

**FINANCIAL AUDIT OF THE
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS**

**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. 86-12
February 1986**

FOREWORD

This financial audit report is the result of an examination of the financial statements and records of the Department of Labor and Industrial Relations for the fiscal year ended June 30, 1985. 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 Labor and Industrial Relations. Part II presents our findings and recommendations on the department's financial and accounting practices. It also includes the department's financial statements and the audit opinion of the fairness and accuracy of the 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 response of the Department of Labor and Industrial Relations 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 Labor and Industrial Relations.

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

February 1986

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PART I

INTRODUCTION AND BACKGROUND

Chapter 1
INTRODUCTION

This is a report of our financial audit of the Department of Labor and Industrial Relations.

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 of Peat, Marwick, Mitchell & Co. (Peat Marwick).

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 Labor and Industrial Relations; 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.

3. To assess the effectiveness and efficiency of the Department of Labor and Industrial Relations in implementing administrative policies relating to petty cash funds and the adequacy, effectiveness, and efficiency of the systems and procedures for financial accounting, internal control, and financial reporting in utilizing petty cash funds.

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, 1984 to June 30, 1985. The accountants' opinion as to the fairness of the financial statements presented is that of Peat Marwick.

Not included as part of the audit was the special compensation fund established under the workers' compensation law. This fund, which is under the administrative control of the department, is audited annually by certified public accountants.

Organization of the Report

This report is organized as follows:

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 and the accountants' opinion on the statements.

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

Chapter 2

BACKGROUND

This chapter describes the responsibilities and organization of the Department of Labor and Industrial Relations.¹

Responsibilities of the Department

The Department of Labor and Industrial Relations is a department established under Chapter 371, Hawaii Revised Statutes. It is headed by a single executive, the Director of Labor and Industrial Relations, who is appointed by the Governor with the advice and consent of the Senate.

Chapters 371 through 397, HRS, assigns to the department the responsibility of administering and enforcing the State's employment security and unemployment insurance programs, occupational safety and health laws, boiler and elevator law, workers' compensation law, temporary disability compensation and prepaid health care laws, and labor laws relating to wages and hours, child labor, and discrimination. The department also provides employment and training services and promotes apprenticeship programs.

In addition to the foregoing, seven entities have been assigned to the department for administrative purposes. These are the Hawaii Employment Relations Board, Hawaii Public Employment Relations Board, Hawaii State

1. Descriptions drawn from the relevant portions of the Hawaii Revised Statutes and the following text: Legislative Reference Bureau, *Guide to Government in Hawaii*, 8th edition, August 1984, pp. 65-69.

Occupational Information Coordinating Committee, Labor and Industrial Relations Appeals Board, Hawaii Job Training Coordinating Council, Commission on Employment and Human Resources, and State Fire Council.

Organization of the Department

The following summarizes the department's organization.

Office of the Director of Labor and Industrial Relations. The Director of Labor and Industrial Relations has overall management control of the department. The director reports directly to the Governor.

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

Personnel Office. This office provides personnel services to other organizational units of the department.

Office of Employment and Training Administration. This office establishes policies and procedures for the administration of the Job Training Partnership Act of 1982. It also administers Title V of the Federal Older Americans Act for the employment of the elderly.

Research and Statistics Office. This office conducts labor market research, maintains the department's statistical reporting system, and provides technical assistance to other organizational units of the department.

Advisory Committee on Labor and Industrial Relations. This committee consists of an equal number of representatives from labor, management, and the general public, who are appointed by the director. One of the public members is designated as chairperson. The committee serves in an advisory capacity to the director on matters within the jurisdiction of the department.

Operational divisions. Six divisions execute the primary responsibilities of the department. Each is headed by a division chief who reports to the director.

1. *Apprenticeship Division.* This division assists program sponsors in maintaining a sufficient number of skilled workers in the work force by encouraging and helping them to establish and utilize apprenticeship and on-the-job training programs. It also develops standards for such programs through joint labor-management apprenticeship programs.

2. *Disability Compensation Division.* This division administers the workers' compensation, temporary disability insurance, and prepaid health care laws which are designed to alleviate the economic hardships of workers who are disabled because of injuries or illness.

3. *Employment Service Division.* This division provides labor force service programs for job seekers and employers. It provides job placement services, employment counseling and testing, and vocational guidance to improve the employability of job applicants. The division also gathers and disseminates labor market information.

4. *Enforcement Division.* This division administers and enforces the state labor laws relating to wages and hours, discriminatory and unlawful employment practices, child labor wage payments, and industrial homework.

5. *Occupational Safety and Health Division.* This division administers the laws, rules, and regulations established under the Occupational Safety and Health Act and the Boiler and Elevator Safety Law. It conducts inspections, investigates industrial injuries, and provides advisory services to both public and private agencies to promote safety practices.

6. *Unemployment Insurance Division.* This division administers the statewide unemployment insurance program including the payment of allowances

under federal and state training or readjustment programs. It also assesses and collects unemployment insurance taxes from insured employers.

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

1. *Hawaii Employment Relations Board.* The board consists of five members appointed by the Governor with the advice and consent of the Senate. Its principal activities include the prevention of unfair labor practices and the certification of the results of collective bargaining elections in the private sector.

2. *Hawaii Public Employment Relations Board.* The board administers state laws on collective bargaining in public employment. It establishes procedures for the designation of appropriate public employee bargaining units, supervises representation elections of employee organizations, and conducts proceedings on complaints of prohibited practices. The board consists of three full-time members representing management, labor, and the public.

3. *Hawaii State Occupational Information Coordinating Committee.* The committee coordinates the development of a career and occupational information system. This committee is composed of representatives from at least the department, the State Board for Vocational Education, the Hawaii Job Training Coordinating Council, the Vocational Rehabilitation Division of the Department of Social Services and Housing, the Department of Education, and the University of Hawaii. Members are appointed by the directors or administrators of the various organizations.

4. *Labor and Industrial Relations Appeals Board.* The board consists of three members appointed by the Governor with the advice and consent of the Senate. The board decides appeals on decisions rendered by the Director of Labor

and Industrial Relations under the workers' compensation law and any other law for which an appeal to the board is provided by law.

5. *Hawaii Job Training Coordinating Council.* The council is a statewide advisory council appointed by the Governor and serves as the State's primary advisory body on employment and training programs provided under the Job Training Partnership Act of 1982.

6. *Commission on Employment and Human Resources.* The commission advises the Governor and Legislature on policies that address the impact of new and developing technologies and automation on the economy, employment, and work force and issues related to education, training, and employment. The 20 commissioners are appointed by the Governor with the advice and consent of the Senate.

7. *State Fire Council.* The council coordinates federally funded fire programs and advises the county fire departments, the Governor, and Legislature with respect to fire prevention and protection. The council consists of ex officio county fire chiefs and the chief of the Fire Prevention Bureau of the City and County of Honolulu.

PART II

FINDINGS AND RECOMMENDATIONS

Chapter 3

FINANCIAL ACCOUNTING AND INTERNAL CONTROL

This chapter contains our findings and recommendations on the Department of Labor and Industrial Relation's financial accounting and internal control practices and procedures.

Summary of Findings

We find that:

1. Excessive fund balances are maintained in certain special funds of the department.
2. The department is not making effective use of petty cash funds.

Excessive Fund Balances

During our examination, we noted that excessive fund balances are maintained in two of the special funds administered by the department. These special funds are the special fund for disability benefits and the special premium supplementation fund. This excessiveness is evidenced by the fact that the fund balances of these special funds have been consistently increasing over the years. The interest income which these special funds generate each year far exceeds the benefit payments disbursed from these funds. Moreover, there is no indication that benefit payments from these funds will significantly increase in the future. Some background information and data for these special funds are presented in the following section.

Special fund for disability benefits. This special fund was established in 1969 under Section 392-61, Hawaii Revised Statutes, for the purpose of providing disability benefits to unemployed individuals who become disabled and disabled employees whose employer is either not in compliance with the Temporary Disability Insurance Law (i.e., has no temporary disability insurance) or is bankrupt. The initial funding for this special fund amounted to \$1,128,637 which was the result of a one-time assessment of 0.2 percent of covered wages of all employers in 1969. Since then, funding has been generated from fines and penalties received in connection with the enforcement of the Temporary Disability Insurance Law and interest earned on funds invested in certificates of deposit. Table 3.1 summarizes the transactions and the fund balances for the past five fiscal years. As the table indicates, the fund balance has been increasing annually with interest income averaging more than 11 times (\$292,544 divided by \$25,627) the disability payments.

Table 3.1
Special Fund for Disability Benefits

<i>Fiscal Year</i>	<i>Interest Income</i>	<i>Penalties and Other Receipts</i>	<i>Disability Payments</i>	<i>Fund Balance</i>
1981	\$267,564	\$ 7,513	\$(21,339)	\$2,368,061
1982	336,677	176	(26,165)	2,678,749
1983	259,498	5,060	(24,909)	2,918,398
1984	272,408	14,276	(32,683)	3,172,399
1985	326,577	7,280	(23,043)	3,483,213
5-Year Average	\$292,544	\$ 6,861	\$(25,627)	

Special premium supplementation fund. This special fund was established in 1974 under Section 393-41, HRS, to supplement health care insurance premium payments for certain employers who employ less than eight employees. This fund received an initial appropriation from the state general fund of \$375,000.

Thereafter, revenues have been generated from interest on funds invested in certificates of deposit and fines and penalties collected under the Prepaid Health Care Act. Table 3.2 summarizes the transactions and fund balances for the past five fiscal years. As shown in the table, the fund balance has been increasing annually with interest income averaging almost 30 times (\$124,288 divided by \$4,180) more than the premium supplement payments.

Table 3.2
Special Premium Supplementation Fund

<i>Fiscal Year</i>	<i>Interest Income</i>	<i>Penalties and Other Receipts</i>	<i>Premium Supplement Payments</i>	<i>Fund Balance</i>
1981	\$117,364	\$826	\$(1,374)	\$1,048,797
1982	138,930	—	(6,663)	1,181,064
1983	112,658	—	—	1,293,722
1984	118,453	459	—	1,412,634
1985	134,036	876	(12,862)	1,534,684
5-Year Average	\$124,288	\$432	\$(4,180)	

Recognizing the possibility of excess funds being accumulated in special funds, the Legislature under Section 37-53, HRS, has provided a mechanism whereby departments may transfer excess funds from the special funds to the general revenues of the State. The apparent reasoning for providing this mechanism is that excess funds kept in special funds should be made available for other public use. Before making any transfers, however, a review is needed to determine the extent to which fund balances are excessive. We understand that the department has not made such a determination.

Recommendation. We recommend that the department conduct a review of the special fund for disability benefits and the special premium supplementation fund to determine the level at which the balance of each fund should be permitted

to accumulate. All amounts in excess of such fund balance level should then be transferred to the general revenues of the State in accordance with Section 37-53, HRS.

Utilization of Petty Cash

Over the years, it has been the state administration's policy to encourage state agencies to pay their smaller bills from petty cash funds which are kept on hand and in checking accounts. Such use of petty cash funds would result in faster payments to vendors and likely cost savings by the State. Also over the years, we have noted the lack of improvement on the part of individual state agencies in making effective use of petty cash funds. As a result of this inaction, the Legislature enacted Act 281, SLH 1985, which made it mandatory that all payments for goods and services of less than \$100 be made from petty cash funds. Act 281 also gives the State Comptroller the authority to establish a higher threshold for petty cash payments and to grant exceptions to the mandatory requirement.

The department has not made effective use of petty cash funds to pay its smaller bills. The department does not use a petty cash checking account but instead uses only a petty cash fund of \$1625 to make cash payments for a limited number of expenses under \$25. We understand that efforts are being made to comply with the requirements of Act 281. Once this is accomplished, it is estimated that approximately 54 percent of the department's disbursement for goods and services will be made through the petty cash fund system.

Recommendation. We recommend that the department continue its efforts towards the effective implementation of Act 281, which requires payments for goods and services of less than \$100 to be made from petty cash funds.

Chapter 4

FINANCIAL STATEMENTS AND ACCOUNTANTS' OPINION

This chapter presents the results of the examination of the financial statements of the Department of Labor and Industrial Relations for the fiscal year ended June 30, 1985. It contains the opinion of Peat, Marwick, Mitchell & Co. (Peat Marwick) regarding the fairness and accuracy of the department's financial statements. It also presents various financial statements of the general fund, special revenue funds, and trust and agency funds administered by the department, together with explanatory notes.

Summary of Finding

In the opinion of Peat Marwick, the financial statements present fairly the financial position of the department at June 30, 1985 and the results of its operations for the 1984-85 fiscal year.

Accountants' Opinion

Peat Marwick 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 Labor and Industrial Relations, State of Hawaii, as of and for the year ended June 30, 1985, 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 Special Compensation Fund. Accordingly, the combined financial statements referred to above do not include the financial statements of the Special Compensation Fund.

The Department of Labor and Industrial Relations does not maintain its own fixed assets records and the 'General Fixed Assets' balances presented in the combined financial statements referred to above were obtained from the fixed assets records of the State of Hawaii. Accordingly, we were unable to satisfy ourselves as to the 'General Fixed Assets' balances amounting to \$2,891,744. 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' account group which is included within the combined balance sheet – all funds as of June 30, 1985.

In our opinion, except that, as explained in the preceding paragraphs, we do not express an opinion on the financial statements relating to the Special Compensation Fund and the general fixed assets account group, the aforementioned combined financial statements present fairly the financial position of the Department of Labor and Industrial Relations, State of Hawaii, at June 30, 1985 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

/s/ PEAT, MARWICK, MITCHELL & CO.

Honolulu, Hawaii
October 10, 1985"

Descriptions and Definitions

Descriptions of financial statements. The following is a brief description of the financial statements examined by Peat Marwick. The financial statements are attached at the end of this chapter.

1. *Combined Balance Sheet—All Fund Types and Account Groups (Exhibit A)*. This statement presents the assets, liabilities, and fund equity of all the funds and account groups used by the department on an aggregate basis.

2. *Combined Statement of Revenues and Appropriations, Expenditures and Changes in Fund Balances—All Governmental Fund Types and Expendable Trust Funds (Exhibit B)*. This statement presents the revenues and appropriations,

expenditures, and changes in fund balances for the governmental fund types and expendable trust funds used by the department on an aggregate basis.

3. *Combined Statement of Revenues and Appropriations, Expenditures and Changes in Fund Balances (Deficit)—Budget and Actual—General and Special Revenue Funds on a Budgetary Basis (Exhibit C).* This statement presents a comparison of budgeted and actual revenues and appropriations and expenditures for the general and special revenue funds used by the department.

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. *Allotted appropriations.* 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. *Revenue.* A financial resource which is both measurable and available to finance expenditures of the fiscal year.

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. *Operating transfers.* Legally authorized transfers from a fund receiving revenue to the fund through which the resources are to be expended.

8. *Other expenditures.* Expenditures other than for personal services.

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

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

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 (GAAP) 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 or account groups, 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, and fund balance. The various funds are summarized by type in the financial statements. The following fund types and account groups 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 are accounted for. The measurement focus is upon determination of changes in financial position, rather than upon net income determination.

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's general fund and are limited to only those appropriations and obligations of the department.

The special revenue funds are used to account for resources legally restricted to expenditure for specific current operating purposes. Federal grants received by the department to fund various programs are accounted for as special revenue funds.

b. *Fiduciary fund types.* Fiduciary funds are used to account for assets held by the department as a trustee or agent for individuals or other organizations.

Expendable trust funds are funds whose principal and income may be expended in the course of their designated operations. A description of the expendable trust funds of the department is presented below:

- . Unemployment Insurance Fund. This fund is used to account for collections from employers for unemployment insurance and payments to unemployed individuals who qualify for unemployment benefits.
- . Special Temporary Disability Insurance. This fund accounts for resources which provide disability benefits to unemployed individuals who become disabled or to disabled employees whose employer does not have disability insurance or is bankrupt.

- . Prepaid Health Fund. This fund accounts for resources used to supplement premium payments for health care insurance by employers meeting certain statutory requirements.

Agency funds are funds which account for assets held by the department as agent for employers and individuals. A description of the agency funds of the department is presented below:

- . Temporary Deposits Fund. This fund accounts for mandatory deposits collected from individuals who appeal decisions on workers' compensation claims to the Supreme Court. The deposit is returned to the appellant after the appeal has been decided.
 - . Temporary Disability Insurance Fund. This fund accounts for excessive employer deductions for prepaid health insurance or temporary disability insurance collected from employers on behalf of a former employee. The department locates the employee and refunds these deductions to them.
 - . Wage Claim Fund. This fund accounts for court settlements on wage claim cases in which the department represents the claimant. The settlement is subsequently disbursed to the claimant.
 - . Nonprofit Employers' Deposit. This fund accounts for deposits by nonprofit organizations for unemployment insurance. These organizations participate in a reimbursement system in contrast to the contributory system of profit-oriented organizations. The deposit is refunded to the nonprofit organization upon its dissolution.
- c. *Account groups.* Account groups are used to establish accounting control and accountability for the department's general fixed assets and long-term debt.
- . General Fixed Assets Account Group. This group of accounts is established to account for all fixed assets of the department.

. General Long-Term Debt Account Group. This group of accounts is established to account for all long-term indebtedness of the department.

2. *Basis of accounting.* The modified accrual basis of accounting is followed by the governmental and fiduciary funds. Under the modified accrual basis of accounting, revenues are recorded when they are both measurable and available to fund expenditures, usually when the appropriations are allotted. Expenditures are recorded when the liability is incurred, if measurable.

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. *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.

Biennial budget. The department uses the following procedures in establishing the budgetary data reflected in the financial statements.

1. *The budget.* Not less than 20 days before the Legislature convenes in every odd-numbered year, the Governor submits to the Legislature and to each

member thereof, a budget which contains the program and budget recommendations of the Governor for the succeeding two fiscal years. The budget in general contains:

- . The state program structure.
- . Statements of statewide objectives.
- . The financial requirements for the next two fiscal years to carry out the recommended programs.
- . A summary of state receipts and revenues in the last completed fiscal year, a revised estimate for the fiscal year in progress and an estimate for the succeeding biennium.

2. *Legislative review.* The Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, and adopts programs and determines the state budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.

3. *Program execution.* Except as limited by policy decisions of the Governor, appropriations by the Legislature, and other provisions of law, the several agencies responsible for administering state programs administer their program assignments and are responsible for their proper management. The appropriations by the Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the Legislature.

Budget basis of accounting. The budgets are prepared on a basis other than generally accepted accounting principles. The actual results of operations are

presented on a budgetary basis in the combined statement of revenues, expenditures and changes in fund balances—budget and actual—governmental fund types to provide a meaningful comparison of actual results with budget.

The major differences between the budget and GAAP bases are that encumbrances are recorded as the equivalent of expenditures (budget) as opposed to a reservation of fund balance (GAAP), federal grant revenues are recognized when received and expenditures are recognized when paid.

Adjustments necessary to convert the results of operations and fund balances for the fiscal year ended June 30, 1985 from the GAAP basis to the budget basis are as follows:

	Excess (deficiency) of revenues over expenditures and other uses	Fund balances (deficit) at end of year
General fund:		
GAAP basis	\$ (89,593)	\$ 100,674
Increase (decrease):		
Expenditures of amounts encumbered during the year ended June 30, 1984	182,115	182,115
Reserved (GAAP) at June 30, 1985, but recognized as expenditures for budget purposes	<u>(175,956)</u>	<u>(175,956)</u>
Budget basis	<u>\$ (83,434)</u>	<u>\$ 106,833</u>
Special revenue funds:		
GAAP basis	\$ 79,047	\$ 79,047
Increase (decrease):		
Due to revenues:		
Received in cash during year but already accrued as receivables (GAAP) at June 30, 1984	932,597	932,597
Accrued as receivables at June 30, 1985, but not recognized in budget	(682,281)	(682,281)
Due to encumbrances:		
Expenditures of amounts encumbered during the year ended June 30, 1984	164,148	164,148
Reserved (GAAP) at June 30, 1985, but recognized as expenditures for budget purposes	<u>(1,413,674)</u>	<u>(1,413,674)</u>
Budget basis	<u>\$ (920,163)</u>	<u>\$ (920,163)</u>

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

<u>Balance at July 1, 1984</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 1985</u>
\$2,664,534	\$292,022	\$145,484	\$2,811,072

Employees' retirement system. The department is included in the Employees' Retirement System of the State which covers substantially all employees of the State, as well as the counties of the State. The department's contribution to the Employees' Retirement System for the year ended June 30, 1985 was \$2,154,337 which includes amortization of the unfunded accrued liability over a 50-year period beginning July 1, 1964. 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.

Note payable. The note payable is due in annual installments of \$19,845 including principal and interest at 11.6 percent, secured by equipment with a cost of \$80,672.

Maturities of the note are as follows:

<u>Year ending June 30,</u>	
1986	\$ 19,845
1987	12,807
1988	14,289
1989	15,942
1990	17,789

Accumulated unpaid vacation and sick leave. Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar

year end and is convertible to pay upon termination of employment. In governmental fund types, the amounts expected to be liquidated with expendable available resources are accrued in the respective funds, and the amounts payable from future resources are recorded in the general long-term debt account group.

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 termination of employment.

A summary of changes in accrued vacation shown in Exhibit A follows:

Balance, July 1, 1984	\$ 3,263,616
Net increase in accumulated vacation	<u>162,548</u>
Balance, June 30, 1985	<u>\$ 3,426,164</u>

Lease commitments. The department leases equipment and office space under noncancelable operating leases that expire over the next five and six years, respectively.

Future minimum lease payments under noncancelable operating leases as of June 30, 1985 are:

<u>Year ending June 30,</u>	
1986	\$ 917,998
1987	333,821
1988	162,067
1989	116,632
1990	76,094
Thereafter	<u>41,008</u>
	<u>\$ 1,647,620</u>

These minimum lease payments include the general excise tax to the extent that there were specific provisions made for the payment of these taxes in the lease agreement. There were no sublease rentals on the property covered by the noncancelable operating leases. Total rental expense for operating leases for fiscal year 1985 was \$995,114.

Special revenue funds encumbrances. At June 30, 1985 encumbrances for special revenue funds exceeded the \$79,047 fund balance by \$1,334,600. Additional funds were not available to be reserved for encumbrances since federal grant revenues are recognized when the related expenditures are made. The encumbrances will be funded by future federal grant revenues.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS

Combined Balance Sheet - All Fund Types and Account Groups

June 30, 1985

<u>Assets</u>	<u>Governmental</u>		<u>Fiduciary</u> <u>fund types</u> Trust and Agency	<u>Account groups</u>		Total (memorandum only)
	<u>fund types</u>			General	General Long-Term Debt	
	<u>General</u>	<u>Special Revenue</u>		Fixed Assets (unaudited)		
Cash:						
Petty cash	\$ 100	1,525	-	-	-	1,625
In bank	-	-	163,634	-	-	163,634
Held in State treasury	287,659	979,649	482,230	-	-	1,749,538
Held in Federal treasury	-	-	150,644,730	-	-	150,644,730
Receivable from the Federal Government	-	682,281	-	-	-	682,281
Short-term investments	-	-	4,835,800	-	-	4,835,800
Fixed assets	-	-	-	2,891,744	-	2,891,744
Amount to be provided for retirement of general long-term debt	-	-	-	-	3,486,991	3,486,991
	<u>\$ 287,759</u>	<u>1,663,455</u>	<u>156,126,394</u>	<u>2,891,744</u>	<u>3,486,991</u>	<u>164,456,343</u>
<u>Liabilities</u>						
Accounts payable	11,100	1,461,776	-	-	-	1,472,876
Accrued vacation payable	-	-	-	-	3,426,164	3,426,164
Employers' unemployment insurance deposits	-	-	450,533	-	-	450,533
Due to State General Fund	100	1,525	-	-	-	1,625
Due to others	-	-	31,697	-	-	31,697
Notes payable	19,845	-	-	-	60,827	80,672
Other accrued liabilities	<u>156,040</u>	<u>121,107</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>277,147</u>
Total liabilities	187,085	1,584,408	482,230	-	3,486,991	5,740,714
<u>Fund Equity</u>						
Investment in general fixed assets	-	-	-	2,891,744	-	2,891,744
Fund balance	<u>100,674</u>	<u>79,047</u>	<u>155,644,164</u>	<u>2,891,744</u>	<u>-</u>	<u>155,823,885</u>
Commitments	<u>\$ 287,759</u>	<u>1,663,455</u>	<u>156,126,394</u>	<u>2,891,744</u>	<u>3,486,991</u>	<u>164,456,343</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS

Combined Statement of Revenues and Appropriations,
Expenditures and Changes in Fund Balances -
All Governmental Fund Types and Expendable Trust Funds

Year ended June 30, 1985

	<u>Governmental</u>		<u>Fiduciary</u>	Total (memorandum only)
	fund types		fund type	
	<u>General</u>	<u>Special Revenue</u>	<u>Expendable Trust</u>	
Revenues and appropriations:				
Allotted appropriations	\$ 9,593,511	-	-	9,593,511
Federal grants	-	26,091,132	-	26,091,132
Interest	-	-	15,335,957	15,335,957
Employer contributions for unemployment insurance	-	-	78,169,801	78,169,801
	<u>9,593,511</u>	<u>26,091,132</u>	<u>93,505,758</u>	<u>129,190,401</u>
Expenditures:				
Personal services	5,904,381	12,465,091	-	18,369,472
Other	3,283,268	13,546,994	77,126,636	93,956,898
	<u>9,187,649</u>	<u>26,012,085</u>	<u>77,126,636</u>	<u>112,326,370</u>
Excess of revenues and appropriations over expenditures	<u>405,862</u>	<u>79,047</u>	<u>16,379,122</u>	<u>16,864,031</u>
Other financing sources (uses):				
Operating transfers in	24,000	50,000	-	74,000
Operating transfers out	(24,000)	(50,000)	-	(74,000)
Transfer - lapse to State General Fund	(495,455)	-	-	(495,455)
	<u>(495,455)</u>	<u>-</u>	<u>-</u>	<u>(495,455)</u>
Excess of revenues and appropriations and other financing sources over (under) expenditures and other financing uses	<u>(89,593)</u>	<u>79,047</u>	<u>16,379,122</u>	<u>16,368,576</u>
Fund balances, July 1, 1984	<u>190,267</u>	<u>-</u>	<u>139,265,042</u>	<u>139,455,309</u>
Fund balances, June 30, 1985	<u>\$ 100,674</u>	<u>79,047</u>	<u>155,644,164</u>	<u>155,823,885</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS

Combined Statement of Revenues and Appropriations, Expenditures and
Changes in Fund Balances (Deficit) - Budget and Actual -
General and Special Revenue Funds on a Budgetary Basis

Year ended June 30, 1985

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	General Fund			Special Revenue Funds			Totals (memorandum only)		
	Budget	Actual	Variance - favorable (unfavorable)	Budget	Actual	Variance - favorable (unfavorable)	Budget	Actual	Variance - favorable (unfavorable)
Revenues and appropriations:									
Allotted appropriations	\$ 9,664,636	9,593,511	(71,125)	-	-	-	9,664,636	9,593,511	(71,125)
Federal grants	-	-	-	28,416,332	26,341,448	(2,074,884)	28,416,332	26,341,448	(2,074,884)
	<u>9,664,636</u>	<u>9,593,511</u>	<u>(71,125)</u>	<u>28,416,332</u>	<u>26,341,448</u>	<u>(2,074,884)</u>	<u>38,080,968</u>	<u>35,934,959</u>	<u>(2,146,009)</u>
Expenditures:									
Personal services	6,080,163	5,883,624	196,539	13,978,477	12,465,091	1,513,386	20,058,640	18,348,715	1,709,925
Other	<u>3,584,473</u>	<u>3,297,866</u>	<u>286,607</u>	<u>14,437,855</u>	<u>14,796,520</u>	<u>(358,665)</u>	<u>18,022,328</u>	<u>18,094,386</u>	<u>(72,058)</u>
	<u>9,664,636</u>	<u>9,181,490</u>	<u>483,146</u>	<u>28,416,332</u>	<u>27,261,611</u>	<u>1,154,721</u>	<u>38,080,968</u>	<u>36,443,101</u>	<u>1,637,867</u>
Excess of revenues and appropriations over (under) expenditures	-	412,021	412,021	-	(920,163)	(920,163)	-	(508,142)	(508,142)
Other financing sources (uses):									
Operating transfers in	-	24,000	24,000	-	50,000	50,000	-	74,000	74,000
Operating transfers out	-	(24,000)	(24,000)	-	(50,000)	(50,000)	-	(74,000)	(74,000)
Transfer - lapse to State General Fund	-	(495,455)	(495,455)	-	-	-	-	(495,455)	(495,455)
	-	(495,455)	(495,455)	-	-	-	-	(495,455)	(495,455)
Excess of revenues and appropriations and other financing sources over (under) expenditures and other financing uses	-	(83,434)	(83,434)	-	(920,163)	(920,163)	-	(1,003,597)	(1,003,597)
Fund balances, July 1, 1984	-	190,267	190,267	-	-	-	-	190,267	190,267
Fund balances (deficit), June 30, 1985	\$ -	<u>106,833</u>	<u>106,833</u>	-	<u>(920,163)</u>	<u>(920,163)</u>	-	<u>(813,330)</u>	<u>(813,330)</u>

See accompanying notes to combined financial statements.

PART III

RESPONSE OF THE AFFECTED AGENCY

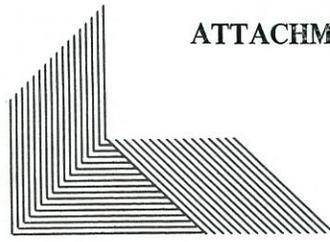
COMMENTS ON AGENCY RESPONSE

On January 13, 1986, copies of a preliminary draft report of this financial audit were transmitted to the Governor, the presiding officers of the Legislature, and the Department of Labor and Industrial Relations. A copy of the letter of transmittal 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 responded by letter dated January 27, 1986, which is included here as Attachment 2.

The department generally agrees with the findings and recommendations in the report. However, the department expresses a concern that it foresees a legal question whether excess funds from the special fund for disability benefits can be transferred to the state general fund as recommended by our report. Our suggestion is that the department seek the advice of the Department of the Attorney General whether it can legally transfer excess funds to the general fund. If it is not proper to transfer such funds under existing law, the department should initiate appropriate legislation to resolve the problem.

ATTACHMENT 1

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



CLINTON T. TANIMURA
AUDITOR

January 13, 1986

COPY

Dr. Joshua C. Agsalud, Director
Department of Labor and Industrial Relations
830 Punchbowl Street
Honolulu, Hawaii 96813

Dear Dr. Agsalud:

Enclosed are two preliminary copies, Nos. 4 and 5, of our report on the *Financial Audit of the Department of Labor and Industrial Relations*. 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 24, 1986, 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 this 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

JOSHUA C. AGSALUD
DIRECTOR

ROBERT C. GILKEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
825 MILILANI STREET
HONOLULU, HAWAII 96813

January 27, 1986

RECEIVED

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OFC. OF THE AUDITOR
STATE OF HAWAII

Mr. Clinton T. Tanimura
Legislative Auditor
Office of the Legislative Auditor
465 S. King Street
Honolulu, Hawaii

Dear Mr. Tanimura:

Re: Financial Audit of the Department of Labor and Industrial Relations

Thank you for the opportunity to review and comment on the draft report of the above-mentioned audit of January, 1986.

We are in general agreement with the two (2) audit findings and recommendations and our responses are listed hereunder:

- 1) Finding: Excess fund balances are maintained in certain special funds of the department.

Recommendation: The department conduct a review of the special fund for disability benefits and the special premium supplementation fund to determine the level at which the balance of each fund should be permitted to accumulate. All amounts in excess of such fund balance level should then be transferred to the general revenues of the State in accordance with Section 37-53, HRS.

Response: We concur with your recommendation that a review should be conducted to determine the level at which the balance of the special funds be permitted to accumulate.

Your findings for the past five fiscal years beginning 1981 through 1985 show that the TDI fund has consistently increased over the years; however, a closer examination reveals that the increase each year is not necessarily an increase over a previous year's receipts and expenditures. There were some years when interest income, penalties and other

January 27, 1986

receipts were lower than a prior year. The same may be said regarding the payment of disability benefits.

Interest income has been the main source of both fund's increase. This has been accomplished by the prudent investments within the limited guidelines provided by statutes. The department makes a projection on the amount of benefits to be paid out during the fiscal year, and the excess is subsequently invested and utilized to the maximum.

Receipts from fines and penalties account for a small percent of both special fund balances. The department has been successful in taking vigorous and affirmative action in pursuing collection of fines and penalties from delinquent and noncomplying employers.

TDI benefit payments have been fairly normal over a period of years while Special Premium Supplementation benefits have been erratic. While there appears no indication that TDI benefit payments will be significantly increased in the future, payments from the Special Premium Supplementation Fund could increase due to the increasing cost of health care. Payment of benefits have been kept to a minimum due to the action of the department to recover from noncomplying employers the amount of benefits paid to employees by the special funds. In addition, the department has been instrumental in resolving problems between insurance carriers and noncomplying employers when status of coverage and liability was in question.

In reviewing Section 37-53, Transfer of Special Funds to General Revenues, provisions are made, with the approval of the governor or the director of finance, to transfer from the special funds to the general revenues of the State, amounts determined to be in excess of fiscal period requirements.

We foresee a legal question whether monies from the TDI Special Fund may be transferred to the general revenue fund. The TDI fund was not appropriated by the Legislature but was established by an assessment on all liable employers. Section 392-67 also provides that when the balance of the TDI special fund falls below \$500,000 as of December 31 of any year, a levy shall be assessed and collected in the next calendar year from insurers of employers. Such being the case, any transfer of funds from the TDI

January 27, 1986

special fund could have an adverse affect on insurance companies providing TDI coverage.

As for the Special Premium Supplementation Fund, we will conduct a study to determine what amount, which are in excess of fiscal period requirement, could be returned.

- 2) Finding: The department is not making effective use of petty cash funds.

Recommendation: The department continue its efforts towards the effective implementation of Act 281, which requires payments for goods and services of less than \$100 to be made from petty cash funds.

Response: We concur with your recommendation to continue our efforts toward the effective implementation of Act 281. We have just recently received our petty cash funds from DAGS and have opened our petty cash checking account at First Hawaiian Bank. At the present time we are manually processing the petty cash payments. We will automate this process upon receipt of approval to acquire the necessary micro-computer.

Should you have any questions please call me or have your staff contact Thomas Yim, our Business Management Officer, at x7626.

Sincerely,

for 
Joshua C. Agsalud
Director of Labor and
Industrial Relations