</sup> This is an inefficient way to perform the function.

It is time for the department to computerize the examination of tax returns in much the same manner as does the federal Internal Revenue Service. Verification of mathematical computations is especially amenable to computerization. Indeed, with a

computer, every return could be checked for mathematical accuracy. However computerization should go beyond simply checking the mathematical accuracy of returns. The computer design should include the capability of scanning all returns and ejecting returns with unusual or abnormal kinds and amounts of income reported or deductions claimed. The ejected returns would be prime candidates for audits.

A computerized system should also be able to generate useful statistics on a current basis. For example, it could issue data on the relative distribution of income among taxpayers of different family sizes. Statistics of this sort could be of value to decision-makers such as the legislators in considering the economic impact of changes in the tax structure. The department presently compiles statistical data on the income of individuals, proprietorships, and corporations, and publishes a report annually entitled, *Hawaii Income Patterns*, for each class of taxpayers. This report, however, is of very limited value since it is published two to three years after the end of each tax year. To be useful, the statistics need to be current.

*Recommendation.* We recommend that the department secure the services of the electronic data processing division of the department of budget and finance to design and implement an EDP system which would make it unnecessary for departmental personnel manually to review the various tax returns. The system design should also include the capability to scan the tax returns for unusual or abnormal income amounts and deductions and to generate useful statistics on a current basis.

<sup>1</sup>Returns categorized as “relatively simple” are those which can be reviewed rather quickly and without extensive effort. This would primarily include returns of taxpayers whose principal source of income is their wage and whose deductions are the common type of deductions claimed by most taxpayers.

## Nonenforcement of Penalty on Underpayment of Estimated Income Taxes

Under section 235-97, HRS, individuals who are self-employed and whose incomes are not subject to withholding for taxes or who receive income from sources such as interest, dividends, and rentals must file early in the taxable year a declaration of the tax estimated to be payable for the year and pay the estimated tax on a quarterly basis during the year. The total estimated tax paid must equal at least 70 percent of the actual tax liability for the year. All corporations are also required to file declarations of estimated tax and to pay the estimated tax in two installments. The total corporate estimated tax paid must equal at least 50 percent of the actual tax liability for the year. The statute prescribes a penalty of 8 percent per annum on any underpayment of the required percentage of the actual tax liability. In essence, it is a penalty for underestimating by more than 30 percent.

Our examination of the records and accounts maintained by the department revealed that the penalty for underestimating is not being imposed on individuals and corporations. A review of 100 individual and 50 corporate returns disclosed that 30 taxpayers (15 individuals and 15 corporations) underestimated their actual income tax liability by more than 30 percent but were not assessed the penalty as required by law.<sup>2</sup> Penalties are assessed presumably to encourage proper estimation of the actual tax liability and to foster the payment of taxes in amounts as nearly equal to the actual tax liability as possible on a periodic basis during the year as income is earned, in much the same way as wage earners are required to pay their taxes via withholding as they earn their wages. To fail to impose the penalty is to discourage payment of the actual tax liability as income is earned and to discriminate against other taxpayers, including wage earners, who dutifully comply with the law in furtherance of the state objectives.

*Recommendation.* We recommend that the department enforce the penalty provision imposed by law for underestimation of income taxes payable. In this connection, we recommend that computation of penalty and notification to taxpayers of underestimation and underpayment be included in any EDP system designed for the department.

## Costly Scheduling of Payment of Withheld Taxes

By law, every employer is required to withhold from the wages and salaries paid to each of his employees so much thereof as represents the employee's liability to the State for taxes on the income earned. The employer is required to withhold such taxes from each paycheck and on a monthly basis file a return and remit the taxes withheld to the state tax office. Section 235-62, HRS, requires that taxes withheld from wages paid in any month must be remitted to the State by the last day of the following month.<sup>3</sup> This statutory provision works to the benefit of employers and to the detriment of the State.

An employer is able to retain (and use) the taxes withheld from employees for a period ranging from one month to seven weeks before payment is required to be made to the State. The period of retention depends upon the payroll period of the employer (that is, weekly, biweekly, semimonthly, or monthly). During this period, the State is denied the use or benefit of the moneys withheld. This denial of use of the moneys is costly to the State. The longer the employer retains the moneys withheld, the higher is the imputed cost to the State—that is, the longer the State is denied the opportunity to invest the moneys which belong to it, with a consequent greater loss in investment earnings.

<sup>2</sup>The review disclosed four additional corporations that underpaid their estimated taxes but voluntarily remitted the penalty payment.

<sup>3</sup>Employers withholding taxes in the amount of \$500 or less per year may file returns on a quarterly basis.

In the case of federal income taxes, the frequency with which payments must be made by employers on taxes withheld from wages paid to employees depends upon the amount of the taxes withheld within a specified period. The frequency increases as the amount of the taxes withheld increases. For example, employers withholding taxes in an amount over \$200 per quarter but less than \$200 per month are required to remit the taxes withheld by the 15th day after the end of the month in which the taxes are withheld. However, if the employer withholds taxes in an amount equal to \$2000 or more each month, he must remit the withheld sums on a weekly basis and within three banking days following the end of each week. With minor exception, payments are deposited in a federal reserve bank or authorized commercial bank and are accompanied by a federal tax deposit form. The form is divided into two parts, the deposit form and a detachable stub which serves as the employer's deposit record. Before making a payment, the employer enters the amount of the payment on the form and stub and records the check or money order number and date on the stub. The stub is detached and the deposit form and the remittance are mailed or delivered to the bank. Timeliness of each deposit is determined by the date of receipt stamped on the form by the

bank. This federal system, unlike that of the State, enables the federal government to gain maximum use of withheld taxes.

During FY 1973-74, the State collected approximately \$144.6 million in withheld taxes. Assuming a monthly average withholding of \$12 million, at the rate of 6 percent per annum, the State could have earned in interest on each month's withheld taxes approximately \$650,000, if the taxes had been required to be paid over to the State within three days after the end of each month. Interest earnings could have been even more if employers withholding above a certain sum had been required to turn over the withheld amounts on a weekly basis.

We believe that the statute should be amended to enable the State to recover withheld taxes sooner than the last day of the month following the month in which the taxes are withheld.

*Recommendation. We recommend that the statute be amended to enable the State to receive the taxes withheld by employers on a more frequent basis. The larger the amount of withheld taxes in any given month, the more frequent should be the payments made to the State.*

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**PART III**

**FINANCIAL STATEMENTS**

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## Chapter 6

### FINANCIAL STATEMENTS AND ACCOUNTANTS' OPINIONS

This chapter contains the results of an examination of the financial statements of the department of taxation for the fiscal year July 1, 1973 to June 30, 1974, including those statements related to the collection of tax revenues and the expenditure of amounts appropriated to the department for administering the State's tax programs. The examination was conducted by Coopers and Lybrand, a certified public accounting firm. Notes explaining the various financial statements, the opinions of the accounting firm regarding the accuracy of the financial statements, and displays of the financial statements of the general fund and trust and agency funds administered by the department are set forth as appropriate.

#### Accountants' Opinion

Upon examination of the financial statements and related financial transactions for the fiscal year 1973-74, Coopers and Lybrand concluded that the financial statements were reasonably accurate and in conformity with generally accepted accounting principles. It filed the following statement with the legislative auditor:

"To the Legislative Auditor  
State of Hawaii  
Honolulu, Hawaii

We have examined the following financial statements of the department of taxation as of June 30, 1974 and for the year then ended:

Statement of Appropriations,  
Expenditures, and Encumbrances—General  
Fund (Exhibit A)

Statement of Revenue—General Fund  
(Exhibit B)

Combined Balance Sheet—Trust and  
Agency Funds (Exhibit C)

Combined Statement of Cash Receipts and  
Deposits—Trust and Agency Funds  
(Exhibit D)

As explained in the general notes to the financial statements, the general fund financial statements (Exhibits A and B) relating to the department of taxation are part of the State of Hawaii general fund and our opinion expressed herein, insofar as it relates to the amounts included for the general fund, is limited to the transactions of the department of taxation only. 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.

In our opinion, the aforementioned financial statements of the department of taxation, State of Hawaii, present fairly the general fund appropriations, expenditures, and encumbrances of the department; the general fund revenues collected by the department; the financial position of the trust and agency funds as of June 30, 1974; and the receipts and deposits of the trust and agency funds for the

year ended June 30, 1974, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

A detail statement of tax operations—all districts (Exhibit E)—showing tax collection activities for the year ended June 30, 1974 is presented primarily for supplemental analysis purposes. The information contained in this statement has been subjected to the same audit procedures applied in the examination of the basic financial statements referred to above and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Coopers & Lybrand  
Certified Public Accountants

Honolulu, Hawaii  
October 18, 1974”

## Descriptions and Definitions

**Description of financial statements.** The following is a brief description of the financial statements examined by Coopers and Lybrand:

**1. Statement of appropriations, expenditures, and encumbrances (general fund).** This statement reflects the funds authorized to be spent by, made available to, and expended, obligated, or lapsed by the department in the year ended June 30, 1974.

**2. Statement of revenue.** This statement shows, by sources of revenue, the amount of general fund revenue that was anticipated to be collected and the amount actually collected by the department during the year.

**3. Combined balance sheet.** This statement discloses the assets, liabilities, and reserves of the department's trust and agency funds as of June 30, 1974.

**4. Combined statement of cash receipts and deposits.** This statement summarizes the cash receipts and deposits of the trust and agency funds during the year.

**5. Detail statement of tax operations.** This statement reflects by types of taxes the amount of revenue collected during the year and the amount recorded as being due but uncollected as of June 30, 1974.

**Definition of terms.** The following technical terms used in this chapter are defined as indicated:

**1. Accrual accounting** — a method of accounting in which revenue is recorded when earned and an expenditure is recorded as soon as a liability results from a benefit received, notwithstanding that the actual receipt of the revenue or the actual payment of the expenditure may take place, in whole or in part, in another accounting period.

**2. Allotment** — an authorization by the director of finance to a state agency to incur obligations and to make expenditures pursuant to an appropriation made by the state legislature.

**3. Appropriation** — a setting aside of money by the state legislature for a specific purpose. Although money may be set aside by the legislature for expenditure by a particular state agency, the agency may not legally expend the sum until it receives an allotment from the director of finance. Appropriations are of two types: (a) those which are available for use until completely expended and (b) those which lapse if not expended or encumbered by the end of the fiscal year.

**4. Cash accounting** — a method of accounting in which revenue is recorded when actually received in cash and an expenditure is recorded when actually paid.

5. **Encumbrance** – earmarking or setting aside a certain sum of money for payment at a future date.

6. **Expenditure** – a disbursement of funds to pay for goods or services received.

7. **Lapsed balance** – the balance of funds authorized but unexpended and uncommitted at the end of a prescribed time period. These funds are available for appropriation by the state legislature in the ensuing fiscal year.

8. **Modified cash accounting** – a method of accounting in which revenue is recorded when actually received and expenditures are recorded when liability is incurred.

9. **Other current expenses** – expenditures other than for personal services, and equipment and capital expenditures.

10. **Personal services** – salaries and wages paid to employees.

11. **Reserve** – an account which sets aside or segregates funds for use in the future, usually for a specific purpose. The funds so set aside are not available for further appropriations.

12. **Transfers** – inter-fund, interdepartment, and other transfers and transactions outside of the agency. Transfers are authorized by the director of finance and/or the governor.

## General Notes to the Financial Statements

Explanatory notes which are pertinent to an understanding of the financial statements and the financial condition of the funds administered by the department are discussed below.

**Accounting principles.** The accounts of the department of taxation are maintained and the accompanying financial statements have been prepared on a modified cash basis of accounting.

Under this method, revenue is generally recognized when actually received and expenditures are recorded at the time liabilities are incurred, except for vacation pay which is recorded when paid. The trust and agency funds record certain uncollected taxes as receivables. However, a related reserve for the collection of these taxes is also recorded, the net effect of which is for revenue to be recognized at the time of collection.

The accounting procedures provide for the recording of expenditure commitments at the time contracts are awarded and orders for equipment, construction, services, and supplies are placed. These commitments are represented as encumbrances in the accompanying financial statements and are necessary to reflect obligations against appropriations. So much of the appropriations made out of the state general fund that are not expended or encumbered by the end of the fiscal year generally lapse.

None of the department's financial statements reflects as "asset" any capital asset constructed or purchased by the department. The cost of any asset acquired is simply recorded as "expenditure" in the year in which the cost is incurred. All capital assets of the State are reflected as "assets" only in the statewide general fixed assets account. The State does not depreciate any asset on its books and hence there is no record of depreciation.

**Fund categories and description.** All of the funds administered by the department are structured to conform to the appropriations and allotments authorized by law. The major funds administered by the department are briefly described below.

1. The **general fund** accounts for all resources not otherwise in other funds. Any activity not financed through another fund is financed through this fund. The annual operating budget as adopted by the legislature provides the basic framework within which the resources and obligations of the general fund are accounted. The general fund of the department

of taxation is a part of the State of Hawaii general fund, and the accompanying general fund financial statements are limited to and reflect only the appropriations, expenditures, and obligations of the department and the general fund revenues collected by the department.

2. *Trust and agency funds* are used to account for all tax revenues collected by the department. These funds function as clearing accounts; that is, the department acts as the central collecting agency for most of the taxes assessed by the State. The collections are subsequently transferred into the state treasury.

**Commitments.** In accordance with the general practice followed by other state agencies, the department does not reflect the accrued and potential liability for vacation and sick leave credits earned by its employees. This is so even though, insofar as vacation is concerned, within certain limitations the employees are entitled to receive cash payments for accrued vacation upon termination of their employment. As of June 30, 1974, employees' accrued vacation totaled approximately \$1,200,000.

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of an illness and is not convertible to pay upon the termination of employment.

All full-time employees of the department are required by section 88 of the Hawaii Revised Statutes to become members of the employees' retirement system of the State of Hawaii, a contributory retirement system. The department's and other state agencies' share of the retirement expense for the fiscal year ended June 30, 1974 was included in the general appropriation bill as an item to be expended by the department of budget and finance and is not reflected in the tax department's financial statements.

**Legislative appropriations.** Funds for the department of taxation totaled \$4,694,784 for the 1973-74 fiscal year. These funds were appropriated from the general revenues of the State and were authorized under the following appropriations:

	<u>1973-74</u>
Act 218, Session Laws, 1973	\$4,681,804
Act 53, Session Laws, 1974	1,149
Section 40-35, HRS	<u>11,831</u>
	<u>\$4,694,784</u>

**Note to the Statement of Revenue-General Fund (Exhibit B).** The statement of revenue reflects the revenue (other than taxes) collected by the department in behalf of the State and credited to the state general fund. They consist mainly of fees. The authority to collect these fees is covered by the various sections of the Hawaii Revised Statutes.

**Note to the Combined Balance Sheet-Trust and Agency Funds (Exhibit C)**

1. *Taxes receivable.* The department has consistently followed the practice of reflecting as receivables in its financial statements the amounts due the State by taxpayers on account of certain types of taxes. The taxes which when due are so reflected include individual and corporate net income, franchise, public service companies, and real property taxes. However, amounts which are due on account of other taxes are not so reflected in the financial statements. These include the amounts due on account of the estimated income, general excise, use, fuel, liquor, tobacco, inheritance and estate, and withholding taxes. Accordingly, exhibit C does not reflect as receivables approximately \$8,400,000 in taxes which were due the State as of June 30, 1974.

Although the nonreflection of any of the taxes due the State does not provide the reader of the department's financial statements with a complete picture of what moneys are receivable

by the State, the inclusion or noninclusion in the financial statements of any or even all of the taxes due is of little consequence. This is because the State is on the cash basis insofar as revenues are concerned. In planning, programming, and budgeting, the State looks to actual collection, not to what is receivable. Indeed, the financial statements are structured to emphasize this cash basis of accounting for revenues. Thus, for example, in exhibit C, the amount shown as "receivables" in the "assets"

section of the statement is offset (and this is always done) by an "unrealized receivables reserve" entry in the "liabilities and reserves" section of the statement in exactly the same amount.

2. *Reserves.* The reserves represent contra-accounts to the related asset balances. The reserve for taxes paid under protest accounts for unsettled cases pending final determination of tax liability.

STATE OF HAWAII  
DEPARTMENT OF TAXATION

EXHIBIT A

GENERAL FUND

Statement of appropriations, expenditures, and encumbrances  
for the year ended June 30, 1974

	AUTHORIZATIONS						
	June 30, 1973 Encum- brances forwarded	Appro- priations	Trans- fers and other items	Total	Expendi- tures	Encum- brances	Lapsed balances
<i>OPERATIONS</i>							
<i>General administration</i>							
Personal services . . . . .	\$ 2,820	\$ 477,972	\$ 77,621	\$ 558,413	\$ 542,212	\$ 971	\$ 15,230
Other current expenses . . . . .	10,680	487,910	(180,810)	317,780	229,110	4,237	84,433
Total general administration . . . . .	13,500	965,882	(103,189)	876,193	771,322	5,208	99,663
<i>Property tax assessment</i>							
Personal services . . . . .	—	1,122,284	186,658	1,308,942	1,240,450	3,578	64,914
Other current expenses . . . . .	1,094	60,469	—	61,563	49,607	4,965	6,991
Total property tax assessment . . . . .	1,094	1,182,753	186,658	1,370,505	1,290,057	8,543	71,905
<i>Income assessment and audit</i>							
Personal services . . . . .	—	1,705,490	45,294	1,750,784	1,702,891	48	47,845
Other current expenses . . . . .	1,348	53,183	—	54,531	46,921	1,273	6,337
Total income assessment & audit . . . . .	1,348	1,758,673	45,294	1,805,315	1,749,812	1,321	54,182
<i>Collections</i>							
Personal services . . . . .	—	651,082	124,270	775,352	758,960	70	16,322
Other current expenses . . . . .	4,452	36,744	(1,000)	40,196	34,802	930	4,464
Total collections . . . . .	4,452	687,826	123,270	815,548	793,762	1,000	20,786
<i>Tax research &amp; planning</i>							
Personal services . . . . .	—	73,153	17,167	90,320	90,103	—	217
Other current expenses . . . . .	—	5,499	1,000	6,499	5,811	121	567
Total tax research & planning . . . . .	—	78,652	18,167	96,819	95,914	121	784
<i>Tax appeals board</i>							
Personal services . . . . .	—	8,018	—	8,018	6,511	—	1,507
Total operations . . . . .	20,394	4,681,804	270,200	4,972,398	4,707,378	16,193	248,827
<i>OTHER</i>							
<i>Interest on litigated claims</i>							
Personal services . . . . .	—	11,831	—	11,831	11,831	—	—
<i>Refund of taxes authorized by law</i>							
Personal services . . . . .	—	1,149	—	1,149	1,149	—	—
Total other . . . . .	—	12,980	—	12,980	12,980	—	—
TOTAL GENERAL FUND . . . . .	\$20,394	\$4,694,784	\$ 270,200	\$4,985,378	\$4,720,358	\$16,193	\$248,827

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

## EXHIBIT B

STATE OF HAWAII  
DEPARTMENT OF TAXATION

## GENERAL FUND

Statement of revenue  
for the year ended June 30, 1974

	<u>Actual</u>	<u>Estimated</u>	<u>Actual over (under)</u>
Taxes, licenses and permits			
General excise taxes . . . . .	\$244,308,547	\$238,333,000	\$5,975,547
General excise licenses . . . . .	246,221	240,000	6,221
Net income taxes – individual . . . . .	151,732,334	157,000,000	(5,267,666)
Net income taxes – corporation . . . . .	18,166,034	14,000,000	4,166,034
Public service companies taxes . . . . .	21,167,132	20,400,000	767,132
Liquor permits and taxes . . . . .	11,414,478	11,150,000	264,478
Tobacco licenses and taxes . . . . .	8,304,732	7,780,000	524,732
Franchise taxes – banks and financial corporations . . . . .	3,629,739	4,150,000	(520,261)
Inheritance and estate taxes . . . . .	2,661,186	2,200,000	461,186
Permits, liquid fuel retail dealers . . . . .	2,660	3,000	(340)
Delinquent compensation and dividend taxes . . . . .	1,499	1,000	499
Total taxes, licenses and permits . . . . .	<u>461,634,562</u>	<u>455,257,000</u>	<u>6,377,562</u>
Others:			
Real property administration assessment . . . . .	1,736,180	1,850,000	(113,820)
Grants by the U.S. government for services rendered the employment security program . . . . .	35,532	11,760	23,772
Sale of maps and prints . . . . .	20,914	19,800	1,114
Fees for real property tax search . . . . .	2,803	6,850	(4,047)
Interest on delinquent payments on liquid fuel tax . . . . .	2,474	2,000	474
Real property appeal costs . . . . .	2,346	3,000	(654)
Fees for certified copies of tax returns . . . . .	2,236	1,880	356
Fees for certified copies of real property assessment notices . . . . .	1,047	700	347
Vacation earned with other funds and agencies . . . . .	598	–	598
Witness or juror fees . . . . .	287	–	287
Escheat unclaimed moneys and cash overages . . . . .	49	–	49
Tax appeal court costs . . . . .	1	1,500	(1,499)
Sale of publications . . . . .	–	120	(120)
Total others . . . . .	<u>1,804,467</u>	<u>1,897,610</u>	<u>(93,143)</u>
Total revenue . . . . .	<u>\$463,439,029</u>	<u>\$457,154,610</u>	<u>\$6,284,419</u>

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

STATE OF HAWAII  
DEPARTMENT OF TAXATION

## TRUST AND AGENCY FUNDS

Combined balance sheet—June 30, 1974

	TAXATION DISTRICT				Total all districts
	First	Second	Third	Fourth	
<i>ASSETS</i>					
Cash:					
Imprest and change funds	\$ 3,025	\$ 650	\$ 1,000	\$ 250	\$ 4,925
Cash collections to be deposited in state treasury	9,889,366	30,973	261,788	70,651	10,252,778
Total cash	<u>9,892,391</u>	<u>31,623</u>	<u>262,788</u>	<u>70,901</u>	<u>10,257,703</u>
Receivables:					
Current —					
Income — corporation	7,002	50	373	1,031	8,456
Income — individual	301,850	29,102	24,502	15,258	370,712
Franchise	543,351	730	—	1,911	545,992
Public service	6,717,267	559,936	618,777	256,843	8,152,823
Real property	623,934	136,989	603,613	95,595	1,460,131
Total current	<u>8,193,404</u>	<u>726,807</u>	<u>1,247,265</u>	<u>370,638</u>	<u>10,538,114</u>
Delinquent —					
Income — corporation	45,013	3,556	7,085	775	56,429
Income — individual	2,183,678	70,728	116,747	24,445	2,395,598
Franchise — financial corporations	6,672	—	—	—	6,672
Public service	808,255	27,855	29,169	6,823	872,102
Real property	256,227	79,304	435,659	25,736	796,926
Total delinquent	<u>3,299,845</u>	<u>181,443</u>	<u>588,660</u>	<u>57,779</u>	<u>4,127,727</u>
Total receivables	<u>11,493,249</u>	<u>908,250</u>	<u>1,835,925</u>	<u>428,417</u>	<u>14,665,841</u>
Taxes paid under protest — unsettled	<u>1,814,862</u>	<u>417,011</u>	<u>11,123</u>	<u>239,060</u>	<u>2,482,056</u>
Total assets	<u>\$23,200,502</u>	<u>\$1,356,884</u>	<u>\$2,109,836</u>	<u>\$738,378</u>	<u>\$27,405,600</u>
<i>LIABILITIES AND RESERVES</i>					
Due to state general fund — imprest and change funds	\$ 3,025	\$ 650	\$ 1,000	\$ 250	\$ 4,925
Due to state treasury — cash collections to be deposited	9,889,366	30,973	261,788	70,651	10,252,778
Reserves:					
Unrealized receivables	11,493,249	908,250	1,835,925	428,417	14,665,841
Taxes paid under protest — unsettled	<u>1,814,862</u>	<u>417,011</u>	<u>11,123</u>	<u>239,060</u>	<u>2,482,056</u>
Total liabilities and reserves	<u>\$23,200,502</u>	<u>\$1,356,884</u>	<u>\$2,109,836</u>	<u>\$738,378</u>	<u>\$27,405,600</u>

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

EXHIBIT D

STATE OF HAWAII  
DEPARTMENT OF TAXATION

TRUST AND AGENCY FUNDS

Combined statement of cash receipts and deposits  
for the year ended June 30, 1974

	TAXATION DISTRICT				Total all districts
	First	Second	Third	Fourth	
Cash balance, July 1, 1973	\$ 7,558,759	\$ 131,975	\$ 202,894	\$ 228,933	\$ 8,122,561
Additions:					
Taxes collected, net of refund payments	553,934,586	27,416,757	38,683,807	13,399,380	633,434,530
Protested taxes collected	<u>1,811,267</u>	<u>271,112</u>	<u>162</u>	<u>96,945</u>	<u>2,179,486</u>
	<u>555,745,853</u>	<u>27,687,869</u>	<u>38,683,969</u>	<u>13,496,325</u>	<u>635,614,016</u>
	<u>563,304,612</u>	<u>27,819,844</u>	<u>38,886,863</u>	<u>13,725,258</u>	<u>643,736,577</u>
Deduction:					
Deposits to state treasury, net of refund payments	<u>553,412,221</u>	<u>27,788,221</u>	<u>38,624,075</u>	<u>13,654,357</u>	<u>633,478,874</u>
Cash balance, June 30, 1974	<u>\$ 9,892,391</u>	<u>\$ 31,623</u>	<u>\$ 262,788</u>	<u>\$ 70,901</u>	<u>\$ 10,257,703</u>

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

STATE OF HAWAII  
DEPARTMENT OF TAXATION

## TRUST AND AGENCY FUNDS

Detail statement of tax operations—all districts  
for the year ended June 30, 1974

Kind of tax	Total unsettled taxes June 30, 1973	Revenue recorded				Balance, June 30, 1974			
		Billings	Receipts collected exclusive of protested payment	Tax appeals settlements	Adjustment and transfer of delinquent taxes	Authorized reductions	Total	Protested payments in escrow	Unsettled taxes receivables
Accrued taxes:									
Current—									
Income—corporation	\$ 5,439	\$ 3,921,007	\$ 3,847,242	\$ —	\$( 68,255)	\$( 2,493)	\$ 8,456	\$ —	\$ 8,456
Estimated income—corporation	—	14,743,626	14,743,626	—	—	—	—	—	—
Income—individual	341,986	15,352,805	14,838,840	81	( 463,733)	( 20,343)	371,794	1,082	370,712
Estimated income—individual	—	19,585,643	19,585,643	—	—	—	—	—	—
Taxes withheld on wages	—	116,411,452	116,411,452	—	58	—	58	58	—
Franchise—financial corporations	461,280	3,851,669	3,764,306	—	( 2,650)	—	545,993	—	545,993
Public service	6,990,698	21,956,672	20,581,839	—	( 191,276)	( 21,432)	8,152,823	—	8,152,823
Real property	3,048,572	120,568,588	117,308,243	19,182	(3,006,635)	( 472,646)	2,810,454	1,350,323	1,460,131
Real property appeal cost	2,421	2,775	—	921	( 3,066)	—	1,209	1,209	—
Total current	<u>10,850,396</u>	<u>316,394,237</u>	<u>311,081,191</u>	<u>20,184</u>	<u>(3,735,557)</u>	<u>( 516,914)</u>	<u>11,890,787</u>	<u>1,352,672</u>	<u>10,538,115</u>
Delinquent—									
Income—corporation	78,111	330,825	(435,687)	10,853	( 769,699)	( 3,995)	60,076	3,647	56,429
Income—individual	2,192,318	1,208,434	884,417	11,901	( 41,551)	( 40,053)	2,422,830	27,232	2,395,598
Franchise—financial corporations	(2)	6,702	(134,566)	—	( 131,490)	( 3,104)	6,672	—	6,672
Public service	1,523,166	495,753	403,318	181,974	( 561,450)	( 75)	872,102	—	872,102
Real property	3,567,887	272,007	886,571	3,648,139	3,009,002	(1,124,678)	1,189,508	392,583	796,925
Real property appeal cost	1,122	—	(3)	1,428	1,311	—	1,008	1,008	—
Total delinquent	<u>7,362,602</u>	<u>2,313,721</u>	<u>1,604,050</u>	<u>3,854,295</u>	<u>(1,506,123)</u>	<u>(1,171,905)</u>	<u>4,552,196</u>	<u>424,470</u>	<u>4,127,726</u>
Total accrued taxes	<u>18,212,998</u>	<u>318,707,958</u>	<u>312,685,241</u>	<u>3,874,479</u>	<u>(2,229,434)</u>	<u>(1,688,819)</u>	<u>16,442,983</u>	<u>1,777,142</u>	<u>14,665,841</u>
Unaccrued taxes:									
General excise and use	1,537,816	243,323,816	243,323,618	984,930	124,998	—	678,082	678,082	—
General excise licenses	—	235,251	235,251	10,568	10,568	—	—	—	—
General excise registration fees	—	403	403	—	—	—	—	—	—
Fuel	—	29,646,733	29,646,733	—	—	—	—	—	—
Fuel permits	—	2,660	2,660	—	—	—	—	—	—
Liquor	9,337	11,405,023	11,405,023	9,337	—	—	—	—	—
Liquor permits	—	118	118	—	—	—	—	—	—
Tobacco	—	8,304,655	8,304,655	—	—	—	—	—	—
Tobacco licenses	—	77	77	—	—	—	—	—	—
Inheritance and estate	25,794	2,660,776	2,660,776	410	1,448	—	26,832	26,832	—
Compensation and dividends	—	1,499	1,499	—	—	—	—	—	—
Total unaccrued taxes	<u>1,572,947</u>	<u>295,581,011</u>	<u>295,580,813</u>	<u>1,005,245</u>	<u>137,014</u>	<u>—</u>	<u>704,914</u>	<u>704,914</u>	<u>—</u>
Other:									
Unemployment insurance contributions	—	25,152,345	25,152,345	—	—	—	—	—	—
Agricultural unemployment insurance	—	16,068	16,068	—	—	—	—	—	—
Temporary disability insurance	—	64	64	—	—	—	—	—	—
Total other	<u>—</u>	<u>25,168,477</u>	<u>25,168,477</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$19,785,945</u>	<u>\$639,457,446</u>	<u>\$633,434,531</u>	<u>\$4,879,724</u>	<u>\$(2,092,420)</u>	<u>\$(1,688,819)</u>	<u>\$17,147,897</u>	<u>\$2,482,056</u>	<u>\$14,665,841</u>

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

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**PART IV**

**RESPONSE OF THE AFFECTED AGENCY**

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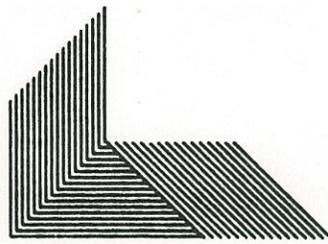
## COMMENTS ON AGENCY RESPONSE

A preliminary copy of this financial audit was transmitted to the department of taxation for its comments on the findings and recommendations contained in the report.

A copy of the transmittal letter to the department is included as attachment 1 of this part. Its response is included as attachment 2.

The department expresses no disagreement with any of the findings and recommendations in the audit report. We are pleased to note the department has taken initial steps to correct and improve some of its administrative and operational practices. The audit revealed the need for computerization of activities which are being performed inefficiently at the present time and we are particularly encouraged that the department intends to expand its use of electronic data processing equipment for its operations. We believe the department should vigorously pursue its efforts in this direction.

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



ATTACHMENT NO. 1

CLINTON T. TANIMURA  
AUDITOR

RALPH W. KONDO  
DEPUTY AUDITOR

August 7, 1975

Mr. Gordon Y. H. Wong, Director  
Department of Taxation  
State of Hawaii  
Honolulu, Hawaii

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Dear Mr. Wong:

Enclosed is a copy of our preliminary report on the *Financial Audit of the State Department of Taxation*. The term "preliminary" indicates that the report has not been released for general distribution. However, copies of this report have been forwarded to the Governor and the presiding officers of both houses of the legislature.

The report contains a number of recommendations to which I would appreciate receiving your written comments. Please have your comments submitted to us by August 21, 1975. 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 August 14, 1975. 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 staff to our auditors.

Sincerely,

/S/ CLINTON T. TANIMURA

Clinton T. Tanimura  
Legislative Auditor

Enclosure



ATTACHMENT NO. 2

GEORGE R. ARIYOSHI  
GOVERNOR

RECEIVED

GORDON Y. H. WONG  
DIRECTOR OF TAXATION

DEPARTMENT OF TAXATION  
STATE OF HAWAII

Aug 21 3 44 PM '75  
OFF. OF THE AUDITOR  
STATE OF HAWAII

STANLEY D. SUYAT  
DEPUTY DIRECTOR

Honolulu, Hawaii  
August 21, 1975

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

Dear Mr. Tanimura:

Thank you for your letter dated August 7, 1975 and the copy of the preliminary report on the Financial Audit of the State Department of Taxation for the fiscal year ended June 30, 1974.

The findings and recommendations of the audit are most welcome and merit serious and more detailed consideration. We are already cognizant of many of the problem areas and deficiencies set forth regarding the operational and administrative practices of the department as a result of personal visits to observe tax operations in all district offices, meetings with my staff and other personnel, and the efforts of the department's S.T.O.P. team. Early this year, the department established a 7-member S.T.O.P. (Survey Tax Office Practices) team consisting of knowledgeable tax office personnel in order to study and evaluate in detail tax office practices and to suggest some alternative solutions to the problems and deficiencies that present themselves. Following the recently completed first phase of the survey, initial planning sessions have been scheduled in early September to discuss and resolve those problems and deficiencies ascertained during the first phase of the survey.

We are considering a re-organization plan under which each of our three basic programs -- Income, Property and Collections -- will be headed by a program chief on a state-wide basis. This, we feel, will give the department a more coordinated and uniform administration and operation in all three programs.

Representatives from our department recently visited and observed the automated tax operations of the Internal Revenue Service in Fresno, California and the states of Maryland, Nebraska and Minnesota, which have tax systems somewhat similar to Hawaii's. As a result of the information and assistance obtained from these visits, the department hopes to pattern its net income tax program and an integrated accounting system to

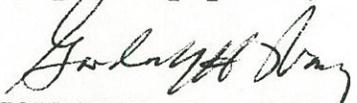
Mr. Clinton T. Tanimura  
Page 2  
August 21, 1975

systems already successfully in operation in these states. Additionally, our General Excise Tax program is scheduled to be automated by mid-1976. We are also in the midst of installing new and improved data-entry equipment which will give us the capability, though limited, of faster communication of certain tax information between the major islands.

In essence, we have already taken prompt and appropriate steps to improve some of our administrative and operational practices. We are continually striving for a more effective and efficient Department of Taxation. Please be assured that your findings and recommendations will be further reviewed and considered in detail. Your recommendations, if feasible, will be implemented as expeditiously as possible. In some instances, consideration must be given to limitations as to space, personnel and equipment requirements. Obviously, a number of your recommendations will not only take time to implement, but also require adequate funding, especially as they relate to the computerization of operations. We firmly believe that the expanded use of electronic data processing and computerization, together with the implementation of a number of your other recommendations will result in a more effective and efficient Department of Taxation.

Thank you for the opportunity to comment on the findings and recommendations of the audit.

Very truly yours,

  
GORDON Y. H. WONG  
Director of Taxation

# PUBLISHED REPORTS OF THE LEGISLATIVE AUDITOR

## AUDIT REPORTS

- 1966 1. Examination of the Office of the Revisor of Statutes, 66 pp. (out of print).
- 1967 1. Overtime in the State Government, 107 pp.  
2. Management Audit of Kula Sanatorium, 136 pp.
- 1968 1. Financial Audit of the Department of Health for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
2. Financial Audit of the Department of Planning and Economic Development for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
3. Financial Audit of the Department of Regulatory Agencies for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
4. Financial Audit of the Department of Hawaiian Home Lands for the Fiscal Year Ended June 30, 1967, 54 pp.  
5. Financial Audit of the Oahu Transportation Study for the Period July 1, 1962 to August 31, 1967, 68 pp.  
6. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1966 to January 31, 1968, 69 pp. (out of print).  
7. State Capital Improvements Planning Process, 55 pp. (out of print).  
8. Financial Audit of the Hilo Hospital for the Fiscal Year Ended June 30, 1967, 43 pp. (out of print).  
9. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1967 to June 30, 1968, 42 pp.
- 1969 1. Financial Audit of the General Fund, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p. (out of print).  
2. Financial Audit of the Judicial Branch, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p. (out of print).  
3. Financial Audit of the State Department of Budget and Finance for the Fiscal Year Ended June 30, 1968, v.p.  
4. General Audit of the Department of Personnel Services, State of Hawaii, 129 pp. (out of print).  
5. A Summary of the General Audit of the Department of Personnel Services, 53 pp.  
6. Financial Audit of the Samuel Mahelona Memorial Hospital for the Fiscal Year Ended June 30, 1968, 34 pp.  
7. Financial Audit of the Honokaa Hospital for the Fiscal Year Ended June 30, 1968, 41 pp.  
8. Financial Audit of the Kohala Hospital for the Fiscal Year Ended June 30, 1968, 34 pp.  
9. Financial Audit of the Kona Hospital for the Fiscal Year Ended June 30, 1968, 44 pp.  
10. Financial Audit of the Kauai Veterans Memorial Hospital for the Fiscal Year Ended June 30, 1968, 30 pp.  
11. An Overview of the Audits of the Act 97 Hospitals, 18 pp.
- 1970 1. Management Audit of the Department of Water County of Kauai, 65 pp.  
2. Audit of the Kamehameha Day Celebration Commission, 47 pp.  
3. Audit of the Medical Assistance Program of the State of Hawaii, 392 pp.
- 1971 1. Financial Audit of the State School Lunch Services Program, Department of Education for the Fiscal Year Ended June 30, 1970, v.p. (out of print).  
2. Audit of the County/State Hospital Program, 124 pp. (out of print).  
3. Audit of the State Vendor Payment Process, 63 pp.  
4. Audit of the Hawaii Educational Television System, 153 pp.
- 1972 1. Audit of the Office of the Public Defender, 39 pp.  
2. Financial Audit of the Department of Agriculture for the Fiscal Year Ended June 30, 1971, v.p.
3. Financial Audit of the Department of Labor and Industrial Relations for the Fiscal Year Ended June 30, 1971, v.p.
4. Audit of Utility Facility Relocation in Street Widening Projects, 73 pp.
5. Audit of the School Construction Program of the State of Hawaii, 297 pp.
- 1973 1. Management Audit of the Department of Education, 410 pp.  
2. Audit of the University of Hawaii's Faculty Workload, 61 pp. (out of print).  
3. Financial Audit of the Department of Education, 73 pp. (out of print).
- 1974 1. Financial Audit of the Department of Regulatory Agencies, 67 pp.  
2. Financial Audit of the State Department of Defense and Civil Air Patrol (Hawaii Wing), 52 pp.
- 1975 1. Financial Audit of the Hawaii Housing Authority, 78 pp.  
2. Program Audit of the School Health Services Pilot Project, 80 pp.  
3. Management Audit of the Public Utilities Program — Vol. I: The Organization for and the General Management of the Public Utilities Program, 154 pp.  
4. Management Audit of the Public Utilities Program — Vol. II: The Regulation of Public Utilities, 193 pp.

## SPECIAL REPORTS

- 1965 1. Long and Short Range Programs of the Office of the Auditor, 48 pp. (out of print).  
2. A Preliminary Survey of the Problem of Hospital Care in Low Population Areas in the State of Hawaii, 17 pp.
- 1966 1. Procedural Changes for Expediting Implementation of Capital Improvement Projects, 9 pp.
- 1967 1. The Large School: A Preliminary Survey of its Educational Feasibility for Hawaii, 15 pp.  
2. State-City Relationships in Highway Maintenance, and Traffic Control Functions, 28 pp.  
3. Manual of Guides of the Office of the Legislative Auditor, v.p.
- 1969 1. Transcript of Seminar in Planning-Programming-Budgeting for the State of Hawaii, 256 pp.  
2. Airports System Financing Through Revenue Bonds, 9 pp. (out of print).  
3. Second Annual Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967 (Relating to State-County Relationships), 13 pp. (out of print).  
4. An Overview of the Governor's 1969-70 Capital Improvements Budget, 61 pp. (out of print).  
5. A Supplementary Report on the Audit of the Hawaii Visitors Bureau, 2 pp. (out of print).
- 1970 1. A Study of the Compensation of Coaches of Inter-scholastic Athletics of the State Department of Education, 31 pp.
- 1971 1. A Study of the State Highway Special Fund, 14 pp.
- 1972 1. A Study of Hawaii's Motor Vehicle Insurance Program, 226 pp.

LEGISLATIVE AUDITOR  
STATE CAPITOL  
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