

**MANAGEMENT AND FINANCIAL AUDIT OF
THE STATE TOURISM OFFICE
DEPARTMENT OF BUSINESS AND
ECONOMIC DEVELOPMENT**

**Conducted by the
Office of the Legislative Auditor
State of Hawaii
and
Coopers & Lybrand
Certified Public Accountants**

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

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

**Report No. 89-2
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FOREWORD

During the 1987 legislative session, the state tourism budget was increased substantially to \$15.68 million for FY 1987-88, an amount twice that of the \$7.46 million appropriated in the prior fiscal year. An additional increase to \$16.04 million was granted for FY 1988-89. However, the Legislature approved these requests cautiously and attached to the appropriations various budget restrictions and directives. One of the provisions in the 1988 budget act requested the Legislative Auditor to conduct a financial and management audit of the State Tourism Office to (1) ascertain its compliance with the FY 1987-88 budget provisions and (2) assess its progress toward implementing the recommendations of our 1987 management audit of the State Tourism Office and the Hawaii Visitors Bureau.

This report responds to these two directives. We were assisted by the certified public accounting firm of Coopers and Lybrand which conducted the financial audit. We wish also to express our appreciation for the continuing cooperation extended to us by staff at the Department of Business and Economic Development and the Hawaii Visitors Bureau, as well as other public officials and private individuals we contacted during the course of this review.

Newton Sue
Acting Legislative Auditor
State of Hawaii

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Chapter 1

INTRODUCTION

In our 1987 management audit of the Hawaii Visitors Bureau (HVB) and the state tourism program, we recommended that the Department of Business and Economic Development (DBED)¹ take a leadership role in developing the state tourism program and administering the contract with HVB. We also recommended that the tourism program be identified in a separate budget category in the DBED budget. The 1987 Legislature agreed by making all appropriations for tourism-related activities to DBED's tourism office in a separate program budget, BED 113. This program budget includes all funding for HVB as well as increased funding for other tourism-related promotions and research projects. The Legislature also earmarked through provisos the spending of most of those funds.

Concern over the State's role in the tourism program led the Legislature to mandate a management and financial audit of the State Tourism Office (Section 17D of Act 390, SLH 1988). More specifically, the Legislature requested a review of compliance with the 1987 spending provisions, a review of contract management controls, and an assessment of the progress made by DBED in implementing the recommendations in our 1987 audit report.

Objectives of the Audit

The objectives of this audit are:

1. To determine whether the department has complied with the various requests, policies, and guidelines expressed in the 1987 General Appropriations Act.
2. To examine the financial transactions of the State Tourism Office to ensure that expenditures have been made for the purposes set forth by the Legislature and to render an opinion on the fairness of the financial statements of the State Tourism Office.
3. To review the department's efforts in implementing the recommendations of the 1987 management audit of the HVB and the state tourism program.
4. To assess the effectiveness of the department's budgeting procedures and the management of its contracts for tourism promotion.

Scope of the Audit

This audit focuses primarily upon the State Tourism Office rather than the HVB. The audit reviews activities undertaken since our 1987 audit and expenditures made during FY 1987-88. We also reviewed consultant contracts and interviewed State Tourism Office staff and consultants about their role in the State's tourism program. Visitor industry facts and trends and information about tourism policy development and programs in other states are presented to provide a context for this audit. The financial audit portion of this audit was conducted by the certified public accounting firm of Coopers & Lybrand.

Organization of the Report

This report has three chapters. Chapter 1 consists of this introduction and update of visitor industry trends. Chapter 2 presents our findings and recommendations on the management of the state tourism program during FY 1987-88. The financial statements of the State Tourism Office and Coopers & Lybrand's report on the audit of such statements are in Chapter 3. The response of DBED to our findings and recommendations and our comments on that response conclude the report.

Visitor Industry Trends

Changes in Hawaii's visitor industry. Tourism has been a predominant industry in Hawaii since the early 1960s. The historic focus of the visitor industry has been to maintain its share of the market. Therefore, annual increases in total numbers of visitors and expenditures are seen by the industry as indicators of success.

In 1987, visitor expenditures increased about 15 percent, with estimated revenues at \$6.5 billion.² The number of visitors increased to 5.8 million in 1987, up 3 percent from 1986.³ However, the total numbers do not tell the entire story as the westbound visitor count actually declined by 1.2 percent and was offset by the eastbound count which increased by 18.2 percent.

While the increase in the eastbound count is easily explained by the large number of Japanese visitors encouraged to travel to U.S. destinations, several explanations are offered for the westbound decrease. *First*, other "sunshine" destinations competitive with Hawaii may be offering more value for the visitor dollar. *Second*, part of the Hawaii market is in the mature phase, and new inducements need to be found to attract returning visitors. *Third*, according to some observers, the recent construction of many upscale resorts projects an image of Hawaii as a destination for the more affluent visitor.⁴ *Fourth*, newly approved and developing transpacific airline routes to other Pacific and Asia destinations no longer require stopovers in Hawaii.

State Tourism Policy Development

Increases in state funding for tourism promotion. Increased competition within the tourism industry has resulted in a large infusion of state funds for tourism promotion in the last fiscal year. According to the U.S. Travel Data Center, for FY 1987-88 Hawaii ranked third behind New York and Illinois in the top ten state travel office budgets. New York's budget was reported at \$21.5 million for FY 1987-88, while Illinois reported spending \$20.5 million in the same fiscal year.⁵

Statutory tourism promotion programs. Along with the increase in funding for tourism promotion, several top ten states have created statutory programs with mandatory reporting requirements. The 1985 New York State Tourism Promotion Act provides specific legislative objectives and guidelines for assistance to tourism promotion agencies. The Act requires the tourism department to adopt a five-year master plan for tourism promotion which will be reviewed annually. Further, the department must submit an annual expenditure report summarizing the activities and effectiveness of all tourism promotion agencies receiving state funds.

Other states with large tourism budgets have also adopted tourism promotion laws providing legislative direction for grants-in-aid programs, development of specific markets, regional tourism promotion, and annual reporting requirements. Among these states are Pennsylvania, Florida, Massachusetts, and Tennessee.

Need to measure impact of tourism on economic development. Researchers in the visitor industry increasingly acknowledge the need to measure the impacts of tourism on the economy of a destination.⁶ Several contributors at the 1987 Travel and Tourism Research Association annual conference indicated that the increase in tourism promotion budgets in the public sector requires accountability in the form of reporting which links return on investment with the objectives of the promotion. These researchers say that economic impact needs to be shown in order to analyze the success of the visitor industry as one component of a larger economic development program. Further, justification for budget increases in order to remain competitive within the market demands some sort of indicator of how the economy is being supported by the present level of spending.

Several states have begun trying to measure the economic impacts of the tourism industry. Of particular note is California, which mandated in its Tourism Policy Act of 1985 an annual report assessing the benefits of the state tourism office's marketing programs. The annual report is supposed to document the direct benefits of the marketing program to the tourism industry, state employment, state and local tax revenues, and underutilized destinations. California's tourism office is now required to submit an annual marketing plan including measurable goals and objectives with its budget request.

Policy development in Hawaii - 1984 to the present. Hawaii has also taken steps in recent years to develop policies for government support and oversight of the visitor industry. The formalization of tourism policy was initiated in 1984 with the adoption by the Legislature of the State Tourism Functional Plan. Nine fundamental policies were adopted under four broad objectives of tourism promotion, physical development, employment and career development, and community relations.

Policies for tourism promotion encouraged increased funding for marketing and promotional efforts and emphasized the convention market. Physical development policies encouraged a well designed and adequately serviced visitor industry which considered the needs of Hawaii's people. Employment and career development policies emphasized the expansion and development of the University of Hawaii School of Travel Industry Management and other training programs. Policies to enhance relations and mutual awareness between the visitor industry and the community encouraged informational programs to show residents the contribution of the visitor industry to Hawaii's economy and to show visitors Hawaii's uniqueness.⁷

Budgetary support for policy. Subsequent budget actions by the Legislature have indicated its support for the aforementioned policies. Every year since 1984, the Legislature has increased the annual appropriation for tourism promotion. In 1984 and 1985, it requested that a percentage of the funds be spent on promotion and advertising of Hawaii to Asian and Pacific markets. In 1985 also, the Legislature mandated the creation of the Tourism Impact Management System (TIMS) and provided \$100,000 for the development and establishment of this monitoring system to assure that tourism development and activities enhance, rather than adversely affect, the quality of life of Hawaii's residents.

The 1986 Supplemental Appropriations Act reflected the Legislature's concern with assessing the outcome of the expenditures for tourism promotion by requesting the audit report which we submitted in early 1987. Additionally, the Legislature requested DBED to submit an implementation plan for the direct assumption of responsibility for the award and administration of the Hawaii Visitors Bureau contract or other contracts for tourism marketing services for the 1987-89 fiscal biennium.

In 1987, the Legislature provided funds to begin to implement the TIMS framework. Further, the Legislature returned to a previous practice of specifically identifying tourism appropriations by appropriating marketing and promotion funds to the State Tourism Office. However, for the 1987-89 fiscal biennium, the Legislature exercised caution in appropriating large increases for tourism promotion by attaching many provisions and designations earmarking the funds for special promotions.

Chapter 2

MANAGEMENT OF THE STATE TOURISM OFFICE DURING FISCAL YEAR 1987-88

A portion of our 1987 audit was directed at the state tourism program administered by the Department of Business and Economic Development (DBED). We emphasized DBED's responsibility to carry out its leadership role as mandated by law. In this chapter, we report on the extent to which DBED's tourism office has complied with legislative requirements and its administration of the HVB contract and other contracts during FY 1987-88.

Summary of Findings

Based on our review of the program and financial records of the State Tourism Office and the Hawaii Visitors Bureau (HVB) for FY 1987-88, we find that:

1. The department partially complied with the planning and reporting requirements of Act 216 by submitting the tourism strategic plan.
2. State Tourism Office contract expenditures were made in compliance with the provisions of the General Appropriations Act of 1987. However, expenditure reports made by the HVB are inadequate to ensure compliance with provisions of that act.
3. The State Tourism Office has taken steps to implement the recommendations of our 1987 audit, but the HVB has not yet implemented most of our recommendations.
4. Consultant contracts are not formally monitored and evaluated by the State Tourism Office.

Compliance with Planning and Reporting Provisions of Act 216

Section 14 of Act 216, the General Appropriations Act of 1987, directed the DBED through its tourism office to undertake several tasks involving planning and reporting to the 1988 Legislature. These mandates included the development of a strategic marketing plan for submission to the Legislature and quarterly reports to the Governor on the effectiveness of its programs. We find that the department initiated its strategic planning efforts by submitting the tourism strategic plan. However, it did not submit written quarterly reports to the Governor assessing the effectiveness of the tourism programs.

Submission and implementation of the tourism strategic plan. The Legislature directed the department to develop and receive gubernatorial approval for a strategic marketing plan prior to the expenditure of more than 25 percent of its marketing and promotions budget for FY 1987-88. The strategic marketing plan was to include the objectives of the respective promotions programs of DBED and its prime contractor in each tourism market, action plans for these programs, and quantifiable measures of effectiveness.

In response to this provision, the department selected a consultant firm to develop what it calls the tourism strategic plan. The plan was prepared by Grant Thornton and approved by the Governor in November 1987.¹ It includes descriptions of the visitor industry environment in Hawaii, projections and trends for tourism to 2005, visitor industry opportunities and initiatives, and potential threats and negative impacts of tourism. It also makes recommendations on state government's role in determining the mix, nature and amount of tourism, on planning strategically for this major industry, and on the use of limited state resources for its promotion.²

According to the department, implementation of the tourism strategic plan by the tourism office and its contractors was begun during FY 1987-88. The HVB contract negotiated for FY 1987-88 included a clause requiring HVB to direct its efforts in consonance with the department's tourism strategic plan.

Section 17 of Act 216 also required the department to prepare and adopt a *ten* year strategic marketing plan for tourism advertising, marketing promotions, and specific island destinations for implementation by July 1, 1988. In the 1988 tourism strategic plan submitted by Grant Thornton, the consultant recommended a *two to four* year timeframe for strategic marketing plans. According to the department, the 1988 Legislature appears to have accepted this recommendation and therefore DBED has fulfilled this provision with the Grant Thornton plan.

Need to update tourism strategic plan. Based on the framework that has been provided in the initial tourism strategic plan, the department needs to maintain and update the plan as an information source for the Legislature. This would include providing the Legislature with current information about trends in the visitor industry in Hawaii, as well as nationally and internationally. Because of the dynamic nature of the visitor industry, the Legislature needs to be made aware of the trends in the industry in order to respond with appropriate policy and budgetary directives. Therefore, the department should maintain the tourism strategic plan by updating the information every two to four years, as suggested by the consultant.

Need to link functional plan and tourism strategic plan to budget. The tourism strategic plan differs from the state tourism functional plan. The tourism *strategic* plan will be used exclusively by the department to direct tourism marketing programs and contracts. The tourism

functional plan, on the other hand, is a broader document delineating state policy related to the visitor industry, and it is the policy statement upon which the department's marketing and programs should be based.

While the State's tourism functional plan provides broad policies encouraging tourism promotion, it does not prescribe the type of promotions or projects which should be funded. Similarly, the DBED tourism strategic plan addresses broad goals relating to certain tourism markets and segments but does not outline specific marketing programs or strategies for achieving these goals. Therefore, various projects received funding for the 1987-89 fiscal biennium without an evaluation by the Legislature or the department as to whether these projects meet the policies or goals of either the state functional plan or the tourism strategic plan. A gap in information provided to the Legislature by the department still exists.

Tourism strategic plan as a basis for annual marketing plan. This gap between the broad policies and goals of the plans and the subsequent funding by the Legislature could be narrowed if DBED developed an annual marketing plan which outlined specific strategies and projects that would meet the goals of its tourism strategic plan. The annual marketing plan should include descriptions of the target markets, the results which are being sought, short-term versus long-term promotional efforts, private sector collaborative efforts, annual themes and promotions, type of media to be used, and promotional materials and distribution plans. The Legislature would then appropriate funds for tourism promotion based on the annual marketing plan submitted with the department's budget request.

Further, a statutory program for the administration of these tourism funds should be established, similar to those enacted in other states. The program should mandate the submission of an annual marketing plan and provide guidelines for: the types of promotions to be supported; the procedures to be followed by the tourism office in making contract awards; and formal performance reporting by the contractors receiving the funds. Finally, the statutes should also mandate an annual report by the tourism office to the Legislature on the effectiveness of the promotions funded during the previous fiscal year and on the execution of the annual marketing plan.

As mentioned in the introduction to this report, recent trends indicate that state governments are adopting statutory programs for funding tourism marketing and promotions. Many states now require proposals to be submitted to a state tourism agency for formal evaluation before tourism promotion funds are granted. Additionally, state tourism agencies must submit annual marketing plans and make reports to the legislatures indicating which projects were funded as well as the effectiveness and measurable impacts of the programs. This approach recognizes the

need to provide accountability for expenditure of public funds used for tourism promotion and the need for the Legislature to become more involved in assessing the outcomes of these expenditures when reviewing subsequent budget requests. It also lessens the possibility that the state's efforts will be fragmented by ad hoc projects receiving state funds at the expense of the policies and programs outlined by a state plan.

DBED has not prepared written quarterly reports. Section 14 further required the department to submit quarterly reports to the Governor on the progress and effectiveness of the tourism programs funded through the Act. We find however that written quarterly reports are not prepared by the tourism office for the Governor. According to the director of the department, oral reports on the progress of the tourism program are made to the Governor during their regularly scheduled meetings. In our opinion this provision was intended to be a monitoring device; requiring the department through its tourism office to make written reports of its progress including detailed information about program operations and providing the Legislature with the basis for requesting copies of such reports, if necessary. We do not believe the director's oral reports satisfy the Legislature's requirement.

Budgetary reporting by DBED. The 1988 Legislature was concerned that the department was not submitting adequate information upon which budgetary analysis and decisions could be made. A review of the information provided by the department during the 1988 session indicates that while it generally complied with requests from the Legislature with detailed information, the type of information provided does not comply adequately with the program budget format. For example, the department's budget request for marketing and promotion was based simply upon an estimate from the advertising agency of funds needed to conduct advertising campaigns, with additional funds requested to support special promotions of local annual events. Which tourism goals would be met by these expenditures was not clear. There was also no reporting of effectiveness or impacts from prior marketing and promotion efforts beyond annual visitor counts and expenditures.

Compliance with Expenditure Provisions of Act 216

Act 216, SLH 1987, as amended by Act 390, SLH 1988 included numerous provisos earmarking the expenditure of \$15,680,351 in appropriations to the State Tourism Office for FY 1987-88. Sections 14, 15, and 16 designated \$12,333,383 of that sum to be expended for specific programs and activities. Most of that sum, \$10,583,000, was designated for HVB programs and activities. Table 2.1 summarizes the provisos. We find that the tourism office is generally in compliance with the provisos, but we could not ascertain full compliance by HVB.

Tourism office complies with staffing provisos. Section 14 provided five exempt positions and \$95,968 during FY 1987-88 to assist the tourism staff with promotions. According to the branch chief of the State Tourism Office, three of the positions are filled with tourism specialists, another position for a strategic marketing planner has been advertised, and the remaining position has yet to be designated. Another \$36,000 was designated for a staff position to coordinate the Tourism Impact Management System project on the neighbor islands. Although the position was vacant in November 1988, it was filled during part of FY 1987-88.

Table 2.1

Allocation of Budget Provisos
for Programs and Activities

<u>Programs and Activities</u> ¹	<u>Hawaii Visitors Bureau</u> ²	<u>Others</u> ²	<u>Total Designated Expenditures</u>
World-wide tourism, marketing, advertising and promotional activities	\$ 7,900,000	\$ 850,000	\$ 8,750,000
State of Hawaii field offices	1,800,000	---	1,800,000
Industry and public relations	---	450,000	450,000
Tourism research and analysis	40,000	75,000	115,000
Sports promotion	---	125,000	125,000
Expo '88 in Australia	408,000	250,383	658,383
Annual visitor expenditure survey	60,000	---	60,000
Neighbor island chapter offices	<u>375,000</u>	<u>---</u>	<u>375,000</u>
	<u>\$10,583,000</u>	<u>\$1,750,383</u>	<u>\$12,333,383</u>

1. Sections 14, 15 and 16 Act 216, SLH 1987 as amended by Act 390, SLH 1988.

2. Allocated by the State Tourism Office.

DBED contracts were in compliance. An additional \$1,750,383 in the FY 1987-88 budget was spent by the State Tourism Office on special promotions and research projects. Most of the special promotions were conducted by consultants who received sole source contracts due to the specific nature of the event; i.e. Aloha Week, Hula Bowl, Ironman Triathlon, and Expo '88. The research contracts, however, were awarded based on competitive bid.

The financial auditors were able to verify that all expenditures made by the State Tourism Office for these special promotions and research projects were in compliance with the provisos of Act 216. These expenditures were easily verified because, in contrast to the HVB contract, each of these contracts was a single purpose award and the contract terms clearly reflected the provisos.

HVB contract compliance cannot be ascertained. As shown by Table 2.2, the Legislature earmarked spending for certain programs and funding levels at HVB. Coopers & Lybrand, the financial auditors, checked for compliance with these directives based on the information in HVB's monthly invoices submitted to DBED. The financial auditors could verify compliance with budget directives for only 68 percent of HVB's expenditures.

Discussions between DBED fiscal staff and the financial auditors revealed that HVB's monthly reports do not always provide sufficient information to enable the fiscal staff to match expenditures with specific provisos of the appropriations act. When this occurs, the fiscal staff arbitrarily allocates the expense to broader expenditure categories. They have been doing this because the State Tourism Office does not require HVB to make expenditure reports specific to the appropriations act. The department should require HVB to make written quarterly reports linking expenditures and activities with the directives of the Legislature. These reports are necessary in order to assess HVB's compliance with legislative directives and to assist the DBED fiscal office to allocate properly HVB expenditures.

Contingency fund needs justification. Several HVB special promotions projects and advertising campaigns were funded from a \$1.5 million contingency fund authorized by DBED during FY 1987-88. According to the director of DBED, the contingency fund was composed of general funds appropriated in BED 113 but not designated by any legislative provisos in the 1987 appropriations act. The department had requested these as discretionary funds in its original budget request.

Table 2.2

Hawaii Visitors Bureau Expenditures
 Compliance With Act 216, SLH 1987
 As Amended by Act 390, SLH 1988

	Total Designated Expenditures	Compliance with Act 216	
		<u>Compliance</u>	<u>Not Determinable</u>
<u>Programs and Activities</u>			
World-wide tourism marketing, advertising and promotional activities	\$ 7,900,000	\$6,754,588	\$1,145,412
State of Hawaii field offices	1,800,000	---	1,800,000
Tourism research and analysis	40,000	---	40,000
Expo '88 in Australia	408,000	408,000	---
Annual visitor expenditure survey	60,000	---	60,000
Neighbor island chapter offices	<u>375,000</u>	<u>---</u>	<u>375,000</u>
	<u>\$10,583,000</u>	<u>\$7,162,588</u>	<u>\$3,420,412</u>

The fund is administered by the department and HVB must submit a request for approval by DBED prior to making commitments for expenditures from the fund. During FY 1987-88, 31 requests from HVB were approved by DBED. Most of the requests were for special promotions which according to HVB, were unanticipated at the time it prepared its budget. The department rejected eight requests because it felt that HVB should plan for its participation in certain promotions in future budget requests.

Contingency funds are usually provided for unanticipated needs which if not met, would adversely affect the operations and programs of an agency. These funds are then expended for a purpose which may not have been reviewed by the Legislature. The use of a contingency fund by DBED needs to be further justified by the department and the Legislature should be given adequate information to decide whether the visitor industry would be adversely affected if these contingency funds are not available.

Implementation of 1987 Audit Recommendations

Section 15 of Act 216, SLH 1987, required DBED to submit a report to the Legislature on the roles and responsibilities of the department and HVB in implementing the State's tourism marketing and promotion program, and an analysis of and plan of action for implementing the recommendations of the Legislative Auditor. According to the department, it had addressed these concerns in its budget presentations to the 1988 Legislature. A separate report outlining a plan of action for implementing our recommendations was not submitted.

Our 1987 audit on the state tourism program and the HVB made two basic recommendations: (1) to improve the broad executive planning and leadership role of DBED, and (2) to improve HVB's programs as the state's primary tourism promotion contractor. We viewed the State Tourism Office to be ultimately responsible for the state tourism program and for HVB's activities via its contract provisions. Therefore, we recommended that the State take a more active role in defining tourism program directions and monitoring the performance of HVB. We also suggested that the State Tourism Functional Plan be updated and used to direct future tourism-related programs and activities. We find that progress has been made to various degrees by DBED in implementing our recommendations.

Efforts to provide tourism leadership. *Increasing program visibility.* In our 1987 report, we recommended that the tourism program be headed by a deputy director. In reviewing DBED's efforts to implement our recommendations, we find that the department has submitted a departmental reorganization plan to the Governor for approval. As part of this reorganization, the tourism office will become part of a new Industry Promotion Division composed of three branches: tourism, film, and ocean resources. The department sees this structure as necessary to coordinate promotion of its film and ocean resources programs with the tourism program.

According to the department, tourism has not been designated as a separate division but it will be the focus within the new industry promotion division. The reorganization plan is being reviewed by the Department of Budget and Finance, and DBED anticipates that the plan will be approved at the beginning of 1989. It is too early to determine whether this reorganization will give the tourism program the necessary emphasis we recommended in 1987.

Revising the tourism functional plan. The *State Tourism Functional Plan* was revised to refocus the State's tourism efforts in the areas of marketing and community relations.³ The revised plan reflects the directions that the tourism program would like to take in pursuing new and developing markets. It also includes implementation of the Tourism Impact Management System. Although these components of the functional plan were revised by the tourism office in September 1987,

approval of the redraft has been withheld pending further work in the areas of physical development and employment by the Governor's Office of State Planning.

Implementing the tourism impact management system. The Tourism Impact Management System (TIMS) was adopted in 1986 by the Legislature to "establish a system for the continuous monitoring of the impact of tourism on the economic, social, and physical environment of the residents of Hawaii."⁴ The State Tourism Office has proceeded with its implementation by awarding a contract to conduct the core survey and by compiling the community journal. Both of these tasks follow the TIMS model and implementation framework developed for the department in January 1986 by consultants.

The core survey collects baseline data necessary for developing indicators to be used to evaluate the impacts of the visitor industry. The core survey was administered to 4,000 residents selected at random. The results of the survey will be reported and made available by DBED in an executive summary to be released in January 1989. The survey will also include five volumes of technical data. The community journal will summarize tourism issues which surface through the news media, community groups, and public hearings. It will also be available at the beginning of 1989.

Stronger management of the HVB contract. In 1987, we recommended that DBED take a stronger role in administering the HVB contract by clarifying HVB's responsibilities in the contract and enforcing its terms on a more systematic basis. DBED appears to have made progress toward implementing these recommendations.

For FY 1987-88, DBED contracted with HVB for a total of \$12,270,000 in three separate contracts.⁵ Since the 1987 appropriations act provided all funds for tourism promotion directly to DBED, the tourism office introduced new requirements in the negotiations for the FY 1987-88 contracts. New procedures included presentations to the tourism office by each HVB department of its program initiatives for the year and development of individual action plans for each department. The HVB was also required to make quarterly presentations to the tourism office on the progress of its promotional efforts. New clauses within the contract include such budgetary controls as mandatory review and approval by the tourism office of any HVB requests for expenditure items over \$100,000 and for any changes in expenditure plans amounting to \$20,000 or more.⁶

HVB reporting inadequate. Section 203-1, HRS, authorizes the department to contract with the HVB and add any additional provisions in the contract which are necessary for effective tourism promotion and development. During negotiations with HVB for the FY 1987-88 contracts, the department added a number of administrative and reporting requirements. Among

these were quarterly reviews by DBED of HVB activities to include analysis of program effectiveness and comparison of expenditures to authorized programs and budgets.⁷ These DBED reviews were to be in addition to the continued HVB practice of submitting the monthly financial statements, which are essentially invoices sent to the department requesting payment for services. These statements are inadequate for the purpose of monitoring program effectiveness. The quarterly review could have been used to fill this void, but they were not conducted in FY 1987-88.

The current HVB contract for FY 1988-89 again requires HVB to make quarterly presentations to DBED, which would assist the department in monitoring the progress of HVB programs and activities. According to the department, the first quarterly review was conducted in October 1988. Written action plans were presented by each HVB department to the state tourism office staff and the director of DBED. During the presentations the state tourism office staff and the director discussed the plans and provided feedback to HVB. Based on the positive outcome of the October presentation, the State Tourism Office will continue to conduct the quarterly reviews for the remainder of FY 1988-89.

HVB advertising program. During the past fiscal year, DBED also started to take a more active role in HVB's advertising program. For FY 1987-88, the advertising agency submitted a detailed media campaign plan for review and approval by both HVB and DBED. In response to the fluctuations in Hawaii's share of the tourism market, the HVB used its advertising contract, with the approval of DBED, to conduct two special campaigns during FY 1987-88. One was targeted at the post-flood period in January 1988 to assure potential travelers that the visitor industry in Hawaii had not been affected by the New Year's flooding. Worldwide attention by the media had been given to the flood areas. The second special campaign was conducted in mid-July 1988 to counter soft visitor counts projected for the summer season. These campaigns were directed at the traditional western market and specifically at those persons who had expressed a desire to vacation in Hawaii in earlier direct-mail responses.

HVB advertising contract lacks agency review. Although the department has become more involved in HVB's advertising program, we find that there still has not been an advertising agency review. An agency review involves solicitation for proposals which are then evaluated based on the purchaser's criteria. The advertising contract is then awarded to the agency whose proposal best meets the criteria.

In our 1987 report, we criticized HVB for a lack of standards or procedures in selecting an advertising agency. We recommended that HVB develop standards for a formal agency review

process and proceed to conduct them. Since 1969, the same advertising agency has been awarded the HVB contract. There have been only three agency reviews in those 19 years, the last in 1984.

The current FY 1988-89 contract was negotiated by HVB with the same agency for \$3.935 million, and in December, it was awaiting final approval by DBED. This action contradicts earlier information provided by HVB and the tourism office staff, in which they indicated that an agency review would be conducted during October 1988.⁸

The staff now asserts that an agency review will be conducted early in 1989, under new procedures now being developed by the department and with the assistance of an independent advisor to the department. The department indicates that HVB will utilize a formal review process approved by the department and will recommend two finalists to the department. In consultation with the tourism office and the independent advisor, the director of DBED will make the final award of the contract.⁹ Since the agency review is scheduled for early 1989, the department should report to the Legislature on the results of this review and indicate whether it will continue to participate in this manner for future reviews.

HVB internal management being reviewed. In our 1987 audit, we questioned the function and activities of the mainland and neighbor island offices as they relate to overall State tourism goals. We also indicated that the marketing, public relations, and research departments needed to better define and coordinate their operations. In response to the criticisms in our audit, HVB has hired a consultant to conduct an internal management review of its organizational structure and operations. The consultant's fee was paid through the DBED contingency fund discussed earlier.

HVB has yet to change its operations or programs in response to our audit recommendations. According to HVB, our 1987 audit concerns are currently being assessed by the consultant, and HVB is anticipating making changes based on the outcome of this review. When the consultant's report is completed, it should be disseminated to the Legislature. A report should then be made by DBED to the Legislature on how it plans to address the consultant's findings and recommendations in light of the recommendations of our 1987 audit. DBED should also detail how it plans to monitor any long-term organizational and management changes recommended to HVB by the consultant.

Inadequate Contract Monitoring and Evaluation

The State Tourism Office does not itself carry out any promotions activities but relies on contractors. Thus, contract management is a vital function of the office. While the actual

expenditures for promotions contracts other than the HVB contract were verifiable, we found that formal monitoring and evaluation of the contractors' efforts were not being performed by the tourism office.

Our review of the contract files and interviews with tourism office staff and contractors indicate that no formal procedures are used to monitor and evaluate the performance of the contractors. The tourism office usually relies on the receipt of a final product or final invoice requesting payment for services. The majority of the contracts do not require written progress reports and sometimes do not require final reports at the completion of the project.

Tourism office staff indicate that they conduct informal monitoring through telephone contact; however, conversations are generally not documented in the contract files. Evaluations of contracts are usually performed only for annual renewable contracts, such as Aloha Week. Again, however, it is an informal assessment which includes a meeting and verbal discussion of the contract results and possible goals for the next year.

An adequate system for monitoring and evaluating contractor performance requires not only frequent communication with contractors, but progress reports indicating their compliance with contract specifications and provisions of the budget act. Ideally, all communication with contractors should be documented in writing, either through formal written progress reports or documentation of conversations in the contract file. Further, the tourism office should make a formal evaluation based on a final written report of the activities undertaken by the contractor and assessment of problems encountered as well as achievement of a project's goals and objectives.

Conclusion

We find that the State Tourism Office has taken steps to assume a leadership role for the state's tourism program, and it is continuing to implement certain directives of the Legislature. However, it needs to develop an annual marketing plan for funding tourism promotion which builds upon its tourism strategic plan and develop a statutory program for administering tourism promotion funds which requires reporting to the Legislature on the effectiveness of these promotional activities. It also needs to enforce HVB contract provisions, and require HVB expenditure reports to provide detail which ensures compliance with Legislative directives. Finally, the office needs to develop a formal monitoring and evaluation system for its contracts.

Recommendations

We recommend the following:

- 1. The Department of Business and Economic Development should update its tourism strategic plan every two to four years and include information relating to visitor industry trends, opportunities and initiatives, and the role of state government in the visitor industry. Further, a program for administering state funded tourism promotions should be adopted in the statutes which requires:*
 - the department to develop an annual marketing plan for submission to the Legislature with its budget request. The annual marketing plan should indicate the target markets for the year, how DBED intends to promote Hawaii in those markets, and how it plans to measure its effectiveness;*
 - submission of proposals for tourism promotion projects to the State Tourism Office by all contractors, including HVB;*
 - a formal review and selection process for funding those projects which meet the goals and objectives of the annual marketing plan;*
 - performance reports by the funded entities according to a formal monitoring and evaluation system developed by the State Tourism Office; and*
 - an annual report by the State Tourism Office on the effectiveness of the promotions and its execution of the annual marketing plan.*
- 2. The department should provide a format for and require the Hawaii Visitors Bureau to submit written quarterly expenditure reports which properly allocate expenses to ensure compliance with the Legislature's budget provisions.*
- 3. The State Tourism Office should continue to develop its role as the leader of the state's tourism programs, and make reports to the Legislature on:*
 - the procedures followed and the outcome of the HVB advertising agency review;*
 - the internal management review of HVB and its proposals for implementing the recommendations of our 1987 audit and the internal review.*
- 4. The State Tourism Office should develop a formal system for monitoring and evaluating its contracts, to include written progress reports and final reports at the completion of each contract.*

Chapter 3

FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT

This chapter presents the results of the audit of the financial statements of the State Tourism Office, Department of Business and Economic Development, for the year ended June 30, 1988. It contains the report of Coopers & Lybrand regarding whether the office's financial statements present fairly, in all material respects, the results of operations of its general fund account for the year ended June 30, 1988, in conformity with generally accepted accounting principles. It also displays various financial statements relating to the general fund account of the State Tourism Office, together with explanatory notes.

Summary of Findings

In the opinion of Coopers & Lybrand, the office's financial statements present fairly, in all material respects, the results of operations of its general fund account for the year ended June 30, 1988.

Independent Auditor's Report

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

"To the Legislative Auditor
State of Hawaii

We have audited the following financial statements of the State Tourism Office, Department of Business and Economic Development, for the year ended June 30, 1988:

Statement of expenditure - general fund account (Exhibit A)
Statement of expenditure - budget and actual - general fund account (Exhibit B)

These financial statements are the responsibility of the office's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit

includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the notes to the financial statements, the general fund account of the State Tourism Office, Department of Business and Economic Development, is a part of the State of Hawaii's general fund and our opinion expressed herein, insofar as it relates to the amounts included for the general fund is limited to the transactions of the State Tourism Office, Department of Business and Economic Development only.

In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations of the general fund account of the State Tourism Office, Department of Business and Economic Development, for the year ended June 30, 1988 in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the financial statements referred to in the first paragraph, taken as a whole. Schedule I is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

/s/ Coopers & Lybrand

COOPERS & LYBRAND
Certified Public Accountants

Honolulu, Hawaii
September 13, 1988"

Descriptions and Definitions

Descriptions of financial statements and schedule. The following is a brief description of the financial statements and schedule audited by Coopers & Lybrand. The financial statements and schedule are attached at the end of this chapter.

1. *Statement of expenditure - general fund account (Exhibit A).* This statement presents the expenditure and other financing source for the general fund account used by the office.

2. *Statement of expenditure - budget and actual - general fund account (Exhibit B)*. This statement presents a comparison of the budgeted and actual expenditure and other financing source for the general fund account used by the office.

3. *General Fund Account - Schedule of expenditure - budget and actual (Schedule I)*. This schedule presents a detailed comparison of the budgeted and actual expenditure for the general fund account, classified by function, within the office.

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. *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.

2. *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.

3. *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.

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

5. *Transfers*. The transactions between funds, departments, and/or programs which are approved by the appropriate authority.

Notes to Financial Statements

Explanatory notes which are pertinent to an understanding of the financial statements and financial condition of the funds administered by the State Tourism Office are discussed below:

Reporting entity. The State Tourism Office is a branch of the Department of Business and Economic Development which is a department of the State of Hawaii.

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

The accounting procedures generally provide for the recording of commitments at the time contracts are awarded and orders for equipment, construction, services, and supplies are placed.

These commitments are recorded as encumbrances in the office's accounting records and are necessary to reflect obligations against appropriations. General fund appropriations that are not expended or encumbered by the end of the fiscal year generally lapse.

Capital assets constructed for or purchased by the office are recorded as expenditures in the year in which the cost is incurred. These assets are not reflected as assets in the accompanying financial statements, but are reflected in the general fixed assets account group of the State. Depreciation of these assets is not recorded by the State.

Costs for pension, health, and social security benefits of state employees are allocated to the respective fund from which the employee is paid. The costs allocated to general fund employees are expended by the Department of Budget and Finance and are not reflected in the office's general fund financial statements.

Required contributions to the Employees' Retirement System are based upon actuarial valuation and include amortization of accrued unfunded liability over a period of 50 years from July 1, 1964. The State's policy is to fund its required contribution annually.

Fund categories and description. Moneys to finance the office's programs and activities are accounted for in the general fund. A fund is an independent fiscal and accounting entity with a separate group of accounts which shows its revenues and expenditures.

The general fund accounts for all resources not otherwise accounted for in other funds. Any activity not financed through another fund is financed through this fund. The budget as adopted by the Legislature provides the basic framework within which the resources and obligations of the general fund are accounted. The general fund of the office is a part of the State's general fund and the accompanying general fund financial statements are limited to and reflect only the appropriations, expenditures, and obligations of the general fund accounts used by the office, and the general fund revenues collected by the office. There were no general fund revenues collected by the office for the year ended June 30, 1988.

Budgeting and budgetary control. Amounts reflected as budgeted expenditure in the *Statement of expenditure--budget and actual* are derived primarily from the General Appropriations Act of 1987 (Act 216, SLH 1987, as amended by Act 390, SLH 1988) and transfers instituted by the Department of Budget and Finance. To provide for comparability, actual expenditures in this statement have been adjusted to include encumbrances at year end and exclude current year expenditures for liquidation of prior year encumbrances.

Commitments and contingencies. 1. *Accumulated vacation and sick leave.* In accordance with the general practice followed by other state agencies, the accompanying financial statements do not reflect accrued and potential liability for earned vacation and sick leave credits.

The State has provided for the recognition of a liability in the general long-term debt group of accounts for liabilities associated with governmental fund compensated absence programs which are not expected to be liquidated with expendable available resources. Accordingly, the State provided for the office's accumulated vacation accrual of approximately \$9,000 at June 30, 1988.

Sick leave accumulates 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. However, a state employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the retirement system. Accumulated sick leave as of June 30, 1988, was approximately \$22,000 and has not been accrued in the financial statements.

2. *Employees' retirement system.* All eligible employees of the office are required by Chapter 88, Hawaii Revised Statutes, to become members of the Employees' Retirement System of the State. Prior to June 30, 1984, the plan was only contributory. In 1984, legislation was enacted to create a new noncontributory plan for members of the system who are also covered under social security. The noncontributory plan which provides for reduced benefits covers most eligible employees hired after June 30, 1984. Employees hired before that date were given the option of remaining in the contributory plan or joining the new noncontributory plan and receiving a refund of the employee contributions. The system consists of a Pension Accumulation Fund which provides basic pension benefits, and a Post Retirement Fund which provides annual increases to individuals receiving pensions.

Actuarial valuations are made for the entire system and are not separately computed for the State and each county. The office's general fund share of the retirement system expense for the fiscal year ended June 30, 1988, was included in the General Appropriation Act as an item to be expended by the Department of Budget and Finance and is not reflected in the office's general fund financial statements.

3. *Post-retirement health care and life insurance benefits.* In addition to providing pension benefits, the State provides certain health care and life insurance benefits for retired state employees. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The office's share of the expense for post-retirement benefits for the year ended June 30, 1988, has not been separately computed and is not reflected in the office's general fund financial statements.

4. *Deferred compensation plan.* The State offers its employees a deferred compensation plan created in accordance with Section 457 of the Internal Revenue Code. The plan, available to

all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The assets of the plan are the property of the State, subject only to the claims of the State's general creditors. The office's share of the liability due to employees for deferred compensation and accumulated net earnings from the plan is not separately computed and is not reflected in the office's general fund financial statements.

5. *Insurance coverage.* The State is self-insured for substantially all perils including workers' compensation. Expenditures for workers' compensation are appropriated annually and are not considered material.

Compliance with provisos of the General Appropriations Act of 1987. Sections 14, 15, and 16 of Act 216, SLH 1987, as amended by Act 390, SLH 1988 (the Act) designated \$12,333,383 to be expended for specific programs and activities. Most of that sum, \$10,583,000, was designated by the office for Hawaii Visitors Bureau (HVB) programs and activities.

The contracts with HVB provide that the moneys awarded are to be spent for numerous approved programs and activities. However, the programs referred to in the contracts do not mirror the provisos of the Act. Thus, while it appears that the amount expended was in accordance with the contracts, it could not be determined whether expenditures of approximately \$3,420,000 were spent in accordance with provisos of the Act. The full contract amounts paid and payable at June 30, 1988, have been reported in the financial statements.

NOTES

Chapter 1

1. Act 336, SLH 1987, renamed the Department of Planning and Economic Development (DPED) as the Department of Business and Economic Development (DBED).
2. *Economic Indicators*, First Hawaiian Bank, May/June 1988.
3. *Ibid.*, Annual Supplement, March/April 1988.
4. Ann Harpham, "Occupancy dips at posh hotels," *The Honolulu Advertiser*, August 26, 1988 and Ann Harpham, "Hawaii could be pricing itself out of tourism, economist warns," *The Honolulu Advertiser*, June 14, 1988.
5. U.S. Travel Data Center, *Survey of State Travel Offices, 1987-88*, Washington, D.C.
6. Selected articles, *Proceedings of the 18th Annual Conference*, Travel and Tourism Research Association, Seattle, June 1987.
7. Hawaii, Department of Planning and Economic Development, *The Hawaii State Plan - ECONOMY*, December 1984, pp. 47-48.

Chapter 2

1. "Tourism Strategic Plan," memorandum from John Waihee to Roger A. Ulveling, November 13, 1987.
2. Hawaii, Department of Business and Economic Development, *Concepts, Analysis, Goals & Activities to Implement DBED's Strategic Plan - Tourism*, Honolulu, 1988.
3. Hawaii, Department of Business and Economic Development, *The Hawaii State Plan - State Tourism Functional Plan, DRAFT*, September 1987.
4. 1986 Haw. Sess. Laws, Act 159, sec. 1.
5. Hawaii, Department of Business and Economic Development, "Agreement for Tourism Promotion and Market Development," Contract No. 23267, November 23, 1987; "Supplemental Agreement No. 1," amending Contract No. 20917; and "Supplemental Agreement No. 2," amending Contract No. 20917.

6. Hawaii, Department of Business and Economic Development, "Agreement for Tourism Promotion and Market Development," Contract No. 23267, November 23, 1987.
7. *Ibid.*
8. Interviews with tourism office staff, December 1988.
9. Hawaii, Department of Business and Economic Development, State Tourism Office, *Implementation Plan for the Award and Administration of the Hawaii Visitors Bureau Advertising Contract*, June 1988.

STATE OF HAWAII
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
STATE TOURISM OFFICE

Statement of expenditure - general fund account
for the year ended June 30, 1988

EXPENDITURE:	
Economic development and assistance	\$13,873,757
OTHER FINANCING SOURCE:	
Operating transfer in	<u>6,821</u>
Expenditure, net of other financing source	<u>\$13,866,936</u>

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

STATE OF HAWAII
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
STATE TOURISM OFFICE

Statement of expenditure - budget and actual
general fund account
for the year ended June 30, 1988

	<u>Budget</u>	<u>Actual On A Budgetary Basis</u>	<u>Variance - Favorable</u>
EXPENDITURE:			
Economic development and assistance	\$15,680,351	\$14,452,128	\$1,228,223
OTHER FINANCING SOURCE:			
Operating transfer in	-	6,821	6,821
Expenditure, net of other financing source	<u>\$15,680,351</u>	<u>\$14,445,307</u>	<u>\$1,235,044</u>

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

STATE OF HAWAII
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
STATE TOURISM OFFICE

General Fund Account
Schedule of expenditure - budget and actual
for the year ended June 30, 1988

<u>Function</u>	<u>Actual Expenditure</u>	<u>Carryover June 30, 1987</u>	<u>Appropriation June 30, 1988</u>	<u>Lapse Of Prior Appropriation</u>	<u>Expenditure Adjusted For Carryover Appropriation</u>	<u>Budgeted Appropriation</u>	<u>Variance Favorable</u>	<u>Transfer</u>	<u>Lapse Of Current Appropriation</u>
Economic development and assistance	<u>\$13,873,757</u>	<u>\$ -</u>	<u>\$578,371</u>	<u>\$ -</u>	<u>\$14,452,128</u>	<u>\$15,680,351</u>	<u>\$1,228,223</u>	<u>\$6,821</u>	<u>\$1,235,044</u>

RESPONSE OF THE AFFECTED AGENCY

COMMENTS ON AGENCY RESPONSE

Preliminary copies of this report were transmitted to the Department of Planning and Economic Development for its review and comments. A copy of the transmittal letter to the department is included as Attachment 1 of this Appendix. The response from the department is included as Attachment 2.

The department agrees with our recommendation to require the Hawaii Visitors Bureau to submit expenditure reports to ensure compliance with the Legislature's budget provisos. It agrees that the State Tourism Office should continue to develop its leadership role in the visitor industry. It also agrees that it should develop a formal system for monitoring and evaluating its contracts although it notes that uniform application of formal monitoring and evaluation procedures may not be appropriate.

The department agrees that it should update its tourism strategic plan, but it does not agree with our recommendation to enact a statute for administering tourism promotions. The statute would require the department to submit an annual report and marketing plan to the Legislature and for its State Tourism Office to have a system for the submission, review, and selection of proposals for promotion projects. The department says that establishing a system by statute would be "an inappropriate policy vehicle, in view of the concept of separation of powers." However, we see our recommendation as enhancing executive accountability for tourism promotion appropriations.



ATTACHMENT 1

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

CLINTON T. TANIMURA
AUDITOR

C O P Y

December 15, 1988

Mr. Roger A. Ulveling, Director
Department of Business and Economic Development
Kamamalu Building, 250 S. King Street
Honolulu, HI 96813

Dear Mr. Ulveling:

Enclosed are two copies, numbered 4 and 5, of our preliminary report on the **Management and Financial Audit of the State Tourism Office, Department of Business and Economic Development**. If you have comments on our recommendations, we ask that you submit them to our office by January 4, 1989, for inclusion in the final report.

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

Since the report is not in final form and changes may be made, access to this report should be restricted to those individuals whom you might wish to call upon to assist you in reviewing 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.

We appreciate the continuing assistance and cooperation extended to us by the staff of the State Tourism Office.

Sincerely,



Clinton T. Tanimura
Legislative Auditor

Enclosures



ATTACHMENT 2

DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT

JOHN WAIHEE
GOVERNOR

ROGER A. ULVELING
DIRECTOR

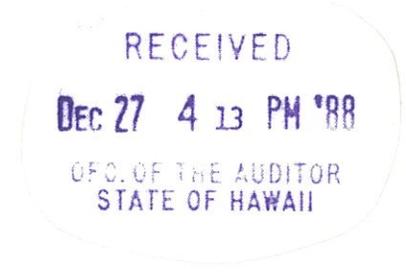
BARBARA KIM STANTON
DEPUTY DIRECTOR

LESLIE S. MATSUBARA
DEPUTY DIRECTOR

KAMAMALU BUILDING, 250 SOUTH KING ST., HONOLULU, HAWAII
MAILING ADDRESS: P.O. BOX 2359, HONOLULU, HAWAII 96804 TELEX: 7430250 HIDPED FAX: (808) 523-8637

December 23, 1988

Mr. Clinton T. Tanimura
Legislative Auditor
State of Hawaii
465 South King Street, Room 500
Honolulu, Hawaii 96813



Dear Mr. Tanimura:

Thank you for your support of our tourism promotional effort and the opportunity to review your preliminary report. Briefly, our departmental assessment of your recommendations found areas of agreement and disagreement.

We agree that our tourism strategic plan should be updated every two to four years, including information relating to visitor industry trends, opportunities and initiatives, and state government roles. We are in agreement, as well, with the need to maintain tight contract administration and adequate management reports. The department however disagrees with your recommendations seeking legislative remedies for what may be termed executive branch responsibilities.

The issue is separating policy direction and policy execution. While at times the line between these two levels of decisionmaking is narrow, in this instance, the line between policy direction and execution appears sharp and distinguishable. Establishment of a program focusing on procedures and an annual marketing plan appears to be solely within the responsibility of the executive branch.

The foreshortening of the time horizon implied by the proposed annual marketing plan is contrary to the movement towards biennial budgetary cycles and programs. Moreover the focus on procedures through a legislative program will hamper, not enhance, our capability to respond to the visitor industry markets.

In our efforts to improve the state marketing program for tourism, we find that the HVB suffers from uneven political impulse at times when its ideas needed support and nurturing. The DBED is intent on making the state's

marketing and promotional efforts highly competitive and effective. Piecemeal additions of reporting detract from understanding the real needs of the organization and its efforts. It is such concentration on form rather than on substance that will cause the effort to fail by becoming responsive to reporting rather than to successful efforts. Its staff will be spending more and more time writing reports rather than promoting tourism.

Let me close by indicating that your report provided us with continuing opportunities to pursue with vigor the direction provided by the Legislature in this important segment of our local economy.

Yours truly,


for Roger A. Ulveling

Attachment

RESPONSE TO MANAGEMENT AND FINANCIAL AUDIT OF THE STATE TOURISM OFFICE
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
PRELIMINARY REPORT

OVERVIEW

The department reviewed your preliminary report relating to an examination, assessment, review and determination of the State Tourism Office compliance with legislative directives, financial transactions, implementation of the 1987 management audit recommendations, and budgeting and contract administration practices. Our review finds that the report aims at improving management practices and procedures, especially during this formative period of departmental development.

In this regard, we would like to provide a broader context for this management audit by attaching Exhibit A. This graph illustrates the dramatic rise in total appropriation, signaling the level of effort required to maintain our role in the visitor industry marketplace. Some of your recommendations have merit; others are questionable.

There are concerns relating to specific legislative solutions to areas which are clearly management responsibilities. These management responsibilities lie with the executive branch of government. Finally, your preliminary recommendations are placed within an annual budgetary cycle, contrary to the thrust of legislative and management programming and budgeting that covers a fiscal biennium. The following response will elaborate upon these concerns.

RECOMMENDATION 1

The department concurs that the tourism strategic plan should be updated every four to six years, include information on visitor industry trends, opportunities and initiatives, and the role of state government in the visitor industry. We intend to program our visitor industry planning effort to accommodate this time horizon.

The department does not agree that "a program for administering state funded tourism promotion should be adopted by statutes," requiring an annual marketing plan, submission of proposals for tourism promotion projects by all contractors, formal review and selection process for funding projects, performance reporting via a formal monitoring and evaluation system, and an annual report on effectiveness of promotions. A statutory remedy to deal with procedural and reporting concerns is an inappropriate policy vehicle, in view of the concept of separation of powers. This accepted separation of responsibilities has withstood the test of time.

The idea of an annual marketing plan does not allow a forward commitment to further market development. The department can advise the Legislature of its intended target markets; however, as we have maintained in the past, it is critical to maintain some degree of flexibility and longer term time horizon to respond to changing conditions, such as strikes, economic conditions, consumer preferences, social and cultural influences, demographics,

technology, and competitive actions. As illustrated by your report on page 14, we need to have a measure of flexibility to respond to changing conditions, whether in response to adverse publicity or changing consumer preferences. Some responses must be made in quick order; others require a longer term.

Regarding measures of effectiveness, there are only indirect evidences available. There is no direct correlation between promotions which aim at broad markets that the department supports and the outcome of such activities. The department's goals are to attract a broad market to Hawaii in marked contrast with the visitor industry promotions which aim at selective markets. These are complementary promotional activities. As a state agency, we aim to provide a broad market for the visitor industry, from which the industry can sell its products and services. We intend to maintain this complementary character which is an appropriate marketing role for a public agency. Accordingly, the success of our promotional efforts is only indirectly measured by the success of the visitor industry itself.

The recommendation to have all contractors, including the HVB, to submit proposals for tourism promotion projects, together with a formal review and selection process and performance reporting within the context of an annual marketing plan is ill-advised. These procedural requirements may hamper the implementation of marketing promotion by setting forth processes and requirements ill-suited to the diverse character of promotional activities. Presently there are over 20 projects funded to implement promotional programs. These projects vary in terms of time of performance, dollar value, and scope; for example, large contracts may be as high as millions of dollars to be expended over a year or more while smaller contracts may last only one month. While the intent of this recommendation is commendable, implementation requires a measure of flexibility and accommodation to fit particular needs.

We concur that an annual report by the State Tourism Office to the Legislature is an appropriate tool to describe and discuss implementation of tourism promotional efforts. However, we note that measures of effectiveness remain elusive and at present we have indirect indicators, as described above.

RECOMMENDATION 2

The department concurs that compliance with budgetary provisos is required. The department will exercise its managerial responsibilities to assure such compliance in the administration of the HVB contracts.

RECOMMENDATION 3

The department concurs that the State Tourism Office should continue to develop its leadership role in the visitor industry through its program activities. The department agrees that timely reports to the Legislature is beneficial in formulation of sound policies. To this end, we will provide the Legislature with information relating to the HVB advertising agency review presently underway. Regarding the HVB internal management review, we find that they have taken steps to implement these recommendations by initiating an organizational development program including the formulation of an organization plan. If desired, we will ask the HVB to make available its organization plan for your information.

RECOMMENDATION 4

The department concurs with your recommendation that formal monitoring and evaluation, including written progress reports and final reports, are appropriate administrative tools. However, we note that uniform application of formal monitoring and evaluation procedures may be inappropriate for all project contracts. As noted previously, the State Tourism Office administers a number of differing contracts relating to visitor industry promotion. A selective application of monitoring and evaluation procedures is necessary to attain efficiency as well as effectiveness.

STATE TOURISM OFFICE

TOTAL APPROPRIATIONS (1975-1994)

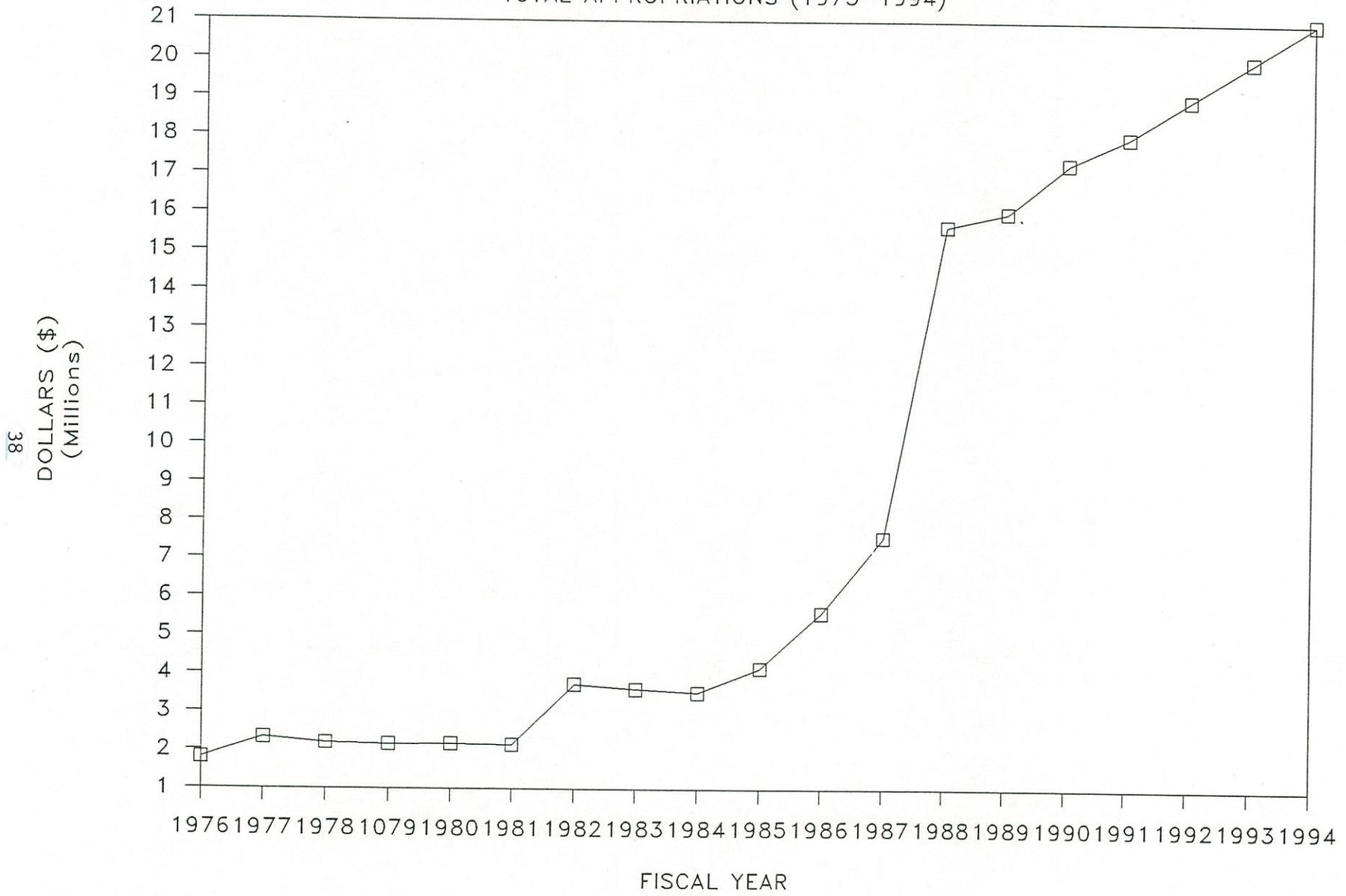


Exhibit A