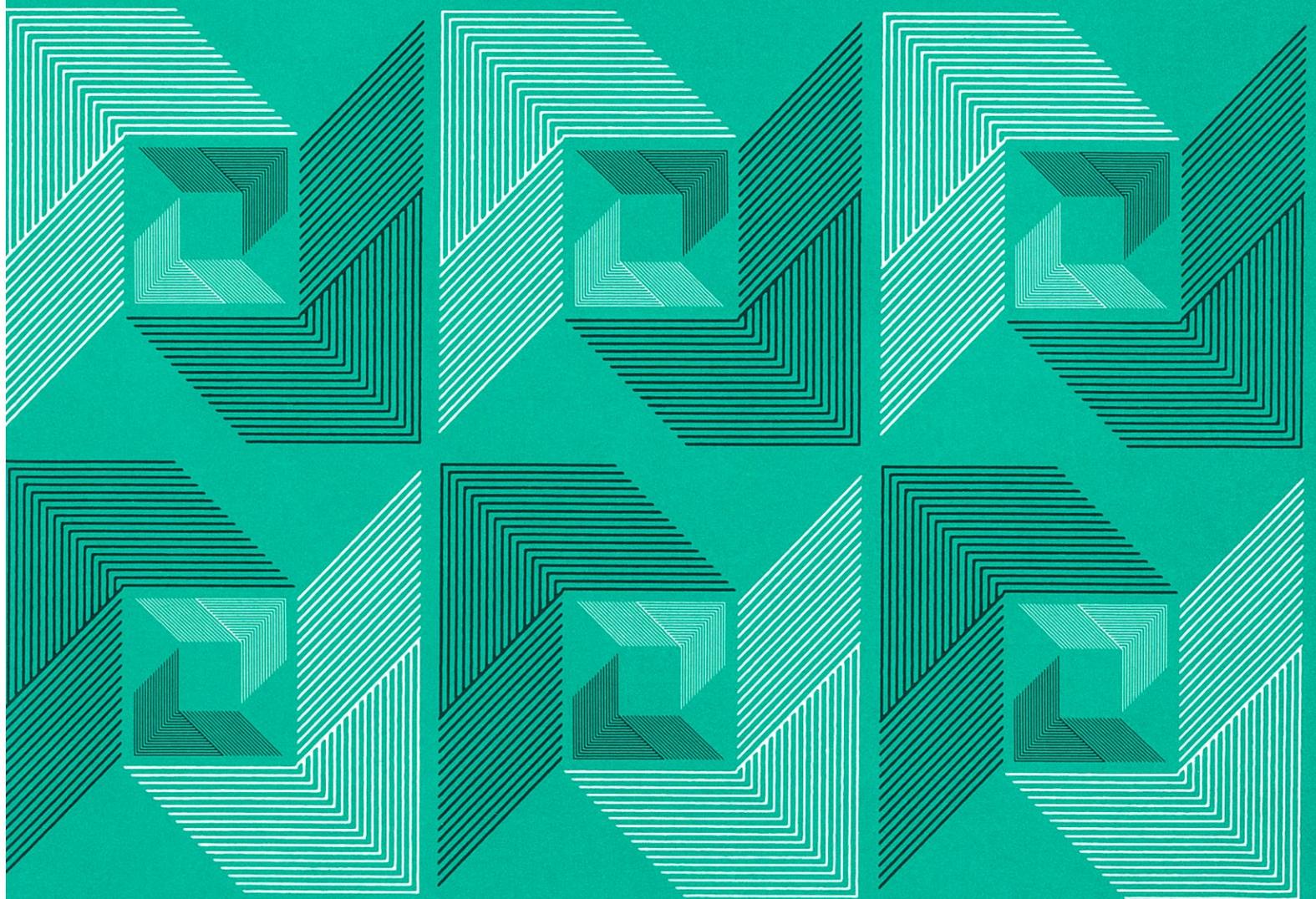


REPORT NO. 82-6
MAY 1982

FINANCIAL AUDIT OF THE DEPARTMENT OF REGULATORY AGENCIES

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



**THE OFFICE
OF THE LEGISLATIVE AUDITOR**

The office of the legislative auditor is a public agency attached to the Hawaii State legislature. It is established by Article VII, Section 10, 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.



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**FINANCIAL AUDIT OF THE
DEPARTMENT OF REGULATORY AGENCIES**

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

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

Report No. 82-6

May 1982

FOREWORD

This financial audit report is the result of an examination of the financial statements and records of the State Department of Regulatory Agencies for the fiscal year ended June 30, 1981. The audit was conducted by the Office of the Legislative Auditor and the CPA firm of Coopers & Lybrand.

This report is divided into three parts. Part I contains an introduction and some background information on the Department of Regulatory Agencies. Part II presents our findings and recommendations regarding the department's financial and accounting practices and displays the department's financial statements, including the audit opinion of the CPA firm on the fairness and accuracy of the department's financial statements. We have followed our customary practice of requesting the agency affected by the audit to comment on the findings and recommendations. Part III contains the Department of Regulatory Agencies' response to this report and our comments on the department's response.

We wish to express our sincere appreciation for the cooperation and assistance extended by the staff of the Department of Regulatory Agencies.

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

May 1982

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PART I

INTRODUCTION AND BACKGROUND

Chapter 1

INTRODUCTION

This is a report of our financial audit of the Department of Regulatory Agencies (DRA).

The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the state auditor to conduct post-audits of all transactions and of all books and accounts kept by or for all departments, offices, and agencies of the State and its political subdivisions.

Objectives of the Audit

The objectives of the audit were:

1. To determine the reasonable accuracy of the financial statements of the Department of Regulatory Agencies.
2. To ascertain whether or not expenditures and other disbursements were made and all revenues and other receipts to which the State is entitled have 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, reporting, and internal

and operational controls, and recommend improvements to such systems and procedures.

Scope of the Audit

This audit examined the financial statements of the DRA for the period July 1, 1980 to June 30, 1981. The audit opinion as to the reasonable accuracy of the financial statements is that of the independent certified public accounting firm of Coopers & Lybrand.

Organization of the Report

This report is organized as follows:

Part I (Chapters 1 and 2) presents this introduction and some background information on the Department of Regulatory Agencies.

Part II (Chapters 3 and 4) presents our audit findings and recommendations on the financial and accounting practices and procedures of the department. It also includes the department's financial statements and the accountants' opinion on such statements.

Part III contains the response of the DRA to our recommendations, together with our comments on the department's response.

Chapter 2

BACKGROUND

This chapter describes the functions, organization, and activities of the Department of Regulatory Agencies (DRA).

Functions of the Department

By law,¹ the DRA is responsible for protecting the interests of consumers, depositors and investors throughout the State. It is responsible for setting standards and enforcing all laws, and rules and regulations governing the licensing, registration, and supervision of trades, businesses, and professions including banks, insurance companies, brokerage firms, and other financial institutions. The department serves as consumer advocate on matters relating to public utilities. In addition, the Hawaii Public Broadcasting Authority is assigned to the department for administrative purposes.

Departmental Organization and Activities

The DRA is headed by an executive officer known as the director of regulatory agencies and the department is organized primarily by type of industry being regulated. A brief description of the organizational units and their activities follows.²

Office of the director. The director is responsible for the general administration of the department including the establishment of departmental policies and organizational plans and the implementation of such policies and

plans and all administrative rules, regulations, and procedures.

Operating units. The operating units and their activities are as follows:

1. **Bank examination division.** This division administers state laws relating to the chartering, licensing, examination, supervision, and regulation of state-chartered banks, international-foreign banking corporations, trust companies, state-chartered savings and loan associations, industrial loan companies, small loan companies, state-chartered credit unions, business development corporations, and escrow depositories.

2. **Community antenna television (CATV).** The CATV division is charged with the responsibility for insuring that quality cable communication services are available to potential subscribers in all locations within the State at reasonable rates. The division issues permits and enforces the rules and regulations governing the practices, procedures, quality, and quantity of services of cable communication companies.

3. **Insurance division.** This division administers the state laws relating to the

1. Section 26-9, HRS.

2. State of Hawaii, Department of Regulatory Agencies, *Major Functions*, July 1, 1981.

licensing, supervision, and regulation of all insurance transacted in the State by insurance companies, insurance agents and nonprofit corporations and associations engaged in insurance transactions. The division is also responsible for administering the medical malpractice patients' compensation fund. Specifically, the division is required to analyze, review, and take action, as required, on insurance company reports, premium rates, insurance contracts, agency operations, and certificates of authority. It is also required to perform field examinations of domestic insurers and rating bureaus and investigate, examine, and license all classes of insurance agents.

4. **Office of Consumer Protection.** This office, assigned to the DRA for administrative purposes, is responsible for protecting consumers and businesses from persons engaged in unfair or deceptive practices. The division investigates consumer complaints, mediates equitable settlements between parties, conducts consumer education programs, and files lawsuits against businesses and individuals engaged in unfair or deceptive business practices.

5. **Business registration division.** The business registration division is responsible for administering state laws relating to corporations, partnerships, registration of trademarks, trade-names, prints and labels, miscellaneous business registrations, charitable organizations, franchises and takeover bids.

6. **Professional and vocational licensing division.** This division provides administrative and technical assistance to some 30 regulatory boards and commissions. Specifically, the division is responsible for reviewing and processing applications for all occupational licenses and license renewals and for maintaining records of licensees. It also develops testing materials, provides technical assistance to the various boards and commissions in the construction of test questions and maintains a system of internal control to ensure that licensees are meeting their respective continuing education requirements.

7. **Public utilities division.** The public utilities division functions on behalf of the director as the State's consumer advocate on public utility matters. The division has the responsibility for representing, advancing, and protecting the interests of consumers of utility services. The division is responsible for conducting investigations, promoting the interests of the consumer in the public utilities field, studying the operations of laws affecting consumers of utility services, and representing the interests of the consumer in public utility matters.

8. **Hawaii Public Broadcasting Authority.** The Authority, assigned to DRA for administrative purposes, is responsible for managing and operating the State's public broadcasting facilities. It produces or otherwise obtains programs for broadcast which are intended to enlighten the people of the State. The affairs and activities of the authority are administered by the board of public broadcasting.

9. **Motor vehicle insurance division.** This division, assigned to the DRA for administrative purposes, administers the Hawaii no-fault insurance law and the state statutes relating to the regulation of motor vehicle insurance. Because of an apparent overlap in the functions of the insurance division and the motor vehicle insurance division, the Legislature, in 1980, amended the state law to provide for the merger of these two divisions. However, this merger had not been effected as of June 30, 1981.

Support offices. Three offices, the Regulated Industries Complaints Office (RICO), the hearings office, and administrative services office provide specialized staff support services to all divisions and boards. The offices and their activities are described below.

1. **Regulated Industries Complaints Office.** This office provides support to the director and divisions within the DRA in resolving complaints. Specifically, RICO directs and maintains a complaint resolution program,

coordinates complaints resolution with other governmental agencies, analyzes and researches trends in consumer complaints and recommends changes to laws, policies, and regulations. For the most part, the activities of this office are directed towards providing staff support to the business registration, bank examination, and professional and vocational licensing divisions.

2. **Hearings office.** This office is responsible for conducting hearings to insure impartial and uniform treatment in the resolution of complaints filed with the department.

3. **Administrative services office.** This office renders fiscal, personnel, and other administrative services to all divisions and offices of the department.

Medical claims conciliation panel. This panel, assigned to the DRA for administrative purposes, provides a means for prompt disposition or settlement of medical tort claims without court action. By statute, any person claiming that a medical tort has been committed must submit a claim to the panel before a suit may be filed in any court. The panel is composed of three members: a person familiar with and experienced in the personal injury claims settlement process, an active trial attorney, and a physician. The chairperson of the panel is appointed by the Chief Justice of the Supreme Court and the attorney and physician are appointed by the panel's chairperson. Each member serves on the panel for a period of one month to hear and decide all claims brought before the panel within that month.

PART II FINDINGS AND RECOMMENDATIONS

PART II
FINDINGS AND RECOMMENDATIONS

Chapter 3

FINANCIAL ACCOUNTING AND INTERNAL CONTROL

This chapter assesses the Department of Regulatory Agencies' (DRA) financial accounting practices and internal control system. Although the focus is on the practices presently followed by the department, this chapter also discusses specific internal control deficiencies reported in our 1968¹ and 1974² financial audit reports of the department which we found have not yet been corrected.

Summary of Findings

Our findings are as follows:

1. The patients' compensation fund has no provision for unpaid and unreported losses resulting from malpractice claims. As a result, the financial position of the fund is not accurately stated.
2. Fees assessed by the various occupational boards and commissions bear no relation to the cost of services rendered.
3. There is inadequate security control over cash receipts.
4. Internal controls over purchase order forms are inadequate.
5. The bank examination division has no manual of instructions or audit programs. In addition, the hourly rates charged for examinations of banks are insufficient and the timelag between completion of bank examinations and preparation of bills is excessive.

6. The cost of employee fringe benefits are not included in the hourly rates charged by the insurance division.

Patients' Compensation Fund

The rising cost of medical malpractice liability insurance for doctors, hospitals and other health care providers and the limited number of insurance carriers providing malpractice coverage in the State prompted the Legislature in 1976 to establish a patients' compensation fund. As intended by statute, the fund offers medical malpractice insurance in excess of \$100,000 to the State's health care providers.

An annual surcharge is levied on all health care providers who participate in the fund. The surcharge is based upon actuarial principles and is levied in terms of a stated percentage of the annual premium paid by the health care provider for the first \$100,000 of malpractice insurance.³

1. Legislative Auditor, State of Hawaii, *Financial Audit of the State Department of Regulatory Agencies*, Report No. 68-3, January 1968.

2. Legislative Auditor, State of Hawaii, *Financial Audit of the State Department of Regulatory Agencies*, Report No. 74-1, March 1974.

3. Under Section 671-37, Hawaii Revised Statutes, no health care provider is permitted to participate in the patients' compensation fund unless the providers first show evidence of medical malpractice insurance in the amount of \$100,000 or a surety bond or other equivalent in the amount of \$100,000.

All moneys are held in trust and all awards and settlements against participants are paid out of the fund. Although the duties of managing the fund are vested by law in the insurance commissioner,⁴ the activities of the fund are being administered by the insurance division.

No provision for losses. At June 30, 1981, the DRA's financial records showed that the balance in the patients' compensation fund totaled \$6,411,170. However, 11 claims that are presently in the process of settlement are not recorded in the department's records. These 11 claims amount to \$5,500,000.

In addition to the \$5,500,000 in unpaid claims, the division has no estimate of claims that have not yet been filed with the department. Such estimates are significant since the law sets no time limit for filing malpractice claims and future losses could adversely affect the fund. In the next chapter we note that the DRA's failure to provide for estimates of losses in the process of settlement and estimates of losses that have not yet been filed with the department were the reasons Coopers & Lybrand could not attest to the fairness of the combined financial statements and the combining trust fund financial statements.

Because there is no provision for losses, the financial statements have given participating health care providers the impression that the fund has \$6,411,170 in resources when in actuality it has only \$911,170 (fund balance of \$6,411,170 less reported and unpaid claims of \$5,500,000). According to the fund administrator, this misleading picture of the fund's financial status has already caused some participants to call for a reduction in the surcharge rate as provided for in Section 671-31(c), HRS.

This section states that:

"If on January 31 of any year the amount of money in the fund exceeds the sum of \$5,000,000 after payment of all claims and expenses and accumulation of appropriate, unencumbered loss reserves in an amount determined by the insurance

commissioner, the insurance commissioner shall reduce or waive the surcharges provided for in this section in order to maintain the fund at an approximate level of \$5,000,000."

In order to present an accurate picture of the fund's financial position and adhere to accounting practices that conform to generally accepted accounting principles, the insurance division should establish reserves in its accounting records for estimates of losses in the process of settlement and estimates of losses that have not yet been filed. The \$5,500,000 in unpaid claims should be reflected in the reserve for losses in the process of settlement. Past experience on the amount filed in each year since 1977 could be used as the basis for estimating the reserve for unfiled claims.

Recommendation. We recommend that the department follow accounting practices that conform to generally accepted accounting principles regarding the recording of estimated losses. Specifically, we recommend that the insurance division earmark \$5,500,000 from the fund's balance, as of June 30, 1981, for the claims that were in the process of settlement. In addition, an amount should be reserved for claims that have not yet been filed.

Occupational Fees

Under Section 26-9 K, HRS, application, examination and license fees assessed by some 30 occupational boards and commissions⁵ may be increased or decreased by the DRA director in order to "maintain a reasonable relation between the revenue derived from the fee and the cost or value of services rendered."

4. Hawaii Revised Statutes, Section 431-31, designates the Director of the Department of Regulatory Agencies as the insurance commissioner.

5. The PVL division also administers 10 regulatory programs which are without boards or commissions. These programs relate to collection agencies, cemeteries, commercial employment agencies, factory built housing, mortgage brokers and solicitors, subdivision registration, time-sharing, solar energy device dealers; fair housing and travel agencies.

Despite the statutorily imposed guideline that fees be related to the cost of providing services, our examination revealed that for the most part, fees assessed by the various boards and commissions bear no relationship to the cost of services performed.

Arbitrary and disparate fees. For the fiscal year ended June 30, 1981, the average⁶ amount in fees collected by the professional and vocational licensing (PVL) division exceeded the cost of services provided to the 30 boards and commissions by \$969,770.

Total fees (Averaged)	\$2,202,122
Allocated costs	\$1,141,589
Other costs	90,763
Total costs	<u>1,232,352</u>
Fees exceeding costs	<u>\$ 969,770</u>

Although the fees collected should at least recover the cost of services provided, an excess of such magnitude suggests disparities between the fees charged and the cost of services rendered.

Table 3.1, the average amount in fees collected by the real estate commission during fiscal year 1980-81 totaled \$951,030. However, because operating costs during this same period amounted to only \$148,596, fees collected exceeded costs by some \$802,434. This means that fees collected by the commission are more than six times its operating costs. Fees collected by the board of medical examiners are about six times more than the board's costs, while fees collected by the contractors license, public accountancy and veterinary examiners boards are 3.0, 1.4, and 1.2 times of costs, respectively.

While the fees collected by the five selected boards and commissions exceed the costs of services provided, this is not the case with some of the remaining 25 boards and commissions.

As shown below, the average amount in fees collected by the remaining 25 boards and commissions during fiscal year 1980-81 amounted to \$572,426. And because the costs associated with these boards and commissions

Table 3.1
Professional and Vocational Licensing Division
Comparison of Average Fees with Related Costs
for Selected Boards and Commissions
for the Year Ended June 30, 1981

	Selected Boards and Commissions				
	Real Estate	Medical Examiner	Contractor	Accounting	Veterinarians
Fees	\$951,030	\$259,481	\$343,455	\$ 71,360	\$ 4,370
Allocated costs	148,596	44,681	113,196	49,258	3,611
Excess fees	\$802,434	\$214,800	\$230,259	\$ 22,102	\$ 759

An examination of five boards and commissions selected, namely, the boards of public accountancy, veterinary examiners, medical examiners, and contractors license, and the real estate commission revealed that fees collected far outdistance the costs. As shown in

6. In order to relate fees, which are collected on a biennial basis to annual operating costs, it was necessary to use an average of the amount collected in fiscal year 1979-80 and fiscal year 1980-81 by the five selected boards and commissions.

amounted to \$782,247, costs exceeded fees by some \$209,821.

Fees	\$572,426
Allocated costs	<u>782,247</u>
Costs exceeding fees	<u>(\$209,821)</u>

Thus, while it appears that the fees assessed by some boards and commissions appear excessive, the fees charged by other boards and commissions are insufficient to cover costs. The disparities in the fees have been a problem that has plagued the division for years and it prompted the Legislature by Act 92, Session Laws of Hawaii 1980, to authorize the DRA director to establish and adjust the various fees charged by the boards and commissions. Previously, fees could only be established and amended by the Legislature. According to the PVL division, the department is unable to set appropriate fee schedules because it is unable to allocate certain kinds of internal service costs to the various boards and commissions, namely, legal services rendered by the State attorney general, general maintenance costs, telephone costs, data processing costs, building allocation costs and clerical support supplied by the department. However, these unallocated costs amounted to only about \$90,000 in fiscal year 1980-81. This is a relatively small amount in relation to the \$1,141,589 which the department is able to allocate to the various boards and commissions. A practical approach would be to allocate internal service costs on the basis of some reasonable guideline, such as the number of licensees in an occupation as a proportion of the total number of licensees in all occupations. This would obviate having to resort to a laborious time tracking and recording system.

Once the division is able to distribute these internal service costs among the various boards and commissions, the department should be able to establish fee schedules which bear a relation to the cost of services performed. After the new fee schedules are adopted by the department, the PVL division should periodically

review the allocation of costs to ensure that the costs are being properly distributed.

Recommendation. We recommend that occupational fees for the various boards and commissions be adjusted to reflect as accurately as possible the cost of services rendered.

Failure to Implement Recommendations Made in Two Previous Audits

This is our third financial audit of the Department of Regulatory Agencies, and as such, we gave special attention to the extent to and the adequacy with which recommendations made in our 1968⁷ and 1974⁸ audits of the department have been implemented.

Unfortunately, our finding is that the DRA has failed to initiate corrective actions to remedy many of the deficiencies cited in both previous audit reports. This is particularly distressing since the department, in its written comments on both audit reports indicated that they were in agreement with many of our recommendations and stated the specific actions to be taken by the department to correct the deficiencies. In some instances, the department even indicated that the recommendations had already been implemented.

Internal control deficiencies in general. Here we describe the deficiencies that still exist in the DRA's system of internal control. In the other sections we describe the deficiencies that persist in specific divisions.

7. Legislative Auditor, State of Hawaii, *Financial Audit of the State Department of Regulatory Agencies*, Report No. 68-3, January 1968.

8. Legislative Auditor, State of Hawaii, *Financial Audit of the Department of Regulatory Agencies*, Report No. 74-1, March 1974.

1. **Inadequate security over cash receipts.** Cash is collected by the DRA's administrative services division. Cash collections, which include license, registration, and permit fees, as well as bank and insurance company examination fees average between \$10,000-\$50,000 a day.

One of the basic principles of internal control concerning collections is that checks be stamped "for deposit only" immediately upon receipt in order to safeguard such collections against losses from theft, robbery or embezzlement. This method of exercising control over receipts does not exist in the administrative services division. Checks received by mail and the document accompanying the payment are routed to the appropriate division for recordation rather than to the cashier directly. Under this practice, checks made out to "cash" or endorsed in blank are particularly vulnerable to loss by theft.

There is no reason why receipts could not be routed directly to the cashier for processing. Routing receipts to the various divisions for recordation of payment is unnecessary since this information can be obtained from the document which accompanies the payment.

Our two previous audits disclosed these same deficiencies in the controls exercised by the DRA over its mail receipts. Each time the DRA's response indicated that the department was taking or had taken necessary action to correct this problem. For instance, in the DRA's response to our 1968 audit, the department stated that "(t)he recommendation that mail receipts be directed to the cashier for immediate recording and depositing is under serious consideration for possible implementation."⁹ The department further stated that "(w)e need to and are studying the development of a suitable method for proper control of mail receipts."¹⁰ Then, in its response to our 1974 audit, the DRA stated that "(t)he recommendation that checks be stamped 'for deposit only to the credit of the State of Hawaii Director of Finance' immediately upon their receipt to prevent their further negotiability, has

already been put into effect."¹¹ Despite this representation, the problem still exists.

2. **Lack of control over purchase order forms.** Our 1974 audit disclosed deficiencies in the controls exercised by the DRA over its blank purchase order forms. In this audit, we found that the deficiencies still exist.

During the day, employees still have access to blank purchase orders and it would be fairly easy for anyone to obtain a blank purchase order, falsify a signature, and make unauthorized purchases. Blank purchase order forms should be kept under lock and key.

The DRA is also continuing its practice of issuing purchase orders to divisions where purchases originate without prenumbering the forms. The forms are still being numbered as they are used.

As we recommended in our second audit, the DRA should either issue prenumbered forms to the divisions or instruct the divisions to number the forms immediately upon receipt.

Recommendations. Adequate internal controls can only be accomplished if the DRA complies with the following:

1. Stamp checks "for deposit only to the credit of the State of Hawaii Director of Finance" immediately upon receipt and deposit all checks into the state treasury on the same day they are received. The validated document accompanying the payment should then be distributed to the appropriate divisions for further processing.

9. Legislative Auditor, *Financial Audit*, Report No. 68-3, Attachment No. 3, pp. 1-2.

10. *Ibid.*, p. 2.

11. Legislative Auditor, State of Hawaii, *Financial Audit of the Department of Regulatory Agencies*, Report No. 74-1, March 1974, p. 58.

2. *Restrict access to blank purchase order forms and either prenumber the purchase order or instruct the divisions to number the forms immediately upon receipt.*

Bank examination division. There are still several deficiencies in the bank examination division's auditing and administrative procedures.

1. *No manual of instructions and audit programs.* Under Section 401-3, HRS, the bank examination division is required to inspect all financial institutions administered by the division at least once every 18 months. The scope of the examination required under the statute includes a complete and careful examination of the institution's financial condition, resources, management, and compliance with state laws.

For the most part, federally regulated financial institutions are examined jointly by the bank examination division and federal examiners. In these instances, the department's bank examiners limit their activities to a review of the institution's compliance with state laws. However, the bank examination division itself must review all aspects of financial condition, resources, management, etc., for those institutions not subject to federal regulation and supervision.

In our 1974 audit we reported that bank examiners do not have a manual of instructions explaining the operations of the various kinds of financial institutions and outlining criteria for evaluating operations and legal compliance. We also reported that the division does not use audit programs, i.e., a detailed list of steps to be performed in the course of the examination, except when performing joint examinations with federal examiners.

Despite the DRA's representations that a reference manual of instruction would soon be prepared, we found in this audit that the deficiency still persists. Bank examiners still perform examinations without the benefit of a manual of instructions.

The division is also continuing its practice of performing examinations without audit programs. The decision not to utilize audit programs appears to stem from the DRA's contention that it conducts "examinations" as opposed to "audits" and that all examiners are experienced and familiar with governing statutes. As stated previously, "(w)e are unable to see the distinction that the DRA attempts to draw between the words 'examination' and 'audit.' It would be impossible for the division to fulfill the requirements of Section 401-3, HRS, i.e., 'a complete and careful examination of the condition and resources of...' any financial institution without performing certain auditing procedures."¹² In addition, audit programs which include a list of steps to be performed during the course of an examination provide a means to guard against possible omissions and duplication of work.

As we recommended in our 1974 audit, the bank examination division should develop a manual of instruction. Such a manual would not only be a convenient reference source, but it would contribute towards the performance of effective and efficient examinations. In addition, audit programs which specifically state the objectives of each examination and the procedures to be performed for each type of financial institution also need to be developed.

2. *Insufficient hourly billing rate.* Whenever a bank is examined, the Hawaii Revised Statutes require that the DRA recover from the examinee the costs of conducting the examination. For the fiscal year ended June 30, 1981, the costs exceeded the fees collected by \$211,812, as shown in Table 3.2.

12. *Ibid.*, p. 53.

Table 3.2
Deficit Incurred by the Bank Examination Division
for the Fiscal Year Ended June 30, 1981

Examination fees	\$409,797
Cost of examinations:	
- Examiners' direct compensation	\$464,000
- Employee benefits and overhead	157,609
	621,609
Costs in excess of fees	(\$211,812)

We reported on this same deficiency in both our 1968 and 1974 audits of the DRA. In both prior reports we noted that deficits occurred because the hourly rates charged for providing bank examination services were grossly insufficient to recover all costs related to the examinations.

The division revised its rate schedule in 1974 by adopting a flat hourly rate of \$16 for its three classifications of examiners, i.e., Examiners I, II, and III. Whether or not this rate was in fact sufficient to recover all costs in 1974 could not be determined without a detailed analysis of all 1974 costs. However, the DRA's method of arriving at the \$16 flat hourly rate was faulty and the use of that rate now results in large deficits.

The method of arriving at the flat hourly rate was faulty in two respects: (1) the rate is the average salary per hour (in 1974) of some standard mix of Examiners I, II, and III then utilized in routine bank examinations;¹³ and (2) the rate may have excluded fringe benefits and other related overhead costs.

To use the average salary of a given mix of examiners as the rate to be charged assumes that only this mix of examiners is utilized in every bank examination. Any deviation from this standard mix results in inequities. Billings to the examinee could conceivably be too high if examiners with salaries lower than those utilized in the standard mix are used. Conversely, billings

will be too low if higher salaried examiners are used. In addition, use of the \$16 hourly flat rate ignores annual salary increments received by examiners.

When the flat rate was developed in 1974, salaries and other divisional costs such as sick leave, vacation and staff training may have been the only costs considered. Unfortunately, no one in the division was able to explain exactly how the \$16 hourly flat rate was arrived at or whether the cost of employee fringe benefits, estimated to be approximately 20 percent of gross wages as well as departmental overhead costs, including time spent by clerks and other DRA personnel in preparing examination reports had been included in the flat rate. For the fiscal year ended June 30, 1981, these costs totaled over \$150,000. This translates into costs of approximately \$5.80 per hour for each examiner.

The difference between hourly compensation, i.e., salary, fringe benefits, and other related overhead costs, and the \$16 hourly flat rate charged for Examiners I, II, and III is (\$.28), (\$4.58) and (\$13.69), respectively. Table 3.3 shows these unrecovered costs.

Table 3.3
Comparison Between Hourly Compensation
and Hourly Rate Charged

Staff Classification	Hourly Compensation*	Hourly Rate Charged	Difference
Bank Examiner I	\$16.28	\$16.00	(\$.28)
Bank Examiner II	20.58	16.00	(4.58)
Bank Examiner III	29.69	16.00	(13.69)

*The hourly compensation is based on the annual salary (including employee fringe benefits and other related overhead costs) and actual hours billed during the fiscal year ended June 30, 1981.

13. Division personnel were unable to provide the number of examiners from each of the three staff classifications used to determine the "standard mix."

Obviously, the bank examination division needs to revise its hourly billing rates if it is to recover the costs of conducting examinations. In revising its rates, the DRA should use the direct compensation received by examiners in each of the three classifications as a base. All fringe benefits and other related overhead costs should then be added to this base in arriving at the actual hourly billing rates charged.

3. **Untimely billings.** In our 1974 audit, we noted that the policy of the bank examination division was to bill banks for the costs of the examinations only after all of its branches had been examined and a copy of the examination report had been transmitted to the bank's head office. This policy meant that billings for and recovery of costs associated with the examination of the first branch were delayed until the last branch had been examined. We noted that the delay could sometimes be as long as eight months.

To enable the division to recover costs sooner, we recommended that the division bill banks for examination costs on a monthly basis. Although the DRA stated that the "... recommendations appear(ed) worthwhile..." banks are still not being billed on a monthly basis. In addition, a sample of 35 examinations revealed that the timelag between completion of bank examinations and preparation of bills averages some 90 days.

This timelag between completion of the examination and preparation of bills added to the timelag which occurs between examination of the first bank branch and its last means that almost one year may elapse before costs associated with the examination of the first branch are recovered. Needless to say, these delays unnecessarily postpone the availability of funds for use by the State.

As we recommended in our 1974 audit, the bank examination division should prepare and submit bills to banks for examination

costs on a monthly basis as the costs are incurred.

Recommendations. We recommend that the bank examination division develop the following:

1. A manual of instructions for bank examiners. In addition, audit programs which specifically state the objective of each examination and the procedures to be performed for each type of financial institution should also be developed.

2. Hourly billing rates which enable the division to recover all costs of conducting bank examinations. In this regard, the hourly billing rates for the three classifications of examiners should include the examiners' direct salaries and all fringe benefits and other related overhead costs.

3. Timely bill preparation and submission procedures to enable the division to recover bank examination costs on a monthly basis.

Insurance division. One of the deficiencies which still exists in the bank examination division also continues to exist in the insurance division. This deficiency relates to the exclusion of employee fringe benefit costs in the hourly rates charged for examinations of insurance companies. The division's failure to include the State's share of these costs, including medical and dental plan coverages, retirement plan contributions, etc., resulted in the non-recovery of \$18,522 for the year ended June 30, 1981.

As shown in Table 3.4, the hourly compensation of the division's two classifications of examiners exceeds the hourly rates charged by \$5.16 for Examiner I and \$3.90 for Examiner II.

Table 3.4
Comparison Between Hourly Compensation
and Hourly Rate Charged

Staff Classification	Hourly Compensation*	Hourly Rate Charged	Difference
Insurance Examiner I	\$17.85	\$12.69	(\$ 5.16)
Insurance Examiner II	11.61	7.71	(3.90)

*The hourly compensation is based on the annual salary (including employee fringe benefits and other related overhead costs) and actual hours billed during the fiscal year ended June 30, 1981.

To a large extent, these deficits are the result of employee benefit costs amounting to \$3.19 an hour for each examiner being excluded from the hourly rates charged.

Recommendation. We recommend that the insurance division recover all costs relating to insurance company examinations.

Chapter 4

FINANCIAL STATEMENTS AND ACCOUNTANTS' OPINION

This chapter presents the results of the examination of the financial statements of the Department of Regulatory Agencies (DRA) for the fiscal year ended June 30, 1981. It contains the opinion of Coopers & Lybrand regarding the fairness and accuracy of the department's financial statements. It also displays various financial statements of the general fund, special revenue funds, and trust funds administered by the department, together with explanatory notes, and supplemental information presented for analysis purposes only.

Summary of Findings

The patients' compensation fund, established to provide medical malpractice insurance in excess of \$100,000 for health care providers has no provision for unpaid losses on medical malpractice claims. Because the DRA's accounting system does not provide for estimates of losses in the process of settlement and for estimates of losses related to claims that have not yet been filed with the department, Coopers & Lybrand could not attest to the fairness of the presentation of the Department's 1980-81 combined financial statements and the combining trust fund financial statements.

In the opinion of Coopers & Lybrand the combining special revenue funds financial statements and the general fund accounts financial statement present fairly the financial

position of the special revenue funds and the results of operations of the department's special revenue funds and general fund accounts for fiscal year 1980-81.

Accountants' Opinion

Coopers & Lybrand's statement filed with the Legislative Auditor is as follows:

"To the Legislative Auditor
State of Hawaii
Honolulu, Hawaii

We have examined the following financial statements of the Department of Regulatory Agencies, as of June 30, 1981 and for the year then ended:

Combined Statements —

Combined balance sheet — special revenue and trust funds (Exhibit A)

Combined statement of revenues, expenditures and changes in fund balance (Exhibit B)

General Fund Accounts —

Statement of revenues and expenditures — actual and budget (Exhibit C)

Special Revenue Funds –

Combining balance sheet (Exhibit D)

Combining statement of revenues, expenditures and changes in fund balance (Exhibit E)

Trust Funds –

Combining balance sheet (Exhibit F)

Combining statement of revenues, expenditures and changes in fund balance (Exhibit G)

As explained in the notes to the financial statements, the general fund accounts of the Department of Regulatory Agencies are a 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 Regulatory Agencies 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.

As discussed in the notes to the financial statements, the patients' compensation fund has not provided for unpaid losses relating to medical malpractice claims including estimates of losses in process of settlement and estimates of losses related to claims that have not yet been filed with the department. Generally accepted accounting principles, in our opinion, require provision for such losses. Because of the departures from generally accepted accounting principles identified above, the financial statements of the patients' compensation fund do not include provisions for estimated losses in process of settlement amounting to \$5,500,000 at June 30, 1981 and the department has been unable to estimate losses related to claims that have not yet been filed with the department.

In our opinion, because of the effects of the matters discussed in the previous paragraph,

the combined financial statements (Exhibits A and B) and the combining trust funds financial statements (Exhibits F and G) referred to above do not present fairly, the financial position of the Department of Regulatory Agencies and the financial position of the Department's trust funds at June 30, 1981 and the results of their respective operations for the year then ended in conformity with generally accepted accounting principles.

Also, in our opinion, the combining special revenue funds financial statements (Exhibits D and E) and the general fund accounts financial statement (Exhibit C) referred to in the first paragraph present fairly the financial position of the special revenue funds of the Department of Regulatory Agencies at June 30, 1981 and the results of operations of the department's special revenue funds and general fund accounts for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our examination was made for the purpose of forming an opinion on the combined, combining and general fund accounts financial statements referred to in the first paragraph taken as a whole. The accompanying supplemental information included in Schedules I and II is presented for purposes of additional analysis and is not a required part of the financial statements described above. This information has been subjected to the auditing procedures applied in the examination of the combined, combining and general fund accounts financial statements and, in our opinion, is fairly stated in all material respects in relation to the general fund accounts of the Department of Regulatory Agencies taken as a whole.

/s/ Coopers and Lybrand

COOPERS & LYBRAND
Certified Public Accountants

Honolulu, Hawaii
October 16, 1981

Descriptions and Definitions

Descriptions of financial statements and schedules. The following is a brief description of the financial statements and schedules examined by Coopers & Lybrand. The financial statements and schedules are attached at the end of this chapter as Exhibits A to G and Schedules I and II.

1. **Combined balance sheet—special revenue and trust funds (Exhibit A).** This statement presents the assets and fund balances of the special revenue and trust funds used by the DRA on an aggregate basis.

2. **Combined statement of revenues, expenditures, and changes in fund balance—all fund types and account groups (Exhibit B).** This statement presents revenues and expenditures for each type of fund and account group used by the DRA on an aggregate basis. It also presents changes in fund balance for the department's combined special revenue and trust funds.

3. **General fund accounts—statement of revenues and expenditures—actual and budget (Exhibit C).** This statement presents a comparison of budgeted and actual revenues and expenditures for the general fund accounts used by the DRA.

4. **Special revenue funds—combining balance sheet (Exhibit D).** This statement presents the balance sheets for all of the individual special revenue funds maintained by the DRA.

5. **Special revenue funds—combining statement of revenues, expenditures, and changes in fund balance (Exhibit E).** This statement presents the revenues, expenditures, and changes in fund balance for all of the individual special revenue funds maintained by the DRA.

6. **Trust funds—combining balance sheet (Exhibit F).** This statement presents the balance

sheets for all of the individual trust funds maintained by the DRA.

7. **Trust funds—combining statement of revenues, expenditures, and changes in fund balance (Exhibit G).** This statement presents the revenues, expenditures, and changes in fund balance for all of the individual trust funds maintained by the DRA.

8. **General fund accounts—schedule of revenues—actual and budget for the year ended June 30, 1981 (Schedule I).** This schedule presents a comparison of budget and actual revenues for the general fund accounts classified by source within each division.

9. **General fund accounts—schedule of revenues—professional and vocational licensing division—actual and budget for the year ended June 30, 1981 (Schedule II).** This schedule presents a comparison of budget and actual revenues for the professional and vocational licensing division by the various boards, commissions, and programs supported by the division.

Definition of terms. Technical terms are used in the financial statements and in the notes to the financial statements. The more common terms and their definitions are as follows:

1. **Allotment.** Authorization by the director of finance to a state agency to incur obligations and to make expenditures pursuant to the appropriation made by the State Legislature.

2. **Appropriation.** An authorization granted by the State Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are of two types: (a) funds which are available for use until completely expended and (b) funds which lapse if not expended by or encumbered at the end of the fiscal year.

3. **Appropriated receipts.** Funds received by the State for designated purposes and specifically authorized by the State Legislature to be expended by the state agency. Depending upon the designated purposes of the receipts, the funds may lapse at the end of the fiscal year or be carried over until completely expended.

4. **Encumbrance.** An obligation in the form of a purchase order or contract which is chargeable to an appropriation, the incurring of which sets aside the appropriation for the amount of the obligation.

5. **Expenditure.** The actual disbursement of funds for the payment of goods delivered or services rendered, the obligation to pay for such goods or services having been incurred against authorized funds.

6. **Lapse of appropriated balance.** The balance of funds authorized, which is unexpended and uncommitted at the end of the prescribed time period. The balance reverts to the designated fund and is available for appropriation by the State Legislature in the ensuing fiscal year.

7. **Other current expenses.** Expenditures other than for personal services.

8. **Personal services.** Salaries and wages paid to employees.

9. **Reserve.** An account used to earmark a portion of the fund balance to indicate that it is not available for expenditure.

10. **Transfers.** The transactions between funds, departments and/or programs which are authorized by the director of finance.

11. **Continuing appropriations.** The unexpended and unencumbered appropriations and appropriated receipts which do not lapse.

General Notes to the Financial Statements

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

Basis of accounting. The accounts of the funds maintained by the DRA and the accompanying financial statements have been prepared on a modified accrual basis of accounting. Under this method, revenues are generally recognized in the period in which they become available and measurable and expenditures are recorded when liabilities are incurred.

The accounting procedures generally provide for the recording of 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. General fund appropriations that are not expended or encumbered by the end of the fiscal year generally lapse. Appropriations for special revenue funds generally do not lapse until completely expended.

Capital assets constructed for or purchased by the DRA are recorded as expenditures in the year in which the cost is incurred. These assets are not reflected as assets in the accompanying financial statements, but are reflected in the general fixed assets of the State of Hawaii. Depreciation of these assets is not recorded by the State. Costs for pension, health and Federal Social Security benefits of State employees are reported as expenditures in the general fund. Required contributions to the Employees Retirement System are based upon actuarial valuation and include amortization of accrued unfunded liability over a period of fifty years from July 1, 1964. The State's policy is to fund its required contribution annually.

Fund categories and description. Moneys to finance the DRA's programs are accounted for in several different funds. These funds have been established by legislative actions, and each fund has a specific purpose or objective to fulfill. Each fund is an independent fiscal and accounting entity and a separate group of accounts is maintained for each to show its revenues and expenditures. There are three categories of these funds. The categories and the funds within each are described briefly below.

1. **General fund.** The general fund accounts for all resources not otherwise accounted for in other funds. Any activity not financed through another fund is financed through this fund. The 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 DRA is a part of the State of Hawaii's general fund and the accompanying general fund financial statement is limited to and reflects only the appropriations, expenditures, and obligations of the general fund accounts used by the DRA, and the general fund revenues collected by the Department of Regulatory Agencies.

2. **Special revenue funds.** Special revenue funds are operated to account for revenue and expenditures designated for particular purposes. There are eight of these special revenue funds.

a. **Educational television.** This special fund is used to account for Federal grant moneys received by the Hawaii Broadcasting Authority for capital improvement projects.

b. **Exceptional Children Section.** This fund is used to defray the costs of administering a hearings panel for the Department of Education (DOE). The purpose of the panel is to determine the needs of handicapped students. Funding for the panel is received from the DOE.

c. **Communications, utilities, and transportation (CATV).** This special fund was

established in accordance with Chapter 440 G of the Hawaii Revised Statutes to account for moneys collected from community cable television companies. The funds are used to offset the cost of administering the Cable Television Systems Law.

d. **Hawaii Public Broadcasting Authority.** This special fund was established in accordance with Hawaii Revised Statutes Section 314-3 to account for revenues and expenditures relating to the production and broadcasting activities of the State's public broadcasting facility.

e. **Study and review of public utility and transportation laws.** This fund was used to account for moneys designated for a special project on the study and review of public utility and transportation laws of Hawaii.

f. **Driver education fund underwriter's fee.** This special fund is used to account for moneys collected from insurance companies. The moneys are distributed to the state Judiciary, DOE, and the Department of Transportation to fund various aspects of driver education programs.

g. **Insurance guaranty program for industrial loan companies.** This special fund was used to account for the cost of establishing an insurance guaranty program to protect depositors of industrial loan companies in Hawaii.

h. **Factory built housing.** This special fund is used to account for moneys collected from factory built housing companies. The moneys are used to regulate the factory built housing industry.

3. **Trust funds.** Trust funds are used to account for resources held by the DRA as a trustee or agent. The accounts are operated in accordance with specific agreements or other governing regulations. A description of the department's various trust funds is presented below:

a. *Temporary deposits.* This fund was established by the department to account for temporary deposits. Moneys deposited in this fund are later transferred to the appropriate fund.

b. *Real Estate Recovery Fund.* This fund was established in accordance with Hawaii Revised Statutes Section 467-16 to account for fees paid by real estate brokers and salesmen. All revenues derived from the investment of moneys in the fund are transferred to the Real Estate Education Fund. Expenditures made from the fund are used to pay court ordered claims arising from grievances filed against brokers and salesmen.

c. *Real Estate Education Fund.* This fund was established in accordance with Hawaii Revised Statutes Section 467-19 to account for moneys transferred from the Real Estate Recovery Fund. The moneys in the fund are available to the real estate commission for educational purposes.

d. *Contractors Recovery Fund.* This fund was established pursuant to Section 444-26 of the Hawaii Revised Statutes to account for moneys collected from contractors. Moneys derived from the investment of the fund are transferred to the Contractors Education fund. All moneys held in the fund are used to pay court ordered claims arising from grievances filed against licensed contractors.

e. *Contractors Education Fund.* This fund was established in accordance with Hawaii Revised Statutes Section 444-29 to account for moneys transferred from the Contractors Recovery Fund. The moneys are made available to the contractors license board for educational purposes.

f. *Travel Agency Recovery Fund.* This fund was established pursuant to Section 468K-3 of the Hawaii Revised Statutes to account for fees paid by travel agents and travel agencies. All revenues derived from the

investment of moneys in the fund are transferred to the Travel Agency Education Fund. Moneys held in the recovery fund are used to pay for claims arising from grievances filed against licensed agents and agencies.

g. *Travel Agency Education Fund.* This fund was established in accordance with Section 468K-6 of the Hawaii Revised Statutes to account for moneys received from the Travel Agency Recovery Fund. The moneys in this fund are available to the director of the DRA for educational purposes.

h. *Patients' Compensation Fund.* This fund was established pursuant to Section 671-31, Hawaii Revised Statutes, to offer medical malpractice insurance in excess of certain basic insurance coverage to the State's health care providers. The fund receives premiums on insurance coverage sold and pays claims against covered health care providers as determined by judgment, award or settlement.

Notes to the Financial Statement of the General Fund (Exhibits B and C)

Budgeting and budgetary control. Amounts reflected as budgeted revenues in the Statement of revenues and expenditures—budget and actual are those estimates as compiled by the Director of Finance. Budgeted expenditures are derived primarily from the General Appropriations Act of 1980 (Act 300, Session Laws of 1980) and from other authorizations contained in the Hawaii Constitution, the Hawaii Revised Statutes, other specific appropriations acts in various Session Laws of Hawaii, and transfers instituted by the Department of Budget and Finance. To provide for comparability, actual expenditures in this statement have been adjusted to include encumbrances and continuing appropriations at year end and exclude current year expenditures for liquidation of prior year encumbrances and continuing appropriations.

Commitments and contingencies. In accordance with the general practice followed by other state agencies, the DRA does not reflect accrued and potential liability for earned vacation and sick leave credits for other than federally-funded project employees.

At June 30, 1981, earned vacation and sick leave for other than federally-funded project employees amounted to approximately \$993,000 and \$2,625,000, respectively.

Within certain limitations, the employees are entitled to receive cash payments for accrued vacation upon the termination of their employment. Sick leave can accumulate 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 illness and is not convertible to pay upon the termination of employment. However, an employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the retirement system.

All full-time employees of the department are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees Retirement System of the State of Hawaii, a contributory retirement system. The system consists of a Pension Accumulation Fund which provides basic pension benefits and a Post Retirement Fund which provides annual increases to individuals receiving pensions.

Actuarial valuations are made for the entire system and are not separately computed for the State and each county. The department's and other state agencies' share of the retirement expense for the fiscal year ended June 30, 1981 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 DRA's financial statements.

The State is self-insured for substantially all perils including workmen's compensation.

Expenditures for workmen's compensation are appropriated annually and are not considered material.

Presently, there are two cases of pending litigation, claims or assessments. These cases are in addition to those relating to the real estate recovery, contractors recovery, travel agency recovery, and patients' compensation funds. Losses, if any, arising from these matters are not expected to have a significant effect on the accompanying financial statements. Any losses would be included in the general appropriations bill as an item to be expended by the Department of Budget and Finance and accordingly would not be reflected in the DRA's financial statements.

Notes to the Financial Statements of the Special Revenue Funds (Exhibits A, B, D and E)

Budgeting and budgetary control. Revenue estimates and budgeted expenditures were not developed for all special revenue funds for the year ended June 30, 1981. However, revenue estimates for those funds under budgetary control, namely Educational Television; Communication, Utilities and Transportation (CATV); and Hawaii Public Broadcasting Special Revenue Funds were \$214,000, \$150,000, and \$765,000, respectively. Budgeted expenditures for the CATV; and Hawaii Public Broadcasting Special Revenue Funds were \$176,013 and \$623,076, respectively.

Notes to the Financial Statements of the Trust Funds (Exhibits A, B, F and G)

Patients' Compensation Fund. The Patients' Compensation Fund recognizes losses resulting from claims filed under the professional liability protection services offered by the fund on a cash basis. Accordingly, no provision has been made for unpaid losses including estimates of losses in the process of settlement or estimates of losses that have been

incurred but which have not been reported. The DRA has estimated that losses in the process of settlement at June 30, 1981 amounted to

\$5,500,000. The department has been unable to estimate losses that have been incurred but which have not been reported.

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

Combined balance sheet - special revenue and trust funds
June 30, 1981

	<u>Special Revenue (Exhibit D)</u>	<u>Trust (Exhibit F)</u>	<u>Totals (Memorandum only)</u>
<u>ASSETS</u>			
Cash with treasury	<u>\$1,598,887</u>	<u>\$8,972,599</u>	<u>\$10,571,486</u>
Total Assets	<u>\$1,598,887</u>	<u>\$8,972,599</u>	<u>\$10,571,486</u>
<u>FUND BALANCES</u>			
Reserved for encumbrances	\$ 59,755	\$ -	\$ 59,755
Reserved for amounts held in trust	-	8,972,599	8,972,599
Reserved for continuing appropriations	<u>1,539,132</u>	<u>-</u>	<u>1,539,132</u>
Total Fund Balances	<u>\$1,598,887</u>	<u>\$8,972,599</u>	<u>\$10,571,486</u>

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

Combined statement of revenues, expenditures and
changes in fund balance - All fund types and account groups
for the year ended June 30, 1981

	<u>General</u>	<u>Special Revenue (Exhibit E)</u>	<u>Trust (Exhibit G)</u>	<u>Totals (Memorandum only)</u>
REVENUES:				
Administrative division	\$ 48,002	\$ 300	\$ 43,566	\$ 91,868
Bank examination division	417,819	-	417,819	417,819
Business registration division	988,475	-	988,475	988,475
Insurance division	24,392,532	529,952	2,095,795	27,018,279
Professional and vocational licensing division	2,158,984	-	780,708	2,939,692
Hawaii public broadcasting	-	1,220,787	-	1,220,787
Public utilities division	-	119,880	-	119,880
Office of consumer protection	6,825	-	-	6,825
Total Revenues	<u>28,012,637</u>	<u>1,870,919</u>	<u>2,920,069</u>	<u>32,803,625</u>
EXPENDITURES:				
Office of consumer protection	569,092	-	-	569,092
Communication, utilities and transportation	658,570	118,117	-	776,687
Banking services	539,819	-	-	539,819
Professional, vocational and personal services	1,010,594	-	249,462	1,260,056
Insurance services	572,865	262,656	1,347,206	2,182,727
Repairs and maintenance	77	-	-	77
Business registration	353,352	-	-	353,352
Wage standards and fair employment practice	500	-	-	500
Hawaii public broadcasting	1,181,033	1,090,064	-	2,271,097
General support	1,270,206	24,192	55,500	1,349,898
Total Expenditures	<u>6,156,108</u>	<u>1,495,029</u>	<u>1,652,168</u>	<u>9,303,305</u>
Excess Of Revenues Over Expenditures	<u>\$21,856,529</u>	<u>375,890</u>	<u>1,267,901</u>	<u>\$23,500,320</u>
OTHER FINANCING SOURCES (USES):				
Operating transfers in		364,860	5,662,581	
Operating transfers out		(530,070)	(5,663,081)	
Total Other Financing Sources (Uses)		<u>(165,210)</u>	<u>(500)</u>	
Excess Of Revenues And Other Financing Sources Over Expenditures And Other Uses		210,680	1,267,401	
FUND BALANCE, Beginning of year		<u>1,388,207</u>	<u>7,705,198</u>	
FUND BALANCE, End of year		<u>\$1,598,887</u>	<u>\$ 8,972,599</u>	

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND ACCOUNTS

Statement of revenues and expenditures - actual and budget
for the year ended June 30, 1981

	<u>Actual</u>	<u>Adjustment To Convert Actual To Budgetary Basis</u>	<u>Actual On Budgetary Basis</u>	<u>Budget</u>	<u>Variance Favorable (Unfavorable)</u>
REVENUES:					
Administrative division	\$ 48,002	\$ -	\$ 48,002	\$ 21,500	\$ 26,502
Bank examination division	417,819	-	417,819	455,323	(37,504)
Business registration division	988,475	-	988,475	912,343	76,132
Insurance division	24,392,532	-	24,392,532	23,402,240	990,292
Professional and vocational licensing division	2,158,984	-	2,158,984	2,219,400	(60,416)
Office of consumer protection	6,825	-	6,825	-	6,825
Total Revenues	<u>28,012,637</u>	<u>-</u>	<u>28,012,637</u>	<u>27,010,806</u>	<u>1,001,831</u>
EXPENDITURES:					
Office of consumer protection	569,092	16,300	585,392	585,427	35
Communication, utilities and transportation	658,570	61,564	720,134	721,142	1,008
Banking services	539,819	(2,477)	537,342	538,316	974
Professional, vocational and personal services	1,010,594	(59,068)	951,526	954,621	3,095
Insurance services	572,865	(381)	572,484	573,739	1,255
Repairs and maintenance	77	42,581	42,658	50,000	7,342
Business registration	353,352	(4,285)	349,067	349,406	339
Wage standards and fair employment practice	500	-	500	500	-
Hawaii public broadcasting	1,181,033	(126,087)	1,054,946	1,107,517	52,571
General support	1,270,206	(14,233)	1,255,973	1,258,481	2,508
Total Expenditures	<u>6,156,108</u>	<u>(86,086)</u>	<u>6,070,022</u>	<u>6,139,149</u>	<u>69,127</u>
Excess Of Revenues Over Expenditures	<u>\$21,856,529</u>	<u>\$ 86,086</u>	<u>\$21,942,615</u>	<u>\$20,871,657</u>	<u>\$1,070,958</u>

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES

SPECIAL REVENUE FUNDS

Combining balance sheet
June 30, 1981

	<u>Educational Television</u>	<u>Exceptional Children Section</u>	<u>Communication, Utilities And Transportation (CATV)</u>	<u>Hawaii Public Broadcasting</u>	<u>Study And Review Of Public Utility And Transportation Laws Of Hawaii</u>	<u>Driver Fund Education Underwriters Fee</u>	<u>Insurance Guaranty Program for Industrial Loan Companies</u>	<u>Factory Built Housing</u>	<u>Total</u>
<u>ASSETS</u>									
Cash with treasury	\$140,087	\$20,000	\$529,697	\$876,159	\$ -	\$ -	\$ -	\$32,944	\$1,598,887
Total Assets	<u>\$140,087</u>	<u>\$20,000</u>	<u>\$529,697</u>	<u>\$876,159</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$32,944</u>	<u>\$1,598,887</u>
<u>FUND BALANCES</u>									
Reserved for encumbrances	\$ 25,441	\$ -	\$ 21,416	\$ 11,708	\$ -	\$ -	\$ -	\$ 1,190	\$ 59,755
Reserved for continuing appropriations	<u>114,646</u>	<u>20,000</u>	<u>508,281</u>	<u>864,451</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>31,754</u>	<u>1,539,132</u>
Total Fund Balances	<u>\$140,087</u>	<u>\$20,000</u>	<u>\$529,697</u>	<u>\$876,159</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$32,944</u>	<u>\$1,598,887</u>

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
SPECIAL REVENUE FUNDS

Combining statement of revenues, expenditures and changes in fund balance
for the year ended June 30, 1981

	Educational Television	Exceptional Children Section	Communication, Utilities And Transportation (CATV)	Hawaii Public Broadcasting	Study And Review Of Public Utility And Transportation Laws Of Hawaii	Driver Fund Education Underwriters Fee	Insurance Guaranty Program For Industrial Loan Companies	Factory Built Housing	Total
REVENUES:									
Federal grant	\$273,267	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 273,267
Surcharge	-	-	119,880	-	-	529,952	-	-	649,832
Community service grant	-	-	-	481,668	-	-	-	-	481,668
Fees for services	-	-	-	230,868	-	-	-	300	231,168
Contributions	-	-	-	223,602	-	-	-	-	223,602
Interest and other	-	-	-	11,382	-	-	-	-	11,382
Total Revenues	<u>273,267</u>	<u>-</u>	<u>119,880</u>	<u>947,520</u>	<u>-</u>	<u>529,952</u>	<u>-</u>	<u>300</u>	<u>1,870,919</u>
EXPENDITURES:									
Personal services	-	-	84,307	-	-	-	-	-	84,307
Other current expenses	232,529	-	33,810	857,535	18,355	262,656	5,023	814	1,410,722
Total Expenditures	<u>232,529</u>	<u>-</u>	<u>118,117</u>	<u>857,535</u>	<u>18,355</u>	<u>262,656</u>	<u>5,023</u>	<u>814</u>	<u>1,495,029</u>
Excess (Deficiency) Of Revenues Over (Under) Expenditures	40,738	-	1,763	89,985	(18,355)	267,296	(5,023)	(514)	375,890
OTHER FINANCING SOURCES (USES):									
Operating transfers in	-	20,000	-	48,746	-	262,656	-	33,458	364,860
Operating transfers out	-	-	-	-	-	(530,051)	(19)	-	(530,070)
Total Other Financing Sources (Uses)	-	20,000	-	48,746	-	(267,395)	(19)	33,458	(165,210)
Excess (Deficiency) Of Revenues And Other Sources Over (Under) Expenditures And Other Uses	40,738	20,000	1,763	138,731	(18,355)	(99)	(5,042)	32,944	210,680
FUND BALANCE, Beginning of year	<u>99,349</u>	<u>-</u>	<u>527,934</u>	<u>737,428</u>	<u>18,355</u>	<u>99</u>	<u>5,042</u>	<u>-</u>	<u>1,388,207</u>
FUND BALANCE, End of year	<u>\$140,087</u>	<u>\$20,000</u>	<u>\$529,697</u>	<u>\$876,159</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$32,944</u>	<u>\$1,598,887</u>

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TRUST FUNDS

Combining balance sheet
June 30, 1981

	<u>Regulatory Agencies - Temporary Deposits</u>	<u>Public Utilities - Temporary Deposits</u>	<u>Real Estate Recovery Fund</u>	<u>Real Estate Education Fund</u>	<u>Contractors Recovery Fund</u>	<u>Contractors Education Fund</u>	<u>Travel Agency Recovery Fund</u>	<u>Travel Agency Education Fund</u>	<u>Patients' Compensation Fund</u>	<u>Total</u>
<u>ASSETS</u>										
Cash with treasury	\$50,900	\$ -	\$1,045,954	\$841,776	\$490,170	\$94,304	\$38,325	\$ -	\$6,411,170	\$8,972,599
Total Assets	<u>\$50,900</u>	<u>\$ -</u>	<u>\$1,045,954</u>	<u>\$841,776</u>	<u>\$490,170</u>	<u>\$94,304</u>	<u>\$38,325</u>	<u>\$ -</u>	<u>\$6,411,170</u>	<u>\$8,972,599</u>
<u>FUND BALANCES</u>										
Reserved for amounts held in trust	\$50,900	\$ -	\$1,045,954	\$841,776	\$490,170	\$94,304	\$38,325	\$ -	\$6,411,170	\$8,972,599
Total Fund Balances	<u>\$50,900</u>	<u>\$ -</u>	<u>\$1,045,954</u>	<u>\$841,776</u>	<u>\$490,170</u>	<u>\$94,304</u>	<u>\$38,325</u>	<u>\$ -</u>	<u>\$6,411,170</u>	<u>\$8,972,599</u>

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
TRUST FUNDS

Combining statement of revenues, expenditures and changes in fund balance
for the year ended June 30, 1981

	Regulatory Agencies - Temporary Deposits	Public Utilities - Temporary Deposits	Real Estate Recovery Fund	Real Estate Education Fund	Contractors Recovery Fund	Contractors Education Fund	Travel Agency Recovery Fund	Travel Agency Education Fund	Patients' Compensation Fund	Total
REVENUES:										
Surcharges	\$ -	\$ -	\$ 196,150	\$220,759	\$ 76,230	\$ -	\$38,325	\$ -	\$2,095,795	\$ 2,627,259
Other	43,566	-	-	180,824	-	68,420	-	-	-	292,810
Total Revenues	43,566	-	196,150	401,583	76,230	68,420	38,325	-	2,095,795	2,920,069
EXPENDITURES:										
Claims	-	-	18,900	-	70,475	-	-	-	1,347,206	1,436,581
Other current expenses	55,500	-	-	132,162	-	27,925	-	-	-	215,587
Total Expenditures	55,500	-	18,900	132,162	70,475	27,925	-	-	1,347,206	1,652,168
Excess (Deficiency) Of Revenues Over (Under) Expenditures	(11,934)	-	177,250	269,421	5,755	40,495	38,325	-	748,589	1,267,901
OTHER FINANCING SOURCES (USES):										
Operating transfers in	-	-	-	-	-	-	-	-	5,662,581	5,662,581
Operating transfers out	(5,662,581)	(500)	-	-	-	-	-	-	-	(5,663,081)
Total Other Financing Sources (Uses)	(5,662,581)	(500)	-	-	-	-	-	-	5,662,581	(500)
Excess (Deficiency) Of Revenues And Other Sources Over (Under) Expenditures And Other Uses	(5,674,515)	(500)	177,250	269,421	5,755	40,495	38,325	-	6,411,170	1,267,401
FUND BALANCE, Beginning of year	5,725,415	500	868,704	572,355	484,415	53,809	-	-	-	7,705,198
FUND BALANCE, End of year	\$ 50,900	\$ -	\$1,045,954	\$841,776	\$490,170	\$94,304	\$38,325	\$ -	\$6,411,170	\$ 8,972,599

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

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND ACCOUNTS

Schedule of revenues - actual and budget
for the year ended June 30, 1981

<u>Source Of Revenues</u>	<u>Budget</u>	<u>Actual</u>	<u>Revenues Over Or (Under) Estimate</u>
ADMINISTRATIVE DIVISION:			
Sale of publications	\$ 15,500	\$ 14,611	\$ (889)
Other	<u>6,000</u>	<u>33,391</u>	<u>27,391</u>
	<u>21,500</u>	<u>48,002</u>	<u>26,502</u>
BANK EXAMINATION DIVISION:			
Examinations	440,880	403,797	(37,083)
Licenses	<u>14,443</u>	<u>14,022</u>	<u>(421)</u>
	<u>455,323</u>	<u>417,819</u>	<u>(37,504)</u>
BUSINESS REGISTRATION DIVISION:			
Corporations	569,228	499,356	(69,872)
Foreign (out of state)	186,710	309,908	123,198
Trademarks and tradenames	81,290	54,041	(27,249)
Security registration	26,600	53,060	26,460
Partnerships	22,805	52,593	29,788
Other	<u>25,710</u>	<u>19,517</u>	<u>(6,193)</u>
	<u>912,343</u>	<u>988,475</u>	<u>76,132</u>
INSURANCE DIVISION:			
Premium tax	23,000,000	23,973,114	973,114
Examinations and licenses	295,740	343,342	47,602
Joint underwriting fee	93,900	56,898	(37,002)
Other	<u>12,600</u>	<u>19,178</u>	<u>6,578</u>
	<u>23,402,240</u>	<u>24,392,532</u>	<u>990,292</u>
PROFESSIONAL AND VOCATIONAL LICENSING DIVISION:			
Examinations and licensing (Schedule II)	<u>2,219,400</u>	<u>2,158,984</u>	<u>(60,416)</u>
OFFICE OF CONSUMER PROTECTION:			
Other	<u>-</u>	<u>6,825</u>	<u>6,825</u>
Total Revenues	<u>\$27,010,806</u>	<u>\$28,012,637</u>	<u>\$1,001,831</u>

STATE OF HAWAII
DEPARTMENT OF REGULATORY AGENCIES
GENERAL FUND ACCOUNTS

Schedule of revenues - professional and vocational
licensing division - actual and budget
for the year ended June 30, 1981

	<u>Budget</u>	<u>Actual</u>	<u>Revenues Over Or (Under) Estimate</u>
Abstract makers	\$ 65	\$ 35	\$(30)
Accountants	54,125	34,785	(19,340)
Acupuncturists	300	930	630
Barbers	4,005	2,121	(1,884)
Boxing	3,725	5,697	1,972
Cemetery board	5,743	5,441	(302)
Chiropractors	3,975	4,625	650
Collection agencies	-	751	751
Commercial employment agencies	-	1,275	1,275
Contractors	104,403	148,290	43,887
Cosmetologists	20,025	16,915	(3,110)
Dentists	11,797	18,030	6,233
Electricians and plumbers	21,900	22,240	340
Elevator mechanics	420	480	60
Engineers	32,275	32,090	(185)
Fumigators	3,425	6,215	2,790
Hearing aid dealers and fitters	30	73	43
Masseur	4,696	15,604	10,908
Medical	62,975	78,825	15,850
Mortgage brokers	12,917	11,267	(1,650)
Motor vehicle dealers	29,310	31,255	1,945
Motor vehicle repair	159,690	144,664	(15,026)
Naturopaths	300	575	275
Nurses	127,100	136,880	9,780
Nursing home administrators	400	510	110
Opticians	1,460	1,675	215
Optometrists	538	938	400
Osteopathic physicians	2,770	2,190	(580)
Pharmacist	3,256	3,548	292
Podiatrist	150	285	135
Port pilots	-	5,417	5,417
Private detectives and guards	2,400	5,495	3,095
Psychologist	1,745	3,785	2,040
Real estate	1,533,990	1,410,906	(123,084)
Speech pathologist and audiologist	520	977	457
Subdivisions	675	1,075	400
Travel agencies	6,740	670	(6,070)
Veterinarians	1,555	2,450	895
	<u>\$2,219,400</u>	<u>\$2,158,984</u>	<u>\$(60,416)</u>

COMMENTS ON AGENCY RESPONSE

A preliminary draft of this report was transmitted on April 12, 1982 to the Governor, the presiding officers of the Legislature and the Department of Regulatory Agencies. We asked the department to comment on the recommendations contained in the report, including the actions that have been taken or will be taken on the recommendations. A copy of the transmittal letter to the department is included in this part as Attachment 1. The response received from the department is included as Attachment 2.

In this part of the report, we summarize and comment on the department's response to our recommendations.

Patients' Compensation Fund

The department administers a patients' compensation fund which offers medical malpractice insurance to the State's health care providers. The department does not record in its financial records and statements the amount of the claims that were in the process of settlement. At June 30, 1981, the claims amounted to \$5.5 million. In addition, no amount is reserved for claims that have not yet been filed.

The department states that while the staff is aware of the above described contingencies, "the State's accounting practices are being followed," and that "expenses can only be recorded as they are incurred."

We disagree. The department's records with regard to the Patients' Compensation Fund should be maintained in a manner which accurately portrays the financial condition of the fund. By not showing in the financial records and statements the \$5.5 million of claims and an estimate of claims not yet filed, the financial health of the fund is grossly misstated.

The American Institute of Certified Public Accountants' audit guide requires that estimates of losses be recorded in the accounting records. The department's failure to provide for estimates of losses was the reason Coopers & Lybrand, the certified public accounting firm engaged to examine the department's financial statements, could not attest to the fairness and accuracy of the Patients' Compensation Fund's financial statements.

Occupational Fees

The department agrees with our recommendation that the occupational fees for the various boards and commissions must be adjusted to reflect as accurately as possible the cost of services rendered and states that a proposed adjusted fee schedule is being prepared.

While the cost data (relating to non-allocated costs) presented in the response is higher than the amount contained in this report, the results still confirm the disparity between the fees assessed and the cost of services.

Lack of Control Over Purchase Order Forms

The department disagrees with our recommendation that purchase order forms be prenumbered before being distributed to the divisions where purchases originate. Use of prenumbered purchase order forms is a common and inexpensive control technique designed to deter unauthorized transactions by providing accountability over unissued forms. This cost-effective control technique should be implemented by the department.

ATTACHMENT 1

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813
(808) 548-2450



CLINTON T. TANIMURA
AUDITOR
RALPH W. KONDO
DEPUTY AUDITOR

April 12, 1982

COPY

Dr. Mary G. F. Bitterman, Director
Department of Regulatory Agencies
1010 Richards Street
Honolulu, Hawaii 96813

Dear Dr. Bitterman:

Enclosed are four preliminary copies, numbered 4 through 7, of our *Financial Audit of the Department of Regulatory Agencies*. The report contains a number of recommendations affecting your department. If you have any comments on the recommendations, we ask that you submit them in writing to our office by April 26, 1982, for inclusion in the final report.

Since the report is not in final form and changes may possibly be made to it, access to this report should be restricted to those officials whom you might wish to call upon to assist you in the review of the report. Public release of the report will be made solely by our office and only after the report is published in its final form and submitted to the Legislature.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures

ATTACHMENT 2

GEORGE R. ARIYOSHI
GOVERNOR



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

MARY G. F. BITTERMAN
DIRECTOR
BANK EXAMINER
COMMISSIONER OF SECURITIES
INSURANCE COMMISSIONER

DONALD D.H. CHING
DEPUTY DIRECTOR

COPY

April 22, 1982

RECEIVED

APR 23 3 09 PM '82

OFFICE OF THE AUDITOR
STATE OF HAWAII

The Honorable Clinton T. Tanimura
Legislative Auditor
Office of the Auditor
State of Hawaii
465 South King Street, Room 500
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

Thank you for the opportunity to review your preliminary report on the Financial Audit of the Department of Regulatory Agencies. The following comments are based on our review of the six problem areas identified in your report and the recommended corrective actions.

Patient's Compensation Fund (pp. 3-2 to 3-3)

You recommended that the department follow accounting practices that conform to generally accepted accounting principles regarding the recording of estimated losses.

We maintain that the State's accounting practices are being followed in the accounting of the Patients' Compensation Fund. The State's accounting system is a modified cash-basis system. As such, expenses can only be recorded as they are incurred. Thus, anticipated charges against accounts cannot be shown on the accounting records and statements, except through the use of footnotes. Our staff is aware of contingencies, such as those mentioned in your report, and administer the fund accordingly. The inability to reflect these contingencies is a problem that is common to all accounting systems, whether they are maintained on a cash or an accrual basis.

Occupational Fees (pp. 3-3 to 3-6)

You recommended that occupational fees for the various boards and commissions be adjusted to reflect as accurately as possible the cost of services rendered. We concur and wish to inform you that while your audit was in progress, we were conducting a study to conform with Act 92, SLH 1980, and Act 75, SLH 1981, which repeated your concerns regarding the occupational fee structure. We have completed our preliminary study and are preparing to propose the adjusted fee schedule in public hearings. Our study, however, does not show as large a disparity between revenues and fees as presented in your report. The following tables show our findings for the boards and commissions revenues and expenses and for the five boards presented in your report.

Boards and Commissions Revenues and Expenses FY 80-81

Total Fees (Averaged)	-	\$ 2,202,122
Allocated Costs	\$ 1,141,589	
Other Costs	863,565	
	<u>2,005,154</u>	<u>2,005,154</u>
Excess Revenues Over Expenses	-	\$ <u>196,968</u>

Selected Boards and Commissions

	Real Estate	Medical Examiner	Contractor	Accounting	Veterinarians
Fees	\$951,030	\$259,481	\$343,455	\$71,360	\$ 4,370
Allocated Costs	<u>436,857</u>	<u>132,576</u>	<u>319,581</u>	<u>81,110</u>	<u>14,441</u>
Net difference	\$514,173	\$126,905	\$ 23,874	(\$ 9,750)	(\$10,071)

Without the opportunity to review the audit working papers, we can only attribute the difference between your table and ours to your failure to include those overhead costs, such as administrative staff support costs which are normally factored into operating costs.

Failure to Implement Recommendations Made in Two Previous Audits (pp. 3-6 to 3-8)

You recommended that tighter internal controls be implemented over cash receipts and blank purchase order forms.

We agree that better control should be implemented in the handling of cash receipts. We have requested that all divisions stamp checks as you recommended immediately upon the opening of the mail. We are also conducting a study of our document handling procedures to identify those changes which can be made to enable a more timely deposit of checks into the State Treasury.

We disagree that our current procedures regarding the control of purchase order forms are inadequate. Our use of unnumbered purchase order forms is in compliance with the Department of Accounting and General Services' control procedures and satisfies the concerns raised by your auditors.

Under our current practices, falsification of a purchase order is made more difficult because two independent organizations are involved in the preparation of the purchase order: the purchasing division prepares the form for issuance and the fiscal office determines the propriety of the expenditure and then issues a purchase

The Honorable Clinton T. Tanimura
Page 3
April 22, 1982

order number. The act of issuing the number serves as our control. Without a match of numbers on the billing document and our logs, requests for payment are not recognized as authorized and valid. If pre-numbered purchase orders were used, we would be less able to detect a falsified document.

We have notified the divisions to restrict access to these forms.

Bank Examination Division (pp. 3-8 to 3-13)

You recommended that an examination manual be prepared, the hourly billing rates be revised and that more timely billings be made.

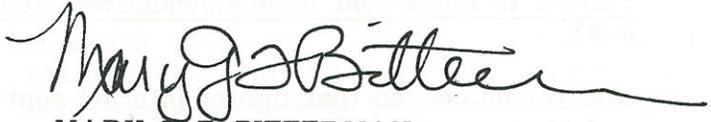
We agree with your recommendations and have taken the necessary steps to implement them. We expect to have the major work on the manual completed within the next 12-18 months. We are also conducting a study to determine the best method of structuring the examination rates and are examining our billing procedures to identify areas which can be improved.

Insurance Division (pp. 3-13 to 3-14)

You recommended that all costs be recovered when making insurance company examinations.

We agree and are now in the process of restructuring the rates to include all fringe and overhead costs.

Sincerely yours,



MARY G. F. BITTERMAN
Director

Legislative Auditor's Note: The page references in this letter refer to pages in the preliminary report. Pages 3-2 to 3-3 referred to in the letter correspond with pages 11 and 12 of this final report; pages 3-3 to 3-6 correspond with pages 12 to 14; pages 3-6 to 3-8 correspond with pages 14 and 15; pages 3-8 to 3-13 correspond with pages 16 to 18; and pages 3-13 to 3-14 correspond with pages 18 and 19.