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## I. INTRODUCTION AND BACKGROUND

Over the years, it has been both legislative and administration policy to encourage State agencies to pay their smaller bills from petty cash funds. The effective use of petty cash funds would result in: (1) faster payments to vendors; (2) an overall reduction in workload; and (3) likely cost savings by the State.

Despite the substantial benefits that can be realized through the use of petty cash funds, there are signs that the State is far from achieving the full potential of the use of such funds. Of the approximately 475 separate petty cash funds established in State agencies, most are very small in size with balances of less than \$100, indicating that the only apparent utility of these funds is to pay for small retail purchases. In addition, the vast majority of petty cash funds are held in cash rather than in checking accounts, thereby affecting the facility and security by which payments can be made. Finally, the Legislative Auditor's financial audit reports, one as recent as January 1984,\* indicate that some of the individual agencies have not been responsive to petty cash fund policies.

While in the past, the Legislative Auditor's findings and recommendations concerning petty cash funds have been part of a financial audit or a larger study, it is believed that the issue can be examined more comprehensively and reported upon by making it the subject of a separate examination to be conducted by a certified public accountant.

Therefore, these specifications describe the nature and work required of the certified public accountant to be engaged by the Legislative Auditor (hereinafter referred to as the "State Auditor") to conduct an examination of the policies, systems and procedures of accounting, reporting and internal controls of petty cash funds of the State of Hawaii.

The instructions for submitting a proposal are intended to assist the certified public accountant in preparing a proposal to conduct the examination. Unless otherwise expressly provided in the contract, all provisions of these specifications shall be a part of the contract entered into by the certified public accountant and State Auditor.

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\*Legislative Auditor, State of Hawaii, Financial Audit of the Department of Budget and Finance, Report No. 84-8, January 1984.

## II. SPECIFICATIONS

### A. Examination Objectives

The objectives of the examination are:

1. To assess the appropriateness and effectiveness of administration policies concerning the use of petty cash funds.
2. To assess the effectiveness and efficiency of executive agencies in implementing administration policies and the adequacy, effectiveness and efficiency of the systems and procedures for financial accounting, internal control, and financial reporting in utilizing petty cash funds.
3. If appropriate, to recommend changes in policies, procedures or practices to improve the utilization of petty cash funds, and systems and procedures for accounting and internal control.

### B. Scope of Examination

1. Policies governing the use of petty cash funds. The basic policies for petty cash funds are Section 40-84, Hawaii Revised Statutes and Title 3, Chapter 11 of the administrative rules, for which the Department of Accounting and General Services (DAGS) is the promulgating agency. The examination shall review the foregoing policies (and any other policies which might exist), particularly with respect to the following:
  - a. The statute establishes a ceiling of \$25,000 for each agency's petty cash funds (except the University of Hawaii and the Stadium Authority which are exempt from the ceiling). The examination shall determine whether the ceiling is appropriate and adequate.
  - b. DAGS' rules specify that a single disbursement from a petty cash fund shall not exceed \$100. The examination shall determine whether this is an appropriate and cost effective threshold, from the standpoint of covering an optimal number of transactions and achieving cost savings while giving due regard to security and appropriate accounting controls.
2. Practices of executive agencies in utilizing petty cash funds. The examination shall review the practices of agencies, particularly with respect to: (1) the extent to which there is maximum use of petty cash funds as allowed and encouraged by policies; and (2) adherence to systems and procedures for financial accounting, internal control and reporting in the use of petty cash funds. The review shall encompass an assessment

of the appropriateness of the organizational location of the custodian of the petty cash funds in terms of efficiency and internal controls. In conducting this aspect of the examination, it is not expected that the certified public accountant shall examine the petty cash funds of all of the executive agencies. Instead, a sample of petty cash funds shall be selected from several specified agencies. The sample of each agency shall be sufficient in number to enable valid findings to be drawn for each agency. The agencies from which a sample shall be selected and examined are:

- a. The Department of Education, to include at least one elementary school and one secondary school from each of the seven school districts.
- b. The Department of Health, to include at least one hospital from each county.
- c. The University of Hawaii, to include at least one petty cash fund from each of the community colleges and the University of Hawaii at Hilo and an appropriate number from the Manoa campus.

The certified public accountant shall specify in the proposal the sample planned to be selected for examination for each agency.

3. Recommendations. If so indicated by the findings, the examination shall make appropriate recommendations. Any recommendation made shall be specific as to whether changes are being proposed to the practices and procedures of the agencies, the policies of DAGS, or the policies expressed in statute.

C. Examination Standards

In conducting the examination and in reporting findings, the certified public accountant shall adhere to the following standards:

1. General standards.
  - a. The examination shall be performed by a person or persons having adequate technical training and proficiency as an auditor.
  - b. Objectivity and independence in mental attitude shall be maintained in all matters relating to the assignment.
  - c. Due professional care shall be exercised in the performance of the examination and the preparation of the report.

2. Fieldwork standards.

- a. The work shall be adequately planned, and assistants, if any, shall be properly supervised.
- b. There shall be proper study and evaluation of the existing internal control system as a basis for reliance thereon.
- c. Sufficient and competent evidence shall be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for recommendations for improvements in accounting, internal control, and reporting systems and procedures.

3. Standards for reporting on internal controls, accounting systems and procedures, etc. With respect to internal controls and accounting systems and procedures relating to the petty cash funds, the certified public accountant shall submit to the State Auditor:

- a. A statement of the scope and objectives of the systems and procedures examination.
- b. All significant findings of weaknesses and inadequacies in the internal and operating controls, accounting and reporting systems and policies, procedures, and practices disclosed as a result of the examination.
- c. Recommendations for improvements.

D. Examination Activities

1. Legal authority. The certified public accountant shall, at a minimum, become sufficiently knowledgeable with the applicable sections of the following reference documents:

- a. Constitution of the State of Hawaii.
- b. Hawaii Revised Statutes.

(1) Laws having general application:

- . Chapter 23--Auditor
- . Chapter 26--Executive and Administrative Departments

- . Chapter 27--State Functions and Responsibilities
- . Chapter 91--Administrative Procedure

(2) Laws relating to fiscal matters:

- . Section 40-84--Petty Cash Funds
- . Chapter 103--Expenditure of Public Money and Public Contracts
- . Title 5--State Financial Administration

c. Applicable rules, regulations, and administrative procedures issued by the following agencies relating to the financial transactions, accounting systems and controls, and operating procedures:

- (1) Office of the Governor
- (2) Department of Accounting and General Services
- (3) Department of Education
- (4) Department of Health
- (5) University of Hawaii

2. Examination working papers. The certified public accountant shall, at any time during and subsequent to the completion of the examination, make available to the State Auditor for his inspection and review, the working papers developed during the examination, including among others, the following:
- a. The examination program and internal control questionnaire.
  - b. Schedules, recommendations, computations, analyses, examination notes, and other data representing a record of work done.
  - c. Documents obtained and other working papers relating to the examination.

The working papers shall not be made available to others except by mutual consent of the State Auditor and the certified public accountant.

3. Discovery of unusual condition. If at any time during the examination the certified public accountant discovers a deficiency that is highly unusual or of such a nature as to require immediate correction or of such a character that to complete the examination a significant amount of time or resources beyond that initially contemplated by the parties to the contract would be required, the certified public accountant shall immediately notify the State Auditor of his finding in writing. If the deficiency is of such a character as to require the expenditure of additional time or resources, the certified public accountant shall include in the notification an estimate of the additional time and cost that would be required, and he shall proceed to complete the examination only upon written authorization of the State Auditor.
4. Progress reports. The certified public accountant shall submit progress reports to the State Auditor as requested by the State Auditor. The progress reports shall indicate whether the project is on schedule and identify and describe in detail the significant findings and recommendations.
5. Outline of the report. Prior to the preparation of the preliminary draft of the examination report, the certified public accountant shall prepare an outline of the report and submit it to and discuss the same with the State Auditor. The outline should include the major points of the report.
6. Preliminary and final draft of report. The certified public accountant shall prepare a preliminary draft of the report in such number of copies as requested by the State Auditor and submit it to and discuss the same with the State Auditor. The examination working papers referred to above shall at the same time be delivered to the State Auditor for his review. The certified public accountant shall perform additional fieldwork, as required, to clarify statements made in the preliminary draft of the examination report. The certified public accountant shall be considered to have completed the work required under his contract only upon the completion of the final draft of the report.
7. Consultation on report findings and recommendations. Upon completion of the work required, the certified public accountant shall be available for attendance at legislative hearings as may be necessary to testify on or to discuss the findings and recommendations contained in the final report.

E. Form and Content of the Preliminary Draft of the Examination Report

The preliminary draft of the examination report shall contain the following parts:

1. A section with background information on the objectives and scope of the examination, the policies governing the use of petty cash funds, and the purposes and benefits of such funds.
2. A section with findings and recommendations concerning the utilization of petty cash funds and adherence to internal and operating controls and accounting systems and procedures in the utilization of such funds.

III. BUDGET AND TIME LIMITATIONS

A. Budget Limitations

1. The total sum to be allocated for conducting the examination shall be limited to the extent of funds appropriated for this purpose and the continued availability of such funds during the course of the project.
2. The method of payment for services provided by the certified public accountant, whether in lump sum or in increments, shall be agreed to mutually by the certified public accountant and the State Auditor. Should progress or incremental payments be agreed upon as the method of payment, the following conditions shall apply:
  - a. The amount of each progress payment shall be subject to agreement.
  - b. Each request for progress payment shall be accompanied by a certified statement of the costs actually incurred, such costs to be displayed by appropriate categories.
  - c. In no event shall the final payment be made except upon the delivery of the final draft of the report acceptable to the State Auditor and upon compliance by the certified public accountant with the requirements of Section 103-53, Hawaii Revised Statutes, relating to tax clearance.

The State Auditor reserves the right to determine and prescribe such other conditions as are appropriate under which progress payments shall be allowed.

B. Time Limitations

The timetable set forth below shall be followed to the closest extent possible. This timetable, however, may be modified by the State Auditor upon justifiable reasons submitted in writing by the certified public accountant and upon his finding that such modifications would not jeopardize the successful completion of the examination.

Expected date for contract to be awarded . . . . . June 28, 1984  
Expected date for commencement of examination . . . . July 10, 1984  
Expected date for submittal of outline  
of examination report . . . . . September 28, 1984  
Expected date for submittal of preliminary  
draft . . . . . October 15, 1984  
Expected date for submittal of final draft . . . November 15, 1984

IV. PROPOSAL

In preparing his proposal for the examination, the Contract Auditor shall describe fully the following:

A. Methodology

The plan for and the approach, method, and procedure that the certified public accountant intends to take in performing the examination. The proposed phases and steps to be followed and the tests and standards to be used in performing the work required shall be outlined.

B. Description of Firm

The certified public accountant's background, staff, and work previously conducted, as outlined below.

1. Background.

- a. Describe the nature of services provided by the firm.
- b. Show how the firm is organized to manage the operation of the examination.

2. Staff.

Give the total full-time staff currently employed by the firm in Hawaii by categories (services, professional and other classification, offices).

3. Previous work.

- a. Describe briefly any work done (especially the experience of the local office) which is similar or related to the examination called for by these specifications.
- b. Give titles of previous reports or publications.

C. Resources To Be Used

The resources that the certified public accountant intends to commit to the work, including the name and qualifications of, the scope of the work contemplated for, and the amount of time to be devoted by each of the firm's personnel and that of any subcontractors that the firm intends to engage.

D. Time Period of Examination

The Contract Auditor's estimate of the time required to complete the work, including an estimate of the dates on which work can commence and a preliminary report will be submitted.

E. Cost of Examination

The cost of the examination shall be itemized as follows:

1. Staff and other technical services, including the fee rates and amounts by staff classification.
2. Out-of-pocket expenses.

F. Allocation of Time, Cost, and Resources

In preparing the proposal, the certified public accountant shall separately state the cost, resource, and time period for the major phases of the examination.

G. Address Where Examination Will Be Conducted

The name of the office and address where the examination activities will be conducted shall be specified. If at more than one office, the name and address of each office shall be listed.

H. Submittal of Proposal

1. The proposal for conducting the examination as outlined herein shall be submitted to the State Auditor in five copies at the following address:

Office of the Auditor  
State of Hawaii  
Kekuanao'a Building, Room 500  
465 South King Street  
Honolulu, Hawaii 96813

2. The proposal shall be submitted to the State Auditor not later than 4:30 p.m. on June 25, 1984.