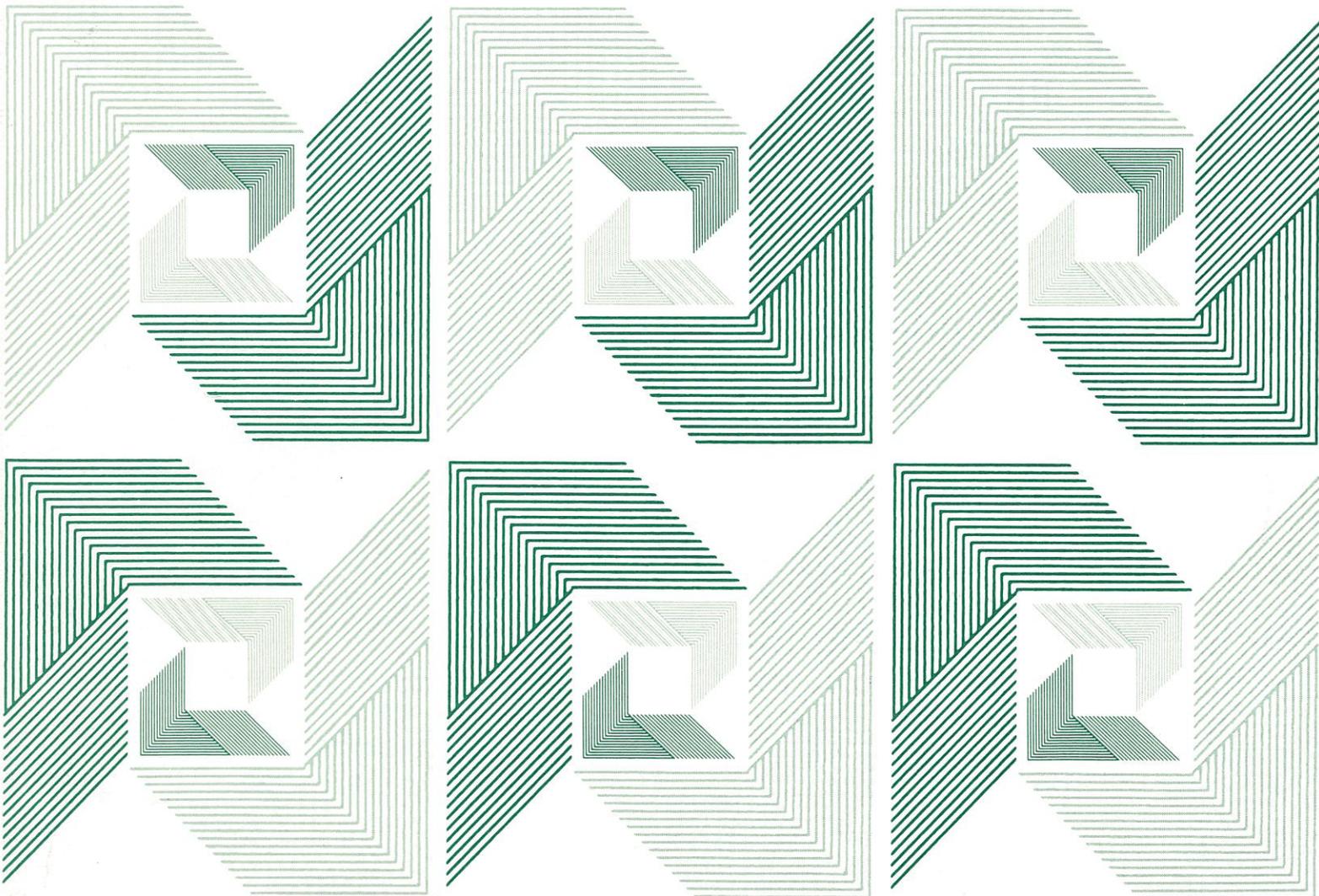


REPORT NO. 84-8
JANUARY 1984

FINANCIAL AUDIT OF THE DEPARTMENT OF BUDGET AND FINANCE

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



SUBMITTED BY THE LEGISLATIVE AUDITOR OF THE STATE OF HAWAII

THE OFFICE OF THE LEGISLATIVE AUDITOR

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



LEGISLATIVE AUDITOR
KEKUANAO'A BUILDING, RM. 500
465 SOUTH KING STREET
HONOLULU, HAWAII 96813

**FINANCIAL AUDIT OF THE
DEPARTMENT OF BUDGET AND FINANCE**

**Conducted by the
Office of the Legislative Auditor
State of Hawaii
and
Peat, Marwick, Mitchell & Co.
Certified Public Accountants**

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

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

Report No. 84-8

January 1984

FOREWORD

This financial audit report is the result of an examination of the financial statements and records of the Department of Budget and Finance for the fiscal year ended June 30, 1983. The audit was conducted by the Office of the Legislative Auditor and the certified public accounting firm of Peat, Marwick, Mitchell & Co.

This report is divided into three parts. Part I contains an introduction and some background information on the Department of Budget and Finance. 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 Budget and Finance's 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 Budget and Finance.

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

January 1984

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programs, and performance of all departments, and members of the

accountants' opinion as to the fairness of the financial statements presented is that of

PART I

INTRODUCTION AND BACKGROUND

Objectives of the Audit

Administrative control of the department, are audited annually by certified public accountants.

The objectives of the audit were:

1. To assess the adequacy,

Chapter 1

BACKGROUND INTRODUCTION

This is a report of our financial audit of the Department of Budget and Finance.

The audit was performed pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices and agencies of the State and its political subdivisions. The audit was conducted by the Office of the Legislative Auditor and the certified public accounting firm, Peat, Marwick, Mitchell & Co.

Objectives of the Audit

The objectives of the audit were:

1. To assess the adequacy, effectiveness, and efficiency of the systems and procedures for financial accounting, internal control and financial reporting of the Department of Budget and Finance; to recommend improvements to such systems, procedures, and reports; and to render an opinion on the reasonable accuracy of the financial statements of the department.

2. To ascertain whether expenditures and other disbursements have been made and all revenues and other receipts have been collected and accounted for in accordance with federal and state laws, rules and regulations, and policies and procedures.

Scope of the Audit

The audit's scope included an examination of the financial statements, internal accounting controls, and legal compliance of the department for the period July 1, 1982 to June 30, 1983. The accountants' opinion as to the fairness of the financial statements presented is that of Peat, Marwick, Mitchell & Co.

Not included as part of the audit were the Hawaii Public Employees Health Fund and the Employees' Retirement System of the State of Hawaii. These programs, which are under the administrative control of the department, are audited annually by certified public accountants.

Organization of the Report

This report is organized into two parts.

Part I (Chapters 1 and 2) presents this introduction and background information on the department.

Part II (Chapters 3 and 4) presents our audit findings and recommendations on the accounting practices and procedures of the department. It also includes the department's financial statements for the period July 1, 1982 to June 30, 1983 and the accountants' opinion on the statements.

Chapter 2

BACKGROUND

This chapter describes the responsibilities and organization of the Department of Budget and Finance.

Responsibilities of the Department

The Department of Budget and Finance is a department established under Chapter 26, Hawaii Revised Statutes (HRS). It is headed by a single executive, the Director of Finance, who is appointed by the Governor with the advice and consent of the State Senate. Section 26-8, HRS, assigns to the department the following responsibilities:

"The department shall undertake the preparation and execution of the executive budget of the State government; conduct a systematic and continuous review of the finances, organization and methods of each department of the State to assist each department in achieving the most effective expenditure of all public funds and to determine that such expenditures are in accordance with the budget laws and controls in force; have custody of State funds and be responsible for the safekeeping, management, investment and disbursement thereof; and administer State debts."

In addition to the foregoing principal responsibilities, the statutes assign four entities to the department for administrative purposes. These are the Employees' Retirement System (ERS), the Hawaii Public Employees Health Fund, the Office of the Public Defender, and the Public Utilities Commission (PUC).

Organization of the Department¹

The following summarizes the department's organization:

Office of the Director of Finance.
The Director of Finance has overall

management control of the department. He is appointed by and reports directly to the Governor.

Administrative Services Office. This office provides fiscal, personnel, and other administrative services to other organizational units of the department.

Operational divisions. Three divisions and the Hawaii Institute for Management and Analysis in Government (HIMAG) execute the primary responsibilities of the department. Each is headed by a division chief (director, in the case of HIMAG), who reports directly to the Director of Finance.

1. **Budget Planning and Management Division.** This division has the lead role in the preparation and execution of the executive budget. It also analyzes programs and makes recommendations to improve management systems, policies, and procedures.

2. **Electronic Data Processing Division.** This division is responsible for the State's data processing system. It operates and maintains the State's centralized computer center and provides personnel and equipment to support the programs of other state agencies.

3. **Finance Division.** This division has custody of all State Treasury funds. It invests and disburses these funds and

1. Descriptions drawn from the relevant portions of the Hawaii Revised Statutes and the following text: Legislative Reference Bureau, *Guide to Government in Hawaii*, 7th edition, September 1980, pp. 35-39.

maintains an inventory of collateral for state deposits. It assists the director in issuing state bonds and manages the State's debt. This division also administers the Veterans Loans Program.

4. **Hawaii Institute for Management and Analysis in Government.** HIMAG provides training, advice, and assistance to other governmental agencies on analytical and managerial techniques. It provides instructional programs and conducts studies on a variety of subjects.

Units assigned for administrative purposes. Four organizational units are assigned to the department for administrative purposes. They function autonomously but receive administrative support from the department.

1. **Employees' Retirement System.** The ERS is governed by a seven-member board of trustees. The board is comprised of (1) the Director of Finance, who is an ex officio trustee, (2) three elected members of the system, and (3) three nonmembers appointed by the Governor with the advice

and consent of the Senate. Under the board's direction, the ERS conducts the retirement benefits program for state and county employees.

2. **Hawaii Public Employees Health Fund.** The Health Fund is governed by a nine-member board of trustees. The board is comprised of (1) the Director of Finance, who is an ex officio trustee, and (2) eight trustees appointed by the Governor. The Health Fund provides health, dental, and insurance benefits to state and county employees and their beneficiaries.

3. **Office of the Public Defender.** This office is governed by a five-member defender council. All five members of the council are appointed by the Governor. The office provides legal defense services for indigent persons.

4. **Public Utilities Commission.** The PUC is governed by a three-member commission appointed by the Governor with the advice and consent of the Senate. The PUC is the regulatory agency for public utilities and has broad powers to deal with public utility issues.



PART II

FINDINGS AND RECOMMENDATIONS



Chapter 3

FINANCIAL ACCOUNTING AND INTERNAL CONTROL

This chapter contains our findings and recommendations on the Department of Budget and Finance's accounting practices and procedures.

Summary of Findings

We find that:

1. The department has allowed funds to accumulate in the Veterans' Loans Fund in excess of the program's requirements, and there also remains an unnecessary balance in the special fund of the Scandinavian Centennial Commission.
2. Because other agencies have been derelict in reporting deposits of state funds, the department has not realized its full potential in interest earnings.
3. The counsel for indigents program has been underfunded, forcing the department to delay payment of claims so as to avoid overexpending the appropriation.
4. A division of the department has failed to follow purchasing procedures required by state regulations.
5. A breakdown in the document review process for the transfer of funds caused the department to overtransfer funds to various other departments.
6. The department is not following statewide accounting policies as to the use of petty cash funds, and it is not making adequate use of such funds.
7. The department is using a special fund which has not been authorized by the

Legislature to carry forward unencumbered funds from year to year.

Lapsing Excess Funds

Both the Veterans Loans Program and Scandinavian Centennial Commission have excess fund balances that should be returned to the general fund.

The Veterans Loans Program, established in 1953, was originally designed to encourage the construction of housing for veterans primarily through the purchase of veterans' mortgages from participating financial institutions. At its peak in 1959, the program had mortgages outstanding totaling \$18,218,414. By 1966, however, the department had completely ceased purchasing mortgages. Its responsibility became one of merely collecting mortgage payments and satisfying the general obligation debt which originally funded the program. At June 30, 1983, the mortgages outstanding totaled \$1,723,360 and the outstanding debt amounted to \$143,389. The outstanding debt will be fully paid by fiscal year 1985.

Over the years, the program has accumulated a substantial amount of cash. As of June 30, 1983, the cash balance was \$2,147,159. This surplus cash came about through general fund appropriations in early program years and through program earnings in later years. During the fiscal year 1983, the loan collections exceeded the debt payment and administrative expenses by \$348,000. It is thus evident that the 1983 cash balance is not needed and should be transferred to the general fund. In addition, the cash balance in future years

will not be needed and should also be assigned to the general fund.

The Scandinavian Centennial Commission was established in 1979 to arrange for the commemoration of the 100th anniversary of the arrival of the first large group of Scandinavians to Hawaii. A special fund was established to account for the costs of the Commission. Funding for the Commission was derived from a \$15,000 transfer from the Governor's contingency fund and through other private means. The program was discontinued in December 1981, as required by statute, but the remaining amount of \$5,900 has been allowed to remain in the special fund.

***Recommendation.** We recommend that the department institute procedures whereby all special funds within its jurisdiction will be periodically scrutinized to determine which funds can be transferred to the general fund. Additionally, the funds now remaining in the Scandinavian Centennial Commission Special Fund and the 1983 cash balance and future cash balances from the Veterans Loans Program should be lapsed to the general fund.*

Maximizing Investment Earnings

State revenues are derived from many sources and flow into the State Treasury through a number of agencies. These agencies normally deposit the receipts directly in the State's depositories and follow with a report of the deposit to the Department of Budget and Finance.

One of the department's responsibilities is to effectively invest the funds of the State. On a daily basis, the department's finance division analyzes the cash on hand, the cash currently received, and anticipated cash requirements, and it invests the cash that is not immediately needed in certificates of deposit.

All agencies are required to notify the department promptly by telephone of all daily deposits in excess of \$100,000. This procedure is intended to reduce the time lag between the deposit date and the date the department receives the appropriate deposit documents. It allows the department to make more timely investments in higher yielding securities and thereby increase interest earnings.

Our examination revealed that certain agencies are complying with the telephone reporting policy. However, many other agencies, including the Department of Commerce and Consumer Affairs, Department of Agriculture, Department of Land and Natural Resources, Department of Social Services and Housing, Department of Education, Department of Health, Department of Transportation, and University of Hawaii are not calling in their deposits or are doing so inconsistently. Because of this, there are times when hundreds of thousands of dollars are not being invested at the best rates, thus resulting in lost interest earnings.

***Recommendation.** We recommend that the department follow up on those agencies not adhering to the telephone reporting policy. To ensure compliance, the department should consider a policy of restricting agency funds when an agency is derelict in its reporting responsibilities and the State loses interest as a result. The amount to be restricted could be equal to the amount of lost interest earnings.*

Budget Overruns in Counsel for Indigents Program

Under Hawaii law, a person charged with a crime punishable by confinement who is determined to be indigent is entitled to representation by a public defender. If, however, conflicting interests exist or if, for any other reason, the public defender is

unable to act, the court may appoint a private counsel to represent the indigent person.

The counsel for indigents program is funded by general fund appropriations which are administered by the Department of Budget and Finance. Program expenditures, however, are approved by the courts. For years, the program has been underfunded. Table 3.1 compares the appropriations for the last two years with the actual costs of the program in those years. As the table shows, a deficit appropriation was needed for both of the years. Even with the supplemental appropriations, the cost of the program exceeded the total appropriations.

Table 3.1
Appropriations and Program Costs
Relating to Counsel for Indigents
June 30, 1982 and 1983

	1982	1983
Original appropriation per the biennium budget	\$400,000	\$400,000
Deficit appropriation in 1982 legislative session	<u>300,000</u>	<u>400,000</u>
Final appropriation	<u>700,000</u>	<u>800,000</u>
Program costs charged to appropriation during fiscal year	699,100	790,883
Adjustments:		
1982 costs carried forward and paid in 1983	35,552	(35,552)
1983 costs carried forward and paid in 1984	<u>---</u>	<u>164,918</u>
Actual program costs during fiscal year	<u>734,652</u>	<u>920,249</u>
Amount underfunded	<u>\$ 34,652</u>	<u>\$120,249</u>

Because Section 37-42, HRS, prohibits any department from incurring an obligation in excess of an allotment, the

department has resorted to extreme measures to avoid overexpending the allotment. Table 3.1 shows that the department has been delaying payments until the following fiscal year when funds became available. Our examination confirmed that fact as invoices amounting to over \$160,000 which were billed prior to June 30, 1983, were noted but were not encumbered or paid until the following fiscal year.

During our examination, we also noted that there is no procedure to encumber funds when an attorney is first appointed by the courts. The department is made aware of the cost of attorney fees and expenses only at the time the final bill is submitted for payment. The lack of an encumbrance procedure is not only a possible violation of state regulations but also makes it very difficult for the department to determine whether it will have sufficient funds to cover costs for the entire year.

Recommendations. We recommend that the department review its budget preparation process to derive more realistic budgets. We also recommend that the department develop and institute a procedure whereby funds can be encumbered at the time the court appoints the attorney. The encumbrance procedure should aid the department in determining earlier in the fiscal year whether additional funds will be required, so that an appropriate amount can be transferred to the program and/or a deficiency appropriation can be requested from the Legislature.

Improving Purchasing Procedures

State regulations require that purchase orders be prepared and approved prior to the purchase of any goods or services. This procedure not only ensures that all

purchases are authorized but also ensures that funds are available and encumbered or reserved for the purchase.

During our examination, several instances were noted in a division of the department where goods had been ordered and received prior to the preparation of the purchase order. In addition, amounts were listed and reported as encumbrances in the year-end encumbrance report to the Department of Accounting and General Services even though purchase commitments were not yet made. This was improper and was apparently done to prevent the funds from lapsing.

Recommendation. We recommend that the department's division heads scrutinize the work of their procurement clerks to ensure that there is a proper basis for purchases, purchase commitments, and encumbrances.

Failure to Follow Funds Transfer Review Procedures

In 1981, the First Circuit Court declared unconstitutional portions of the Hawaii Revised Statutes which limited the compensation of certain public officers and employees excluded from collective bargaining. The court awarded the affected officers and employees back pay.

The statewide funding for salary adjustments for the affected officers and employees was made through the following acts:

Act 5, SLH 1981, First Special Session	\$ 823,915
Act 264, SLH 1982, Regular Session	306,524
	<hr/>
	\$1,130,439

The department was responsible for distributing these funds to the various agencies affected by the court ruling. The

initial amount funded by Act 5 was allotted to the respective departments. When the second distribution was to be made, the department transferred \$1,130,439 to the various departments (rather than \$306,524), resulting in an overtransfer of \$823,915. The error was not detected until the third quarter of FY 1982-83. Efforts to have the funds returned to the department were in vain as the receiving departments reported that the funds had already been spent. The department ended up absorbing the overtransfer from its own operating budget.

Transfers of this kind are supposed to be subjected to a detailed review and two approvals before being effected. This particular excessive transfer received the necessary approvals but had not been reviewed in detail.

Recommendation. We recommend that the department review its procedures for the reviews and approval of transfer documents. Specifically, all documents should be subject to a detailed review and those persons approving the documents should also review supporting documents prior to final approval.

Utilization of Petty Cash

In 1981, the Legislature raised the maximum petty cash amount that each department could have from \$5,000 to \$25,000. At about the same time, the Department of Accounting and General Services instituted a policy requiring that all low dollar value purchases be paid with petty cash funds. The intent of these actions was to speed up vendor payments and increase the overall efficiency of the statewide vendor payment process.

The department has several petty cash funds ranging from \$25 to \$275 maintained

at various locations. As of June 30, 1983, there were six funds with a total of \$1,000. Because of the low dollar amounts of the individual funds, the funds can be used for only very minor purchases. Table 3.2 displays the six funds available at June 30, 1983.

Table 3.2
Petty Cash Funds by Division

Administrative Services Office	\$ 25
Hawaii Institute for Management and Analysis in Government	225
Electronic Data Processing Division	100
Finance Division	275
Public Defender	225
Public Utilities Commission	150
	<u>\$1,000</u>

Summary of Finding

A review of the utilization of petty cash revealed only a sporadic use by the department. Low dollar purchases continue to be routed to the Department of Accounting and General Services for payment by state warrant.

Recommendation. We recommend that the department institute the petty cash

utilization policy as required by the Department of Accounting and General Services. To facilitate this process, the department should request and maintain larger petty cash balances.

Electronic Data Processing Division "Special Fund"

The Electronic Data Processing Division (EDPD) utilizes a "special fund" to account for all appropriated receipts derived from user charges and for related operating expenses. The establishment of such a "special fund" was not authorized by the Legislature. Thus, the receipts and expenditures from the "fund" are actually transactions of the general fund. Accordingly, to the extent the unused appropriated receipts at the end of a fiscal year are not encumbered, that amount should be lapsed to the general fund. At June 30, 1983, the "fund" had a balance of \$44,445, all of which was not encumbered. Similarly, the balance at June 30, 1982, stood at \$220,072, again unencumbered.

Recommendation. We recommend that the department lapse any unencumbered balances from EDPD appropriated receipts at the end of each year.

Chapter 4

FINANCIAL STATEMENTS AND ACCOUNTANTS' OPINION

This chapter presents the results of the examination of the financial statements of the Department of Budget and Finance for the fiscal year ended June 30, 1983. It contains the opinion of Peat, Marwick, Mitchell & Co. regarding the fairness and accuracy of the department's financial statements. It also displays various financial statements of the general fund, special revenue funds, enterprise fund, and trust and agency funds administered by the department, together with explanatory notes and supplemental information presented for analysis purposes.

Summary of Finding

In the opinion of Peat, Marwick, Mitchell & Co., the financial statements present fairly the financial position of the department at June 30, 1983, and the results of its operations for the 1982-83 fiscal year.

Accountants' Opinion

Peat, Marwick, Mitchell & Co. filed the following report on the financial statements with the Legislative Auditor:

"To the Legislative Auditor
State of Hawaii
Honolulu, Hawaii:

We have examined the combined financial statements of the Department of Budget and Finance, State of Hawaii, as of and for the year ended June 30, 1983, as listed in the accompanying table of contents. 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, except as stated in the following paragraphs.

The scope of our examination did not include the audit of the Hawaii Public Employees Health Fund and the Employees' Retirement System as both funds function autonomously from the Department of Budget and Finance and receive only administrative support from the Department. Accordingly, the combined financial statements referred to above do not include the financial statements of the Hawaii Public Employees Health Fund and the Employees' Retirement System.

The Department of Budget and Finance does not maintain its own fixed asset records. The "General Fixed Assets" balances presented in the combined financial statements referred to above were obtained from the fixed asset records of the State of Hawaii. Accordingly, we were unable to satisfy ourselves as to the "General Fixed Assets" balances amounting to \$3,104,963. Therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the "General Fixed Assets" column of the combined balance sheet—all funds as of June 30, 1983.

In our opinion, except that, as explained in the preceding paragraph, we do not express an opinion on the financial statements relating to the general fixed assets, the aforementioned combined financial statements present fairly the

financial position of the Department of Budget and Finance, State of Hawaii, at June 30, 1983 and the results of its operations and the changes in financial position of proprietary fund type 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 financial statements taken as a whole. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic combined financial statements. The information in such schedule has been subjected to the auditing procedures applied in the examination of the basic combined financial statements and, in our opinion, such information is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

/s/ Peat, Marwick, Mitchell & Co.

PEAT, MARWICK, MITCHELL & CO.
Certified Public Accountants

Honolulu, Hawaii
October 14, 1983"

Descriptions and Definitions

Descriptions of financial statements and schedules. The following is a brief description of the financial statements and schedule examined by Peat, Marwick, Mitchell & Co. The financial statements and schedule are attached at the end of this chapter.

1. *Combined Balance Sheet—All Fund Types (Exhibit A).* This statement

presents the assets, liabilities and fund equity of all the funds used by the department on an aggregate basis.

2. *Combined Statement of Appropriations, Expenditures and Changes in Fund Balances—Governmental Fund Types (Exhibit B).* This statement presents the appropriations, expenditures and changes in fund balance for the general and special revenue funds used by the department on an aggregate basis.

3. *Combined Statement of Appropriations, Expenditures and Changes in Fund Balances—Budget and Actual—General Fund Budget Types (Exhibit C).* This statement presents a comparison of budgeted and actual appropriations and expenditures for the general fund accounts used by the department.

4. *Combined Statement of Revenues, Expenses and Changes in Retained Earnings/Fund Balance—Proprietary and Fiduciary Fund Types (Exhibit D).* This statement presents the revenues, expenses and changes in retained earnings/fund balance for all proprietary and fiduciary funds maintained by the department.

5. *Combined Statement of Changes in Financial Position—Proprietary Fund Type—Enterprise (Exhibit E).* This statement presents the changes in financial position of the proprietary fund maintained by the department.

6. *Revenues—Governmental Fund Types (Schedule 1).* This schedule presents the actual revenues for the general fund accounts classified by source within each 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 to incur obligations and to make expenditures pursuant to the appropriation made by the Legislature.

2. **Appropriation.** An authorization granted by the 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 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. **Transfer—lapse.** 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 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 approved by the appropriate authority.

Notes to Combined Financial Statements

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

Summary of significant accounting policies. The accounting policies of the department conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the more significant policies:

1. **Basis of presentation—fund accounting.** The accounts of the department are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance and retained earnings, revenues and expenditures/expenses. The various funds are

summarized by type in the financial statements. The following fund types are used by the department:

a. *Governmental fund types.*

Governmental funds are those through which the acquisition, use, and balances of the department's expendable financial resources and the related liabilities (except for those accounted for in proprietary funds) are accounted for. The measurement focus is upon determination of changes in financial position, rather than upon net income determination.

(1) General Fund. The general fund is the general operating fund of the department. It is used to account for all financial resources except for those required to be accounted for in another fund. The general fund programs presented are a part of the State of Hawaii general fund and are limited to only those appropriations and obligations of the department.

(2) Special Revenue Funds. Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. There are two of these special revenue funds.

. Public Utilities Commission Federal Grant—This fund is used to account for the federal moneys granted for the establishing of regulations over small alternative energy power procedures.

. Scandinavian Centennial Commission—This special fund is used to account for the costs of a commission established to arrange

for the commemoration of the 100th anniversary of the arrival of the first large group of Scandinavians to Hawaii.

b. *Proprietary fund types.* Proprietary funds are used to account for the department's ongoing operations, primarily the providing of low interest mortgages to veterans. The measurement focus is upon determination of net income.

(1) Enterprise Fund. The enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods or services be recovered primarily through user charges. There is one enterprise fund.

(2) Veterans' Loans Fund. This enterprise fund is used to account for the revenues and expenses relating to the providing of home mortgages to qualifying veterans.

c. *Fiduciary fund types.* Fiduciary funds are used to account for assets held by the department in a trustee capacity or as an agent for other funds.

(1) Trust and Agency Funds. Trust and agency funds include funds in the State of Hawaii Treasury. A description of the six trust and agency funds is presented below:

(2) Revenue Sharing Trust. This fund is used to account for revenue sharing Federal grants paid to the State.

. Special Purpose Revenue Bonds—This fund is used to account for deposits made by

private enterprises requesting the department to issue tax-exempt revenue bonds, the proceeds of which would be loaned to the requesting enterprise.

- . State Mortgage Guarantee—This fund is used to account for moneys used to guarantee the mortgages of qualified homeowners.

- . State Treasury—This fund represents the cash and cash equivalents of the State for which the department is responsible.

- . Federal College Aid Appropriation—This fund is used to account for certain Federal funds held for the University of Hawaii, the earnings of which are transferred to the University of Hawaii.

- . Abandoned Property—This fund is used to account for abandoned property where the legal owner cannot be located.

d. *Account groups.* Account groups are used to establish accounting control and accountability for the department's general fixed assets.

- (1) General Fixed Assets Account Group. This group of accounts is established to account for all fixed assets of the department, other than those accounted for in the proprietary funds.

2. *Basis of accounting.* The modified accrual basis of accounting is followed by the governmental funds. Under the modified accrual basis of accounting, revenues are recorded when susceptible to

accrual, usually when the appropriations are allotted. Expenditures are recorded when the liability is incurred, if measurable. The accrual basis of accounting is used by proprietary fund and fiduciary fund types.

3. *Encumbrances.* Encumbrance accounting, under which purchase orders and contract commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Open encumbrances are reported as reservations of fund balances since the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities.

4. *General fixed assets.* General fixed assets have been acquired for general governmental purposes. Assets purchased are recorded as expenditures in the governmental funds and capitalized at cost in the general fixed assets account group.

No depreciation has been provided on general fixed assets, nor has interest been capitalized.

5. *Accumulated vacation and sick leave.* State employees' sick leave and vested annual vacations are recorded as expenditures when actually taken.

Vested accumulated vacation and sick leave have not been accrued in the financial statements. In August 1982, the National Council of Governmental Accounting (NCGA) issued Statement 4 which requires governmental fund types to accrue accumulated vacation. The statement is effective for fiscal years beginning after December 31, 1982.

6. **Investments.** Under the Hawaii Revised Statutes, Chapter 523, the department is the custodian for all unclaimed property. The unclaimed property includes stocks and bonds which are valued at the lower of cost or market at balance sheet date. The cost of the investment as shown on Exhibit A as "Investments: Other" is based on fair market value at the date of acquisition.

7. **Total data.** The total data are the aggregate of the fund types. No consolidating or other eliminations were made in arriving at the totals; thus they do not present consolidated information.

Budget basis of accounting. The budgets are prepared on a basis other than generally accepted accounting principles (GAAP). The actual results of operations are presented on a budgetary basis in the combined statement of appropriations, expenditures and changes in fund balances—budget and actual—general fund budget basis to provide a meaningful comparison of actual results with budget.

The major differences between the budget and GAAP bases are that:

- Revenues are recorded when received in cash (budget) as opposed to when susceptible to accrual (GAAP).
- Encumbrances are recorded as the equivalent of expenditures (budget) as opposed to a reservation of fund balance (GAAP).

Adjustments necessary to convert the results of operations for the year ended

June 30, 1983, and fund balances at June 30, 1983, from the GAAP basis to the budget basis are as follows:

	<i>General</i>	
	<i>Excess (Deficiency) of Revenues Over Expenditures and Other Uses</i>	
	<i>Balances at End of Year</i>	
GAAP basis	\$(753,553)	\$ 595,802
Increase (decrease):		
Due to revenues:		
Received in cash during year but already accrued as receivables (GAAP) at June 30, 1982	136,621	136,621
Accrued as receivables at June 30, 1983, but not recognized in budget	(83,568)	(83,568)
Due to encumbrances:		
Expenditures of amounts encumbered during year ended June 30, 1982	932,015	932,015
Reserved (GAAP) at June 30, 1983, but recognized as expenditures for budget purposes	(613,638)	(613,638)
Budget basis	<u>\$(382,124)</u>	<u>\$ 967,231</u>

General fund deficit. The undesignated general fund deficit shown on the Combined Balance Sheet—All Fund Types (Exhibit A) is due principally from a deficit of \$160,000 in the counsel and other services for indigent defendants program. The department plans to eliminate the deficit with appropriations for the fiscal year ending June 30, 1984.

Bonds payable. Bonds payable at June 30, 1983, for the proprietary funds shown on Exhibit A are summarized as follows:

\$2,000,000 1964 general obligation reimbursable serial bonds due in annual installments of \$111,333 through May 15, 1984; interest at 3.25 percent	\$111,333
\$288,500 1965 general obligation reimbursable serial bonds due in annual installments of \$16,028 through May 1, 1985; interest at 3.2 percent	<u>32,056</u>
	<u>\$143,389</u>

The annual principal requirements for the general obligation reimbursable bonds as of June 30, 1983, are as follows:

Year ending June 30:	
1984	\$127,361
1985	<u>16,028</u>
	<u>\$143,389</u>

Fixed assets. A summary of changes (unaudited) in general fixed assets shown on Exhibit A follows:

<i>Balance</i> <i>July 1, 1982</i>	<i>Additions</i>	<i>Deletions</i>	<i>Balance</i> <i>June 30, 1983</i>
\$2,228,444	\$882,176	\$5,657	\$3,104,963

Veterans' Loans Fund. The Veterans' Loans Fund was established to encourage the construction of housing for veterans through the purchase of qualifying veterans' mortgages from financial institutions.

The following is a condensed balance sheet as of June 30, 1983, and condensed statement of revenues, expenses and changes in retained earnings of the Veterans' Loans Fund for the year then ended:

Condensed Balance Sheet

<i>Assets</i>	
Cash in State Treasury	\$2,147,159
Notes and Other Receivables	1,723,360
Other Assets	<u>3,349</u>
Total Assets	<u>\$3,873,868</u>

Liabilities and Fund Equity

Reimbursable General Obligation Bonds	\$ 143,389
Other Liabilities	3,349
Fund Equity:	
Contributed Capital	1,693,593
Retained Earnings—Unreserved	<u>2,033,537</u>
Total Liabilities and Fund Equity	<u>\$3,873,868</u>

Condensed Statement of Revenues, Expenses and Changes in Retained Earnings

Revenues—Interest	\$ 102,777
Expenses:	
Interest	\$ 8,775
Service Fees	10,211
Administrative	18,684
Net Income	37,670
	65,107
Retained Earnings, July 1, 1982	<u>1,968,430</u>
Retained Earnings, June 30, 1983	<u>\$2,033,537</u>

Employees' Retirement System. The department is included in the Employees' Retirement System (the System) of the State of Hawaii which covers substantially all employees of the State of Hawaii, as well as the counties of the State. The department's contribution to the System for the year ended June 30, 1983, was \$1,542,500 which includes amortization of the unfunded accrued liability over a 38-year period. The department's policy is to fund pension cost accrued.

Data concerning the actuarial present value of accumulated plan benefits, vested plan benefits and net assets available for benefits which are relevant to the department are not available since such determinations are made on a systemwide

basis and not for individual participating departments.

Lease commitments. Commitments under operating lease agreements for facilities and equipment provide for minimum annual rental payments as of June 30, 1983, as follows:

Year ending June 30:	
1984	\$689,500
1985	127,300
1986	79,200
1987	37,500
1988	---
	<u>\$933,500</u>

The total rent expense for the fiscal year ended June 30, 1983, was \$2,454,000.

Special purpose revenue bonds. The department is authorized under Chapter 39A of the Hawaii Revised Statutes to issue special purpose revenue bonds in order to provide private entities with an available low-cost source of capital financing for the construction of facilities deemed to be in the public interest. Fees are assessed for all administrative and processing costs incurred. The bonds are secured by the property financed and payments made by the borrowing entities. The department has no obligation for this debt. Accordingly, these bonds are not reflected in the accompanying financial statements.

As of June 30, 1983, special purpose revenue bonds outstanding were as follows:

	Interest Rate	Maturity Date	Outstanding Amount
The Queen's Medical Center	7.50%—10.75%	2012	\$ 80,000,000
Hawaiian Electric Company, Inc.	13.00%	2012	42,580,000
Wahiawa General Hospital	11.00%—15.50%	2012	9,900,000
Pohai Nani Good Samaritan Kauhale Health Care Facility	7.00%—10.50%	2002	9,000,000
Maui Electric Company, Limited	13.00%	2012	7,720,000
Hawaii Electric Light Company, Inc.	13.00%	2012	7,200,000
Citizens Utilities Company	9.75%	2012	3,300,000
Castle Memorial Hospital (Bond Anticipation Note)	70.00% of prime	1986	1,500,000
			<u>\$161,200,000</u>

As of June 30, 1983, the special purpose revenue bonds which were authorized but unissued included:

Kaiser Foundation Hospital	\$ 62,000,000
Kuakini Medical Center	20,000,000
The Queen's Medical Center	20,000,000
St. Francis Hospital	13,000,000
Hawaii Electric Light Company, Inc.	11,445,000
Aloha Studios, Inc.	10,000,000
Kapiolani/Children's Medical Center	8,000,000
Castle Memorial Hospital	7,600,000
Wahiawa General Hospital	1,900,000
G. N. Wilcox Hospital	1,000,000
Maui Electric Company, Limited	7,000
	<hr/>
	\$164,952,000

STATE OF HAWAII
 DEPARTMENT OF BUDGET AND FINANCE
 Combined Balance Sheet - All Fund Types
 June 30, 1983

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Assets	Governmental fund types		Proprietary fund type Enterprise	Fiduciary fund type Trust and agency	Account group General fixed assets (unaudited)	Total
	General	Special revenue				
Cash:						
Cash on hand	\$ -	-	-	96,621	-	96,621
Cash in banks including certificates of deposit of \$705,107,992	717,600	40,795	2,147,159	735,718,580	-	738,624,134
Cash with fiscal agent	-	-	-	30,685,382	-	30,685,382
Cash in U. S. Treasury	-	-	-	112,275,560	-	112,275,560
Investments:						
U. S. Treasury bills	-	-	-	2,224,287	-	2,224,287
Other	-	-	-	57,147	-	57,147
Total investments	-	-	-	2,281,434	-	2,281,434
Receivables:						
Notes	-	-	1,712,739	-	-	1,712,739
Other	83,658	-	10,621	-	-	94,279
Total receivables	83,658	-	1,723,360	-	-	1,807,018
Fixed assets	-	-	-	-	3,104,963	3,104,963
Other assets	-	-	3,349	-	-	3,349
	<u>\$ 801,258</u>	<u>40,795</u>	<u>3,873,868</u>	<u>881,057,577</u>	<u>3,104,963</u>	<u>888,878,461</u>

(Continued)

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE

Exhibit A (cont)

Combined Balance Sheet - All Fund Types, Continued

	<u>Governmental fund types</u>		<u>Proprietary fund type Enterprise</u>	<u>Fiduciary fund type Trust and agency</u>	<u>Account group General fixed assets (unaudited)</u>	<u>Total</u>
	<u>General</u>	<u>Special revenue</u>				
<u>Liabilities</u>						
Accounts payable	\$ 202,913	1,575	-	-	-	204,488
Deposits	2,543	-	-	-	-	2,543
Due to other State of Hawaii agencies	-	-	-	875,607,577	-	875,607,577
Reimbursable general obligation bonds	-	-	143,389	-	-	143,389
Other	-	-	3,349	-	-	3,349
Total liabilities	<u>205,456</u>	<u>1,575</u>	<u>146,738</u>	<u>875,607,577</u>	<u>-</u>	<u>875,961,346</u>
<u>Fund Equity</u>						
Contributed capital	-	-	1,693,593	-	-	1,693,593
Investment in general fixed assets	-	-	-	-	3,104,963	3,104,963
Retained earnings - unreserved	-	-	2,033,537	-	-	2,033,537
Fund balances:						
Reserved for encumbrances	629,546	-	-	-	-	629,546
Unreserved:						
Undesignated	(33,744)	39,220	-	-	-	5,476
Designated	-	-	-	5,450,000	-	5,450,000
Total retained earnings/fund balances	<u>595,802</u>	<u>39,220</u>	<u>2,033,537</u>	<u>5,450,000</u>	<u>-</u>	<u>8,118,559</u>
Total fund equity	<u>595,802</u>	<u>39,220</u>	<u>3,727,130</u>	<u>5,450,000</u>	<u>3,104,963</u>	<u>12,917,115</u>
	\$ <u>801,258</u>	<u>40,795</u>	<u>3,873,868</u>	<u>881,057,577</u>	<u>3,104,963</u>	<u>888,878,461</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE

Combined Statement of Appropriations,
Expenditures and Changes in Fund Balances -
Governmental Fund Types

Year ended June 30, 1983

	<u>General</u>	<u>Special revenue</u>	<u>Total</u>
Allotted appropriations	\$ 231,262,768	-	231,262,768
Appropriated receipts	<u>1,171,943</u>	<u>-</u>	<u>1,171,943</u>
	<u>232,434,711</u>	<u>-</u>	<u>232,434,711</u>
Expenditures:			
Personal services	7,979,888	2,886	7,982,774
Other	<u>221,377,298</u>	<u>-</u>	<u>221,377,298</u>
	<u>229,357,186</u>	<u>2,886</u>	<u>229,360,072</u>
Excess (deficiency) of revenues over expenditures	3,077,525	(2,886)	3,074,639
Other financing sources (uses):			
Operating transfers in	646,386	-	646,386
Operating transfers out	<u>(1,819,238)</u>	<u>-</u>	<u>(1,819,238)</u>
	1,904,673	(2,886)	1,901,787
Excess (deficiency) of revenues and other sources over expendi- tures and other uses	1,904,673	(2,886)	1,901,787
Transfer - lapse to State General Fund	<u>(2,658,226)</u>	<u>-</u>	<u>(2,658,226)</u>
Deficiency of revenues and other sources over expenditures and other uses and lapses	(753,553)	(2,886)	(756,439)
Fund balance, July 1, 1982	<u>1,349,355</u>	<u>42,106</u>	<u>1,391,461</u>
Fund balance, June 30, 1983	\$ <u><u>595,802</u></u>	<u><u>39,220</u></u>	<u><u>635,022</u></u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE

Combined Statement of Appropriations,
Expenditures and Changes in Fund Balances - Budget and Actual -
General Fund Budget Basis (note 2)

Year ended June 30, 1983

	Budget	Actual on a budgetary basis	Variance - favorable (unfavorable)
Revenues:			
Allotted appropriations	\$ 231,262,768	231,262,768	-
Appropriated receipts	1,400,400	1,224,996	(175,404)
	<u>232,663,168</u>	<u>232,487,764</u>	<u>(175,404)</u>
Expenditures:			
Personal services	8,843,601	7,957,994	885,607
Other	223,819,567	221,080,816	2,738,751
	<u>232,663,168</u>	<u>229,038,810</u>	<u>3,624,358</u>
Excess of revenues over expenditures	-	3,448,954	3,448,954
Other financing sources (uses):			
Operating transfers in	-	646,386	646,386
Operating transfers out	-	(1,819,238)	(1,819,238)
	-	<u>2,276,102</u>	<u>2,276,102</u>
Excess of revenues and other sources over expenditures and other uses	-	2,276,102	2,276,102
Transfer - lapse to State General Fund	-	(2,658,226)	(2,658,226)
Deficiency of revenues and other sources over expenditures and other uses and lapses	-	(382,124)	(382,124)
Fund balance, July 1, 1982	-	1,349,355	1,349,355
Fund balance, June 30, 1983	\$ -	<u>967,231</u>	<u>967,231</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE

Combined Statement of Revenues, Expenses and
Changes in Retained Earnings/Fund Balance -
Proprietary and Fiduciary Fund Types

Year ended June 30, 1983

	Proprietary fund type <u>Enterprise</u>	Fiduciary fund type Non- expendable <u>trust</u>	<u>Total</u>
Revenues - Veterans' Loans Fund interest income	\$ 102,777	-	102,777
Expenses:			
Interest	8,775	-	8,775
Service fees	10,211	-	10,211
Administrative	18,684	-	18,684
	<u>37,670</u>	-	<u>37,670</u>
Net income	65,107	-	65,107
Retained earnings/fund balance, July 1, 1982	<u>1,968,430</u>	<u>5,450,000</u>	<u>7,418,430</u>
Retained earnings/fund balance, June 30, 1983	\$ <u>2,033,537</u>	<u>5,450,000</u>	<u>7,483,537</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
 DEPARTMENT OF BUDGET AND FINANCE

Combined Statement of Changes in Financial Position -
 Proprietary Fund Type - Enterprise

Year ended June 30, 1983

Sources of cash:		
Operations - net income		\$ 65,107
Decrease in notes receivable		<u>410,559</u>
		475,666
Use of cash - repayment of reimbursable general obligation bonds		<u>127,361</u>
		348,305
Net increase in cash		
Cash balance, July 1, 1982		<u>1,798,854</u>
Cash balance, June 30, 1983		\$ <u><u>2,147,159</u></u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE

Revenues - Governmental Fund Types

Year ended June 30, 1983

	<u>Allotted appropriations</u>	<u>Appropriated receipts</u>	<u>Total</u>
Electronic data processing services	\$ 7,099,536	1,171,310	8,270,846
Program, planning, analysis and budgeting	2,926,805	633	2,927,438
Cash and debt management	198,027,528	-	198,027,528
Legal assistance in criminal actions	2,198,943	-	2,198,943
Transportation, communications and utilities	762,405	-	762,405
Grants-in-aid to the counties	19,447,551	-	19,447,551
Counsel and other services to indigent defendants	<u>800,000</u>	<u>-</u>	<u>800,000</u>
Total revenues	\$ <u>231,262,768</u>	<u>1,171,943</u>	<u>232,434,711</u>

COMMENTS ON AGENCY RESPONSES

On ~~January 3, 1984~~, copies of a preliminary draft report of this financial audit were transmitted to the Governor, the presiding officers of the Legislature and to the Department of Budget and Finance (B&F). A copy of the transmittal letter to the department is included here as **PART III**. As is our practice, we invited the department to comment on the recommendations made in the report. The department's response is **RESPONSE OF THE AFFECTED AGENCY**.

In his response dated January 16, 1984, the Director of Finance has expressed general agreement with all but one of the recommendations. The one disagreement is over our recommendation for B&F to consider restricting the funds of agencies when they fail to make timely notification to B&F of large bank deposits and maximum interest income is not realized because of such failure. We suggested that the amount to be restricted could be equal to the amount of lost interest earnings. The director believes that such action could jeopardize an agency's program. Our view is that the establishment of such a policy would be the most effective way to obtain the compliance of the agencies and thereby enable B&F to maximize interest income for the State.

COMMENTS ON AGENCY RESPONSES

On January 3, 1984, copies of a preliminary draft report of this financial audit were transmitted to the Governor, the presiding officers of the Legislature and to the Department of Budget and Finance (B&F). A copy of the transmittal letter to the department is included here as Attachment 1. As is our practice, we invited the department to comment on the recommendations made in the report. The department's response is included here as Attachment 2.

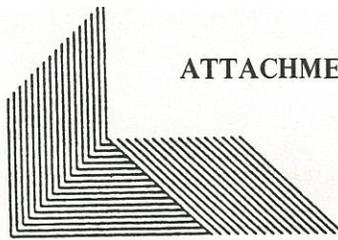
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Departmental Response

We concur with the recommendation that excess cash balances in the Veteran's Loan Program be transferred to the general fund. On November 3, 1983, \$1.7 million was transferred from the Veteran's Loan Program to the general fund. Balances in the Veteran's Bond special fund will be reviewed periodically and such amounts as are determined to be in

ATTACHMENT 1

THE OFFICE OF THE AUDITOR
STATE OF HAWAII
465 S. KING STREET, RM. 500
HONOLULU, HAWAII 96813



CLINTON T. TANIMURA
AUDITOR

January 3, 1984

C O P Y

Mr. Jensen S. L. Hee, Director
Department of Budget and Finance
State Capitol, Room 411
Honolulu, Hawaii 96813

Dear Mr. Hee:

Enclosed are two preliminary copies, Nos. 4 and 5, of our *Financial Audit of the Department of Budget and Finance*. We call your attention to the recommendations affecting your department which are made in Chapter 3 of the report. If you have any comments on the recommendations, we ask that you submit them in writing to our office by January 17, 1984, for inclusion in the final report.

The Governor and the presiding officers of the Legislature have been provided with copies of this preliminary report.

Since the report is not in final form and there may be changes 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



JENSEN S. L. HEE
DIRECTOR

DENNIS K. GODA
DEPUTY DIRECTOR

HAWAII PUBLIC EMPLOYEES HEALTH FUND
EMPLOYEES' RETIREMENT SYSTEM
PUBLIC UTILITIES COMMISSION
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
STATE CAPITOL
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

DIVISIONS:
BUDGET, PLANNING AND MANAGEMENT
HAWAII INSTITUTE FOR MANAGEMENT
AND ANALYSIS IN GOVERNMENT
ELECTRONIC DATA PROCESSING
FINANCE

January 16, 1984

RECEIVED

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OFFICE OF THE AUDITOR
STATE OF HAWAII

Mr. Clinton Tanimura
Legislative Auditor
The Office of the Auditor
465 S. King Street, Rm. 500
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

Thank you for providing me with the opportunity to review and comment on the recommendations that were made on the Financial Accounting and Internal Control of the Department of Budget and Finance. Pursuant to your letter of January 3, 1984, we have completed our review and submit herewith our written comments on the recommendations.

1. Finding

THE DEPARTMENT HAS ALLOWED FUNDS TO ACCUMULATE IN THE VETERAN'S LOAN FUND IN EXCESS OF THE PROGRAM'S REQUIREMENTS, AND THERE ALSO REMAINS AN UNNECESSARY BALANCE IN THE SPECIAL FUND OF THE SCANDINAVIAN CENTENNIAL COMMISSION.

Recommendation

THE DEPARTMENT INSTITUTE PROCEDURES WHEREBY ALL SPECIAL FUNDS WITHIN ITS JURISDICTION WILL BE PERIODICALLY SCRUTINIZED TO DETERMINE WHICH FUNDS CAN BE TRANSFERRED TO THE GENERAL FUND. ADDITIONALLY, THE FUNDS NOW REMAINING IN THE SCANDINAVIAN CENTENNIAL COMMISSION SPECIAL FUND AND THE 1983 CASH BALANCE AND FUTURE CASH BALANCES FROM THE VETERAN'S LOANS PROGRAM SHOULD BE LAPSED TO THE GENERAL FUND.

Departmental Response

We concur with the recommendation that excess cash balances in the Veterans Loan Program be transferred to the general fund. On November 3, 1983, \$1.7 million was transferred from the Veteran's Loan Program to the general fund. Balances in the Veteran's Bond special fund will be reviewed periodically and such amounts as are determined to be in

excess of Program requirements will be transferred to the general fund. Moreover, as of this date, we have also lapsed the remaining balance of the Scandinavian Centennial Commission special fund to the general fund.

2. Finding

BECAUSE OTHER AGENCIES HAVE BEEN DERELICT IN REPORTING DEPOSITS OF STATE FUNDS, THE DEPARTMENT HAS NOT REALIZED ITS FULL POTENTIAL IN INTEREST EARNINGS.

Recommendation

THE DEPARTMENT FOLLOW UP ON THOSE AGENCIES NOT ADHERING TO THE TELEPHONE REPORTING POLICY. TO ENSURE COMPLIANCE, THE DEPARTMENT SHOULD CONSIDER A POLICY OF RESTRICTING AGENCY FUNDS WHEN AN AGENCY IS DERELICT IN ITS REPORTING RESPONSIBILITIES AND THE STATE LOSES INTEREST AS A RESULT. THE AMOUNT TO BE RESTRICTED COULD BE EQUAL TO THE AMOUNT OF LOST INTEREST EARNINGS.

Departmental Response

We concur with the recommendation that the Department of Budget and Finance follow up on State agencies which do not adhere to the policy of reporting deposits in excess of \$100,000. However, we do not agree that agencies which fail to adhere to this policy should have their funds restricted. We believe that such action could jeopardize an agency's program operations to the detriment of the State.

Moreover, it should be noted that the Airports Division and the Harbors Division of the Department of Transportation do report their large deposits by telephone on a regular basis. Also the need for telephone reporting, generally, by the Department of Transportation - Highways Division, Department of Social Services and Housing, Department of Education and the University of Hawaii has been obviated, since, for the most part, their large collections are received directly at the State Treasury either by check or by wire transfer.

In addition, as a result of recent changes in federal banking laws, depositories are now permitted to pay interest on public funds in checking accounts. As of March 1983, the State began to convert its non-interest bearing checking accounts to interest bearing demand accounts, commonly referred to as "Super Now" accounts. We believe that this has significantly alleviated the problem of lost interest earnings due to untimely reporting of deposits as such deposits now draw interest from the date of deposit.

3. Finding

THE COUNSEL FOR INDIGENTS PROGRAM HAS BEEN UNDERFUNDED, FORCING THE DEPARTMENT TO DELAY PAYMENT OF CLAIMS SO AS TO AVOID OVEREXPENDING THE APPROPRIATION.

Recommendation

THE DEPARTMENT REVIEW ITS BUDGET PREPARATION PROCESS TO DERIVE MORE REALISTIC BUDGETS. WE ALSO RECOMMEND THAT THE DEPARTMENT DEVELOP AND INSTITUTE A PROCEDURE WHEREBY FUNDS CAN BE ENCUMBERED AT THE TIME THE COURT APPOINTS THE ATTORNEY. THE ENCUMBRANCE PROCEDURE SHOULD AID THE DEPARTMENT IN DETERMINING EARLIER IN THE FISCAL YEAR WHETHER ADDITIONAL FUNDS WILL BE REQUIRED, SO THAT AN APPROPRIATE AMOUNT CAN BE TRANSFERRED TO THE PROGRAM AND/OR A DEFICIENCY APPROPRIATION CAN BE REQUESTED FROM THE LEGISLATURE.

Departmental Response

We do not disagree and intend to follow-up on this recommendation. However, we would like to explain that it is very difficult, if not impossible, to formulate precise budgetary requirements since the caseload determinants are predicated upon the operations of other governmental agencies such as the police department, prosecutor and courts (Judiciary).

Moreover, the Department of Budget and Finance is now authorized by the Legislature to transfer savings from any program appropriation within the General Appropriations Act as a means of assuring prompt payment for services rendered. It was not previously possible for the Department to administratively augment the specific appropriation amounts for fiscal years 1981-82 and 1982-83.

4. Finding

A DIVISION OF THE DEPARTMENT HAS FAILED TO FOLLOW PURCHASING PROCEDURES REQUIRED BY STATE REGULATIONS.

Recommendation

THAT THE DEPARTMENT'S DIVISION HEADS SCRUTINIZE THE WORK OF THEIR PROCUREMENT CLERKS TO ENSURE THAT THERE IS A PROPER BASIS FOR PURCHASES, PURCHASE COMMITMENTS, AND ENCUMBRANCES.

Departmental Response

We have not been able to identify the specific program or incident(s) involved in this citation. To the best of our knowledge, all programs are in compliance with purchasing regulations. We nevertheless plan to take immediate action to remind our program personnel of the need for more stringent scrutiny to assure that all programs within the Department comply with proper procedures.

5. Finding

A BREAKDOWN IN THE DOCUMENT REVIEW PROCESS FOR THE TRANSFER OF FUNDS CAUSED THE DEPARTMENT TO OVERTRANSFER FUNDS TO VARIOUS OTHER DEPARTMENTS.

Recommendation

THAT THE DEPARTMENT REVIEW ITS PROCEDURES FOR THE REVIEWS AND APPROVAL OF TRANSFER DOCUMENTS. SPECIFICALLY, ALL DOCUMENTS SHOULD BE SUBJECT TO A DETAILED REVIEW AND THOSE PERSONS APPROVING THE DOCUMENTS SHOULD ALSO REVIEW SUPPORTING DOCUMENTS PRIOR TO FINAL APPROVAL.

Departmental Response

We do not disagree with this recommendation and will take immediate steps to effectuate more stringent reviews of transfer documents.

6. Finding

THE DEPARTMENT IS NOT FOLLOWING STATEWIDE ACCOUNTING POLICIES AS TO THE USE OF PETTY CASH FUNDS, AND IT IS NOT MAKING ADEQUATE USE OF SUCH FUNDS.

Recommendation

THE DEPARTMENT INSTITUTE THE PETTY CASH UTILIZATION POLICY AS REQUIRED BY THE DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES. TO FACILITATE THIS PROCESS, THE DEPARTMENT SHOULD REQUEST AND MAINTAIN LARGER PETTY CASH BALANCES.

Departmental Response

The Department has held several division level meetings to encourage greater use of petty cash amounts and transactions. The result was the recent increases of petty cash amounts and transactions for HIMAG and the PUC. Nevertheless, we concur with the recommendations and shall take necessary action to effectuate more adequate utilization of such funds.

7. Finding

THE DEPARTMENT IS USING A SPECIAL FUND WHICH HAS NOT BEEN AUTHORIZED BY THE LEGISLATURE TO CARRY FORWARD UNENCUMBERED FUNDS FROM YEAR TO YEAR.

Recommendation

THE DEPARTMENT LAPSE ANY UNENCUMBERED BALANCES FROM EDPD APPROPRIATED RECEIPTS AT THE END OF EACH YEAR.

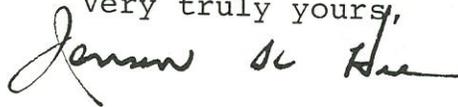
Departmental Response

We concur with this recommendation inasmuch as it has been our general practice for the past several years such that unencumbered balances that carryover would be the exception and not the rule. Fiscal Year 1981-82 was particularly exceptional since the outstanding, unencumbered balance was the result of our inability to procedurally acquire the necessary authorizations to execute contracts and purchase orders for essential goods and services by June 30, 1982. The purchases and payments were therefore made early in FY 1982-83.

We appreciate your calling this situation in our "interdepartmental transfer fund" to our attention and shall take the necessary steps to prevent future occurrences of this kind.

I would like to extend my appreciation for this opportunity to comment, and please do not hesitate to contact me if you may have any further questions or require additional information.

Very truly yours,



JENSEN S. L. HEE
Director of Finance