

**FINANCIAL AUDIT OF THE
DEPARTMENT OF DEFENSE**

**Conducted by the
Office of the Legislative Auditor
State of Hawaii
and
Cabrinha & Yim CPA, Inc.
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. 86-8
January 1986**

FOREWORD

This financial audit report is the result of an examination of the financial statements and records of the Department of Defense 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 Cabrinha & Yim CPA, Inc.

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

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

January 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 Defense. The audit was conducted by the Office of the Legislative Auditor and the certified public accounting firm, Cabrinha & Yim CPA, Inc.

The audit was performed pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct postaudits of all transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

Objectives of the Audit

The objectives of the audit were:

1. To assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the Department of Defense; 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 ascertain the extent to which recommendations contained in Chapter 4 of the Legislative Auditor's Audit Report No. 74-2, *Financial Audit of the*

State Department of Defense and the State Grant for Civil Air Patrol, Fiscal Year Ended June 30, 1973, have been implemented.

4. To assess the effectiveness and efficiency of the Department of Defense 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 examined the financial statements, legal compliance, and internal control system of the department for the period July 1, 1984 to June 30, 1985. The accountants' opinion as to the fairness of the financial statements is that of Cabrinha & Yim CPA, Inc.

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 financial accounting practices and procedures, and system of internal control 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

The Department of Defense is the state agency responsible for the safety, welfare, and defense of the people of Hawaii in case of war or in the event of natural or man-made disasters. The department is headed by a single executive known as the Adjutant General, who is a member of the Governor's cabinet. The Adjutant General is also the Commander of the Hawaii National Guard and Director of the State Civil Defense.

Organization of the Department¹

The following summarizes the department's organization.

Hawaii National Guard. The Hawaii National Guard is the military component of the department. It consists of two separate divisions, the army national guard and the air national guard. A majority of the national guard members are part-time employees of the department and only train and serve with federal pay during selected weekends and during the annual 15-day training period.

Hawaii National Guard members occupy a dual status. They serve simultaneously as members of the state militia and as a reserve component of either the U.S. Army or the U.S. Air Force. In keeping with the dual status of its members, the Hawaii National Guard serves a dual mission. It provides for the

1. Descriptions drawn from the relevant portions of the following documents: Hawaii, Legislative Reference Bureau, *Guide to Government in Hawaii*, 8th ed., August 1984, pp. 47-48; and Hawaii, Department of Defense, *Annual Report, Fiscal Year 1984*, pp. 2-24.

public's safety during state emergencies and serves as a reserve unit ready for call to active duty by the President of the United States in a national emergency.

Civil Defense. The civil defense division is a nonmilitary arm of the department. Its mission is to minimize the loss of life and damage to property and to expedite the restoration of essential public services during natural or man-made disasters within the State. Administratively, it is headed by the Adjutant General who serves as the state director of civil defense and who is assisted by a vice director and deputy directors in each of the State's four counties. During civil defense emergencies, this division provides the nucleus for the emergency state headquarters and coordinates the civil defense activities of all public and private organizations within the State.

Departmental staff service units. The department has five organizational units which provide the required staff services for departmental operations and which serve as the staff of the Adjutant General. These five departmental staff service units employ full-time federal employees as well as state employees. The staff service units are as follows.

1. ***United States Property and Fiscal Office.*** This office provides and accounts for federal property, funds, and services provided to the Hawaii National Guard. The office has six sections: administrative office, data processing installation, analysis and internal review division, comptroller division, purchasing and contracting office, and logistics division.

2. ***Engineering Office.*** This office manages all real property under the jurisdiction of the department, including the acquisition, construction, disposal, and maintenance of facilities. It also provides operational supervision over custodial and security personnel and services at departmental installations.

3. *Administrative Services Office.* This office administers all federal and state funds appropriated and received by the department. It also coordinates and controls all departmental activities related to planning, programming, budgeting, and execution of departmental programs and performs the departmental accounting function.

4. *Support Personnel Management Office.* This office provides centralized civilian personnel administration for all assigned federal technicians and administers the active duty guard and reserve program. It is responsible for technical assistance on employee services, personnel and position management, labor relations, training, and equal opportunity matters.

5. *Public Affairs Office.* This office plans, develops, directs, and administers the department's community relations and public and internal information programs.

Hawaii State Guard. The Hawaii State Guard is currently inactive and may be activated should the need arise. When activated, this unit is composed of citizen volunteers and supplemented, if necessary, by members of the State's unorganized militia.

Army and air advisory groups. These groups consist of active army and air force personnel who are assigned to duty as advisors with the Hawaii National Guard.

Civil Defense Advisory Council. This council consists of seven members appointed for four-year terms by the Governor with the advice and consent of the Senate. This council serves in an advisory capacity to the director of civil defense on matters pertaining to civil defense.

PART II

FINDINGS AND RECOMMENDATIONS

Chapter 3

FINANCIAL ACCOUNTING AND INTERNAL CONTROL

This chapter presents our findings and recommendations on the financial accounting practices and internal control system of the Department of Defense.

Summary of Findings

Our findings are as follows:

1. The department does not obtain advance funding from the federal government for federally funded projects. Consequently, the interim use of state funds for these projects results in lost interest earnings to the State.
2. The recordkeeping for federal reimbursements are not sufficient to facilitate verification and accountability.
3. The department is not making effective use of petty cash funds to pay for small purchases.

Failure to Obtain Advance Funding for Federally Funded Projects

In the past, under various federal contracts and grants for civil defense projects, the department was required to expend state funds on these projects prior to requesting reimbursement from the federal government. However, since February 1982, the federal government has permitted the department to receive federal funds in advance of disbursements under a letter of credit system, thus eliminating the need to advance state funds for federally assisted projects.

We noted that the department has not taken advantage of advance funding and has continued to request federal funds on a reimbursement basis. Since state funds are unnecessarily being used when federal funds are available, the State is losing the opportunity to earn thousands of dollars annually in interest. It usually takes four to five months from the time state funds are expended to when federal reimbursements are received by the department. For fiscal year 1985 approximately \$650,000 of federal funds could have been received in advance but instead were received on a reimbursement basis. Based on the State Treasury's effective interest rate for fiscal year 1985 of 9.09 percent, we estimate that the State lost over \$20,000 in interest earnings in fiscal year 1985.

Recommendation. We recommend that the department obtain advance funding of federally funded projects whenever possible.

Insufficient Recordkeeping for Federal Reimbursements

The department is under several service and site contracts which are funded on a matching basis with the federal government. At the end of each month, reconciliations are made to determine the actual amount to be borne by each party. The results of these reconciliations usually show an overpayment by the State. Accordingly, a claim for reimbursement is prepared and billed to the federal government.

During our examination we noted that the recordkeeping relating to these billings for federal reimbursement and the subsequent payments is not sufficient to facilitate verification and accountability. There are no notations or records to cross-reference these billings with subsequent payments. As a result, the tracing of billings to the appropriate validated deposit slip or vice versa becomes a very

cumbersome and time-consuming task. This tracing procedure is needed to determine that payments for billings are properly received. An essential feature of a sound recordkeeping system is one which facilitates transactions to be traced or related to source documents so that accountability can be established and verified.

Recommendation. We recommend that the department install a procedure or maintain a record wherein appropriate cross-references are made to facilitate the verification and accountability of federal reimbursements.

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. 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 or 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. Although the department has a petty cash fund of \$1,000 in a checking account, payments made from this account are limited to miscellaneous expenses under \$25. We understand that the department is making every effort to comply with the requirements of Act 281. Once this is accomplished, it is estimated that approximately 38 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 Defense for the fiscal year ended June 30, 1985. It contains the opinion of Cabrinha & Yim CPA, Inc., regarding the fairness and accuracy of the department's financial statements. It also displays various financial statements of the general fund, and special revenue, trust, and agency funds administered by the department, together with explanatory notes.

Summary of Findings

In the opinion of Cabrinha & Yim CPA, Inc., except as explained in the Accountants' Opinion in the following section, the financial statements present fairly the financial position of the department as of June 30, 1985, and the results of its operations for the fiscal year then ended.

Accountants' Opinion

Cabrinha & Yim CPA, Inc., filed the following statement with the Legislative Auditor:

"To the Legislative Auditor
State of Hawaii
Honolulu, Hawaii

We have examined the following financial statements of the Department of Defense, as of June 30, 1985, and for the year then ended:

1. Combined balance sheet – all fund types (Exhibit A)

2. Combined statement of revenues, expenditures and changes in fund balances – governmental fund types and expendable trust funds (Exhibit B)
3. Combined statement of revenues, expenditures and changes in fund balances – budget and actual – governmental fund types (Exhibit C)
4. Combined statement of changes in assets and liabilities – agency funds (Exhibit D)

Except as explained in the following paragraph, 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.

The Department of Defense does not maintain detailed accounts receivable control logs for federal contract reimbursement claims. Accordingly, we were unable to satisfy ourselves as to the amount of the receivables that should be presented. Therefore, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the 'Governmental Fund Type – Special Revenue', fund accounts included with the combined balance sheet – all fund types as of June 30, 1985.

In our opinion, except that, as explained in the preceding paragraph, we do not express an opinion on the financial statement relating to the special revenue fund accounts, the aforementioned combined financial statements present fairly the financial position of the Department of Defense, State of Hawaii, as of 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/ CABRINHA & YIM CPA, INC.

CABRINHA & YIM CPA, INC.
CERTIFIED PUBLIC ACCOUNTANTS

Honolulu, Hawaii
October 3, 1985"

Descriptions and Definitions

Descriptions of financial statements. The following is a brief description of the financial statements examined by Cabrinha & Yim CPA, Inc. The financial statements 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 balances of all funds used by the department on an aggregate basis.

2. *Combined Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Fund Types and Expendable Trust Funds (Exhibit B)*. This statement presents the revenues, expenditures, and changes in fund balances for the general fund, special revenue funds, and expendable trust funds used by the department on an aggregate basis.

3. *Combined Statement of Revenues, Expenditures, and Changes in Fund Balances—Budget and Actual—Governmental Fund Types (Exhibit C)*. This statement presents a comparison of budgeted and actual revenues, expenditures, and changes in fund balances for the general fund and special revenue funds used by the department.

4. *Combined Statement of Changes in Assets and Liabilities—Agency Funds (Exhibit D)*. This statement presents the activity of the individual agency funds maintained 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. *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.

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

5. *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.

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

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

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

Notes to the 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.

Basis of accounting. The accounts of the funds maintained by the department are on a modified accrual basis of accounting. Under this method revenues are

recognized in the accounting period in which they become measurable and available. Expenditures are recorded when the liability is incurred.

The accounting procedures provide for the recording of commitments at the time contracts are awarded and orders placed for services, equipment, construction, and supplies. These commitments are represented as encumbrances and are necessary to reflect obligations chargeable against appropriations.

Capital assets constructed for or purchased by the department are recorded as expenditures of the department in the year the cost is incurred. These expenditures are shown as assets in the state general fixed assets account group and are not shown as assets in the accompanying financial statements. Depreciation on these assets are not recorded by the State.

Basis of presentation—fund accounting. The department's accounts are organized on a fund basis, with each fund operated as a separate fiscal and accounting entity. Each fund operates with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures. The fund types used by the department are as follows:

1. **General fund.** The general fund is used to account for all financial resources except those required to be accounted for in another fund. Any state activity not financed through another fund is financed by this fund. The general fund accounts presented in the accompanying financial statements are a part of the state general fund and are limited to only the appropriations, expenditures, and obligations of the department.

2. **Special revenue funds.** The 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 nine of these special revenue funds.

a. *Amelioration of Physical Disasters.* This fund was established to account for federal matching funds used to provide for departmental personnel administrative costs charged as direct expenses to the civil defense program and for services provided by the State for operation, maintenance, and repair costs of authorized army and air national guard facilities.

b. *Civil Defense Sirens and Equipment.* This fund was established to account for federal matching funds used to assist in the procurement of emergency equipment required to conduct a viable civil defense program.

c. *Radiological Defense Program Management System.* This fund was established to account for federal funds used to develop operational plans and procedures in order to integrate radiological defense (RADEF) support capabilities required by state and local emergency operational plans.

d. *Federal RADEF Maintenance Contract.* This fund was established to account for federal funds used to develop a capability in every locality for detection and measurement of hazardous levels of radiation; maintain all civil defense radiological instruments; assist in the development and maintenance of radiological emergency plans; and provide radiological training.

e. *Federal Civil Defense Training Contract.* This fund was established to account for federal matching funds used by the State to (1) orient key state and local officials to their emergency responsibilities; (2) provide professional instruction for civil defense personnel and other emergency operations; and (3) place survival and protective information in the curricular of secondary schools within the State.

f. *Federal Disaster Plans Contract.* This fund was established to account for federal matching funds used to assist the State in the development and

improvement of state plans, programs, and capabilities for disaster preparedness and prevention.

g. *Federal Nuclear Planning Contract.* This fund was established to account for federal funds used for the development of nuclear civil protection planning for the State.

h. *Earthquake Hazard Effects Study—Contingency Response Plan.* This fund was established to account for federal funds used to prepare a comprehensive impact study and subsequent inventory of effects study on earthquakes occurring within the State, with special emphasis on damage on the island of Oahu.

i. *Hurricane Plans Contract.* This fund was established to account for a one-time grant used to prepare plans for all levels of government in order to increase preparedness capabilities in the event of severe hurricanes in certain high density, high risk areas.

3. *Trust and agency funds.* Trust and agency funds are used to account for assets held by the department in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. Expendable trust funds are accounted for in essentially the same manner as other governmental funds. Agency funds are custodial in nature and do not involve measurement of results of operations.

a. *Expendable Trust Funds.* This fund accounts for the proceeds from the sale of bonds to finance capital improvement projects. Generally, the Department of Accounting and General Services (DAGS) is responsible for the administration of the capital improvement projects. However, DAGS may delegate to a department for execution a project or a portion of it when that department is capable of administering the project.

b. *Agency Funds.*

- . Temporary Deposits—County Civil Defense. This fund was established as a holding account for federal funds used primarily to make payments to county civil defense agencies for their normal operating expenses.
- . Temporary Deposits—Employee Fringe Benefits. This fund was established as a holding account for matching federal funds used to reimburse employers contribution for employee fringe benefit payments for retirement, health, workers' compensation, and unemployment compensation.
- . Temporary Deposits—Federal Disaster Funds. This fund was established as a holding account for matching federal funds used to provide assistance to State, counties, owners, or selected private nonprofit facilities, and individuals in alleviating suffering and hardship resulting from emergencies or major disasters.

Budgetary basis of accounting. The amounts reflected in the combined statement of revenues, expenditures, and changes in fund balances—budget and actual—governmental fund types are presented to provide a meaningful comparison of actual results with budget. Since accounting principles applied on a budgetary basis differ from generally accepted accounting principles (GAAP) a reconciliation to convert the excess (deficiency) of revenues over expenditures from the GAAP basis to the budgetary basis for the year ended June 30, 1985, is presented below:

	<u>General Fund</u>	<u>Special Revenue Funds</u>
Excess of revenues over expenditures (GAAP basis)	\$ 201,521	\$ 132,941
Increase (Decrease)		
Expenditures of amounts encumbered during the year ended June 30, 1984	395,635	211,234
Reserved at June 30, 1985, but recognized as expenditures for budget purposes	<u>(624,763)</u>	<u>(13,960)</u>
Excess (deficiency) of revenues over expenditures (budgetary basis)	<u>\$ (27,607)</u>	<u>\$ 330,215</u>

Employees' retirement system. All eligible employees of the department are required by Chapter 88, Hawaii Revised Statutes, to become members of the Employees' Retirement System of the State. Contributions to the system are based on actuarial valuation and include amortization of the unfunded liability over a period of 38 years from July 1, 1976. It is the State's policy to fund pension cost accrued.

Actuarial valuation data for the department are not available since the computations are made on a systemwide basis. The department's contribution, and those for other state agencies are included in the appropriation to the Department of Budget and Finance and is not reflected in the department's financial statements.

Accumulated vacation and sick leave. The department does not reflect vested accumulated vacation and sick leave credits earned by employees in the financial statements. Vacation and sick leave credits are recorded as expenditures when actually taken, a practice followed by other state agencies.

STATE OF HAWAII
DEPARTMENT OF DEFENSE
COMBINED BALANCE SHEET - ALL FUND TYPES
JUNE 30, 1985

	<u>Governmental</u> <u>Fund Types</u>		<u>Fiduciary</u> <u>Fund Type</u>	<u>Total</u> <u>(Memorandum</u> <u>only)</u>
	<u>General</u>	<u>Special</u> <u>Revenue</u>	<u>Expendable</u> <u>Trust</u>	
<u>ASSETS</u>				
Cash on hand	\$ <u>1,000</u>	\$ <u>--</u>	\$ <u>--</u>	\$ <u>1,000</u>
Cash in State Treasury	<u>629,211</u>	<u>406,270</u>	<u>51,092</u>	<u>1,086,573</u>
Total assets	\$ <u><u>630,211</u></u>	\$ <u><u>406,270</u></u>	\$ <u><u>51,092</u></u>	\$ <u><u>1,087,573</u></u>
<u>LIABILITIES AND FUND BALANCES</u>				
Due to State Treasury	\$ <u>1,000</u>	\$ <u>--</u>	\$ <u>--</u>	\$ <u>1,000</u>
Fund Balances:				
Reserved for encumbrances	629,211	51,998	--	681,209
Unreserved	--	354,272	--	354,272
Unencumbered allotments	<u>--</u>	<u>--</u>	<u>51,092</u>	<u>51,092</u>
Total fund balances	<u>629,211</u>	<u>406,270</u>	<u>51,092</u>	<u>1,086,573</u>
Total liabilities and fund balances	\$ <u><u>630,211</u></u>	\$ <u><u>406,270</u></u>	\$ <u><u>51,092</u></u>	\$ <u><u>1,087,573</u></u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF DEFENSE
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS
FOR THE YEAR ENDED JUNE 30, 1985

	<u>Governmental</u> <u>Fund Types</u>		<u>Fiduciary</u> <u>Fund Type</u>	<u>Total</u> <u>(Memorandum</u> <u>only)</u>
	<u>General</u>	<u>Special</u> <u>Revenue</u>	<u>Expendable</u> <u>Trust</u>	
REVENUES:				
Allotted appropriations	\$ 4,048,883	\$ --	\$ --	\$ 4,048,883
Federal matching grants in aid	--	1,024,600	--	1,024,600
Federal contracts	<u>--</u>	<u>345,910</u>	<u>--</u>	<u>345,910</u>
Total revenues	<u>4,048,883</u>	<u>1,370,510</u>	<u>--</u>	<u>5,419,393</u>
EXPENDITURES:				
Personal services	2,367,070	645,966	--	3,013,036
Other	<u>1,398,665</u>	<u>591,603</u>	<u>91,998</u>	<u>2,082,266</u>
Total expenditures	<u>3,765,735</u>	<u>1,237,569</u>	<u>91,998</u>	<u>5,095,302</u>
Excess (deficiency) of revenues over expenditures	<u>283,148</u>	<u>132,941</u>	<u>(91,998)</u>	<u>324,091</u>
TRANSFER - LAPSE TO GENERAL FUND	<u>(81,627)</u>	<u>--</u>	<u>(152)</u>	<u>(81,779)</u>
Excess (deficiency) of revenues over expenditures and lapses	201,521	132,941	(92,150)	242,312
FUND BALANCE, July 1, 1984	<u>427,690</u>	<u>273,329</u>	<u>143,242</u>	<u>844,261</u>
FUND BALANCE, June 30, 1985	<u>\$ 629,211</u>	<u>\$ 406,270</u>	<u>\$ 51,092</u>	<u>\$ 1,086,573</u>

See accompanying notes to combined financial statements.

EXHIBIT C

STATE OF HAWAII
DEPARTMENT OF DEFENSE
COMBINED STATEMENT OF REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES - BUDGET AND ACTUAL
GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 1985

	General Fund			Special Revenue Funds		
	Budget	Actual on a Budgetary Basis	Variance- Favorable (Unfavorable)	Budget	Actual on a Budgetary Basis	Variance- Favorable (Unfavorable)
REVENUES:						
Allotted appropriations	\$ 6,058,475	\$ 4,048,883	\$ (2,009,592)	\$ --	\$ --	\$ --
Federal matching grants in aid	--	--	--	907,015	1,024,600	117,585
Federal contracts	--	--	--	451,264	345,910	(105,354)
Total revenues	<u>6,058,475</u>	<u>4,048,883</u>	<u>(2,009,592)</u>	<u>1,358,279</u>	<u>1,370,510</u>	<u>12,231</u>
EXPENDITURES:						
Personal services	2,317,095	2,367,866	(50,771)	669,116	645,967	23,149
Other	<u>3,741,380</u>	<u>1,626,997</u>	<u>2,114,383</u>	<u>689,163</u>	<u>394,328</u>	<u>294,835</u>
Total expenditures	<u>6,058,475</u>	<u>3,994,863</u>	<u>2,063,612</u>	<u>1,358,279</u>	<u>1,040,295</u>	<u>317,984</u>
Excess of revenues over expenditures	--	54,020	54,020	--	330,215	330,215
TRANSFER - LAPSE TO GENERAL FUND	--	(81,627)	(81,627)	--	--	--
Excess (deficiency) of revenues over expenditures and lapses	--	(27,607)	(27,607)	--	330,215	330,215
FUND BALANCE, July 1, 1984	--	427,690	427,690	--	273,329	273,329
FUND BALANCE, June 30, 1985	<u>\$ --</u>	<u>\$ 400,083</u>	<u>\$ 400,083</u>	<u>\$ --</u>	<u>\$ 603,544</u>	<u>\$ 603,544</u>

See accompanying notes to combined financial statements.

STATE OF HAWAII
DEPARTMENT OF DEFENSE
COMBINED STATEMENT OF CHANGES IN ASSETS AND LIABILITIES -
AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 1985

	<u>Balance</u> <u>July 1, 1984</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 1985</u>
<u>TEMPORARY DEPOSITS - COUNTY CIVIL DEFENSE</u>				
<u>ASSETS</u>				
Cash in State Treasury	\$ <u>209</u>	\$ <u>364,652</u>	\$ <u>364,861</u>	\$ <u>--</u>
<u>LIABILITIES</u>				
Due to Counties	\$ <u>209</u>	\$ <u>364,652</u>	\$ <u>364,861</u>	\$ <u>--</u>
<u>TEMPORARY DEPOSITS - EMPLOYEE FRINGE BENEFITS</u>				
<u>ASSETS</u>				
Cash in State Treasury	\$ <u>--</u>	\$ <u>133,411</u>	\$ <u>133,411</u>	\$ <u>--</u>
<u>LIABILITIES</u>				
Due to other State Agencies	\$ <u>--</u>	\$ <u>133,411</u>	\$ <u>133,411</u>	\$ <u>--</u>
<u>TEMPORARY DEPOSITS - FEDERAL DISASTER FUNDS</u>				
<u>ASSETS</u>				
Cash in State Treasury	\$ <u>30,976</u>	\$ <u>1,609,598</u>	\$ <u>1,640,574</u>	\$ <u>--</u>
<u>LIABILITIES</u>				
Due to Counties	\$ <u>30,976</u>	\$ <u>1,609,598</u>	\$ <u>1,640,574</u>	\$ <u>--</u>
<u>TOTAL AGENCY FUNDS</u>				
<u>ASSETS</u>				
Cash in State Treasury	\$ <u>31,185</u>	\$ <u>2,107,661</u>	\$ <u>2,138,846</u>	\$ <u>--</u>
<u>LIABILITIES</u>				
Due to other State Agencies and Counties	\$ <u>31,185</u>	\$ <u>2,107,661</u>	\$ <u>2,138,846</u>	\$ <u>--</u>

See accompanying notes to combined financial statements.

PART III

RESPONSE OF THE AFFECTED AGENCY

COMMENTS ON AGENCY RESPONSE

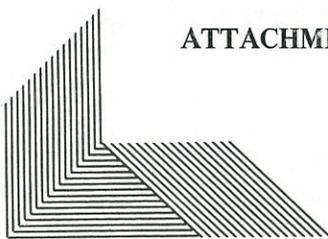
On December 24, 1985, copies of a preliminary draft report of this financial audit were transmitted to the Governor, the presiding officers of the Legislature, and the Department of Defense. A copy of the letter of transmittal to the department is included here as Attachment 1. As is our practice, we invited the department to comment on the recommendations made in the report. The department responded by letter dated January 9, 1986, which is included here as Attachment 2. The department generally agrees with our findings except for the following.

Our report recommended that the department obtain advance funding of federally funded projects whenever possible. The reason for this recommendation is that the department's present practice of obtaining federal funds on a reimbursement basis requires the interim use of state funds and such use results in lost interest earnings to the State. In response to this recommendation, the department dismisses the merits of advance funding on the basis that it is cumbersome, time consuming, and difficult to administer.

On the contrary, we believe that the advance funding process should be fairly simple and easy to administer and should not create any significant hardship on the department's workload. This conclusion is based on our review of the federal requirements and procedures for advance funding and our discussions with other state agencies which follow the practice of requesting advance funding for federal projects. Therefore, we urge the department to reconsider its position and adopt the practice of obtaining advance funding since interest earnings lost by the State is significant.

ATTACHMENT 1

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



CLINTON T. TANIMURA
AUDITOR

December 24, 1985

COPY

Major General Alexis T. Lum
Adjutant General
Department of Defense
State of Hawaii
3949 Diamond Head Road
Honolulu, Hawaii 96816

Dear General Lum:

Enclosed are two preliminary copies, Nos. 4 and 5, of our report on the *Financial Audit of the Department of Defense*. 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 9, 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 the report. Public release of the report will be made solely by our office and only after the report is published in its final form and submitted to the Legislature.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura
Legislative Auditor

Enclosures

ATTACHMENT 2



GEORGE R. ARIYOSHI
GOVERNOR

STATE OF HAWAII
DEPARTMENT OF DEFENSE
OFFICE OF THE ADJUTANT GENERAL
3949 DIAMOND HEAD ROAD, HONOLULU, HAWAII 96816 -4495

ALEXIS T. LUM
MAJOR GENERAL
ADJUTANT GENERAL

~~DANIEL K. O'NEILL~~
COLONEL
~~DEPUTY ADJUTANT GENERAL~~
PAUL K. NAKAMURA
COLONEL (HI)
DEPUTY ADJUTANT GENERAL

HIADM

January 9, 1986

Honorable Clinton T. Tanimura
Legislative Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

Dear Mr. Tanimura:

In response to your letter of December 24, 1985, regarding the report on the Financial Audit of the Department of Defense, we offer the following comments.

a. Failure to Obtain Advance Funding for Federally Funded Projects. The letter of credit system discussed in the audit finding is only applicable to Federal funds received for State Civil Defense from the Federal Emergency Management Agency (FEMA). The letter of credit system discussed in the audit finding does not provide for advance funding per se, but limits payment of authorized obligations within three days from draw-down of letter of credit funds. This procedure is cumbersome, time consuming and difficult to administer. Thus, it was decided to use some of the excess carry-over Federal fund receipts to initially pay for the authorized Federal expenditures and process the claims payment from the letter of credit as a cost reimbursement claim. Without setting up this kind of procedure, the department would require additional account clerks to maintain claims payment on a current basis.

b. Insufficient Recordkeeping for Federal Reimbursements. The department has records to cross-reference Army and Air Service and Site Contracts to verify billings and reimbursements. However, we do concur and will develop a simpler, more direct recordkeeping procedure to facilitate tracing of transactions to source documents.

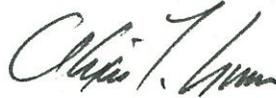
c. Utilization of Petty Cash. The department has increased the petty cash fund to \$6,000 and has established a departmental petty cash system to comply with Act 281, SLH 1985, to pay for goods and services of less than \$100 from the petty cash fund.

HIADM
Honorable Clinton T. Tanimura

Except as indicated, we generally agree with the audit findings. We appreciate being given the opportunity to provide comments.

If there are any questions, please to contact Mr. Eric Tom at 737-8986.

Sincerely,



Alexis T. Lum
Major General, Hawaii
Army National Guard
Adjutant General