Financial Audit of the Department of Personnel Services

A Report to the Governor and the Legislature of the State of Hawai'i

Report No. 92-1
January 1992

THE AUDITOR
STATE OF HAWAI'I

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits,* which are also referred to as *performance audits,* examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits,* when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits,* when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

THE AUDITOR
STATE OF HAWAII

Kekuanao'a Building
465 South King Street, Room 500
Honolulu, Hawaii 96813

OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Department of Personnel Services

Summary

The Office of the Auditor and the certified public accounting firm of Deloitte & Touche conducted a financial audit of the Department of Personnel Services pursuant to Section 23-4, Hawaii Revised Statutes, which requires the auditor to conduct post audits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State.

In the opinion of Deloitte & Touche, the department's financial statements present fairly its financial position, the results of its operations, and the changes in its proprietary fund as of June 30, 1991. All were in conformity with generally accepted accounting principles. Deloitte & Touche found no instances where the department did not comply with applicable laws and regulations, nor did the firm find weaknesses in the department's control measures that would affect an opinion of the financial statements.

We found, however, that the department had effected a reorganization without obtaining the necessary approvals as required by administrative directive. The legal basis of the administrative directive is found in the State Constitution and Chapter 26, Sections 38 and 39, Hawaii Revised Statutes. In an action related to this unauthorized reorganization, a key position was upgraded and a substantial retroactive pay adjustment was made in January 1991. In documentation authorizing the position upgrade, the then director certified that the position was "not contrary to the approved organization or functional statements." Sections 76-53(a) and 76-53(b), Hawaii Revised Statutes, provide that no payroll disbursement be made unless the director certifies that the person has been employed in accordance with applicable rules, regulations, and orders, and that any payment made contrary to those rules, regulations, or orders may be recovered.

The authority to approve departments' organizational changes rests with the governor. Unauthorized changes circumvent the controls established by the governor to exercise that authority. In this case the unauthorized change enabled the department to make a substantial retroactive pay adjustment to an employee. Payments made in an action related to the unauthorized reorganization may be recoverable by the State.

We also found differences between the department's records and those of the Department of Accounting and General Services (DAGS). We were informed that the department had not reconciled its accounting records to those of DAGS. The Department of Accounting and General Services maintains the official accounting records of the State, while the department maintains the detailed accounting records supporting the DAGS' records. Periodic reconciliations of the records are necessary to identify and correct any differences.

Recommendations and Response

We recommended that the department take steps to ensure that all organizational changes follow applicable administrative directives and that the organizational structure be authorized by the governor. We also recommended that the department consult with the attorney general to determine whether it is possible to seek restitution of pay made as a result of an unauthorized reorganization. We further recommended that the department periodically reconcile its accounting records with DAGS' records.

The department agreed with our recommendations. It is assessing its operations with an eye towards reorganization and, upon completion, will submit a request for approval of reorganization as required by administrative directive. It is also seeking restitution of payments made as a result of an unauthorized reorganization. The department now reconciles its records to those of DAGS.

Background

The financial audit was for the fiscal year July 1, 1990, to June 30, 1991. Examined were the department's financial records and its systems of accounting and internal controls. We also reviewed all records and systems examined for compliance with applicable laws and regulations.

Since its creation in 1959, the Department of Personnel Services has been responsible for the state's personnel program. It is responsible for personnel development and training, as well as the recruitment, examination, position classification, and pay administration for all departments. It is also responsible for the processing and payment of workers' compensation claims of state employees.

Office of the Auditor
State of Hawaii
465 South King Street, Suite 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830

Financial Audit of the Department of Personnel Services

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

Conducted by

The Auditor
State of Hawaii
and
Deloitte & Touche
Certified Public
Accountants

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 92-1
January 1992

Foreword

This is a report of a financial audit of the Department of Personnel Services for the fiscal year July 1, 1990, to June 30, 1991. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the state auditor to conduct post audits of all departments, offices, and agencies of the State. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Deloitte & Touche.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Personnel Services.

Marion Higa
Acting Auditor
State of Hawaii

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Chapter 1

Introduction

This is a report of our financial audit of the State of Hawaii, Department of Personnel Services (DPS). The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of Deloitte & Touche.

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

Objectives of the Audit

1. Report on the fair presentation of the department's financial statements.

2. Assess the adequacy, effectiveness, and efficiency of the department's systems and procedures for financial accounting, internal control, and financial reporting; and recommend improvements.

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

Scope and Methodology

We audited the financial records and transactions and the related systems of accounting and internal controls of DPS for the fiscal year July 1, 1990, to June 30, 1991. Included were all fund types and account groups. We also reviewed for compliance with applicable laws and regulations those transactions, systems, and procedures tested.

The audit examined the accounting, reporting, and internal control structure to identify deficiencies and weaknesses and make appropriate recommendations for improvements. Covered were the forms and records, and the accounting and operating procedures.

The accountants' opinion as to the fairness of the financial statements presented is that of Deloitte & Touche. The audit was conducted from July 1991 through November 1991 in accordance with generally accepted government auditing standards.

Background

In the Hawaii State Government Reorganization Act of 1959 (Act 1, Session Laws of Hawaii 1959), the Legislature created the Department of Personnel Services. Section 26-5, Hawaii Revised Statutes, enumerates the department's responsibilities:

> The department shall administer the state personnel program, including personnel development and training, and such central personnel services as recruitment, examination, position classification, and pay administration for all departments.

Organization of the Department

The department is headed by an executive known as the director of personnel services. The Office of the Director plans, organizes, directs and coordinates the various activities of the personnel program within the scope of laws, rules, and established policies. The main activity areas are personnel development and training, recruitment, examination, position classification, pay administration, workers' compensation payments, and labor relations.

Divisions

Six divisions administer a variety of departmental functions.

Administrative and Audit Division. Administers a program of statewide services to ensure that personnel actions comply with state and federal personnel laws, state personnel rules and regulations, negotiated labor agreements, and executive orders; and provides departmental personnel management services.

Labor Relations Division. Administers a program to interpret and apply the provisions of collective bargaining agreements; develops and coordinates the handling of grievances; and develops State temporary disability benefits plan and monitors its administration.

Training and Safety Division. Develops and administers the Statewide Training and Employee Development Program, including identifying and prioritizing training needs and coordinating the development, implementation, and evaluation of training programs; and administers the Statewide Safety Program.

Classification and Compensation Review Division. Develops and maintains the Position Classification System by auditing and analyzing new and existing positions; and develops and maintains the Compensation Plan by formulating pricing criteria and assigning classes of positions to salary ranges or grades.

Recruitment and Examination Division. Administers a recruitment program concerned with filling state civil service positions with qualified persons; and administers an examination program concerned with identifying persons having the knowledge, skill, and ability requirements of a position.

State Workers' Compensation Division (Hawaii State Workers' Compensation Self-Insurance Program). Designs, develops and maintains a system of pertinent workers' compensation data.

Commission and Boards

Three agencies are placed within the Department of Personnel Services for administrative purposes:

State Civil Service Commission. Accepts and hears appeals from departments, job applicants, and employees concerning classification actions, examinations, suspensions, dismissals, and other civil service actions taken by the department or any other state agency and which are not covered by Hawaii collective bargaining law and contractual agreements.

Public Employees Compensation Appeals Board. Accepts and hears appeals for initial pricing or repricing appeals and reports its findings to the Legislature. Appeals are those filed by departments, representative unions, and employees on actions taken by the State, the counties, and the Judiciary.

Board of Trustees Deferred Compensation Plan. Administers a tax-sheltered savings and investment program for state employees. Has authority to engage services to establish, administer, or maintain the plan under its direction.

Chapter 2
Internal Control Practices

This chapter presents reportable conditions and recommendations on the financial accounting and internal control practices and procedures of the Department of Personnel Services.

Summary of Findings

1. The department effected a reorganization without obtaining the authorization required by Administrative Directive 90-01.

2. The department has not reconciled its accounting records to those of the Department of Accounting and General Services.

Unauthorized Departmental Reorganization

The governor's Administrative Directive 78-4, superseded by Administrative Directive 90-01, outlined the procedure for obtaining authorization for all organizational changes. The department effected a reorganization by an internal memorandum dated February 19, 1987, without obtaining authorization as required in the directive. In an action related to the unauthorized reorganization, the department in December 1990, upgraded a key position, which resulted in a substantial pay adjustment.

The legal basis for the governor's directive is found in the Hawaii State Constitution and Chapter 26, Sections 38 and 39, Hawaii Revised Statutes. These sections state that "*with the approval of the Governor,* [emphasis added]" departments may establish or abolish divisions or other administrative segments and may change the duties titles, and compensation of offices and positions.

The department reorganized without following the directive and did not obtain the required approval. The Department of Budget and Finance, in an April 1991 review of the department's organization structure, confirmed that the department's reorganization had not been approved as required.

The reorganization transferred the Budget and Supporting Services Office (BSSO) from the Administrative & Audit Division to the Office of the Director, and elevated the office to division-level status effective February 19, 1987. The department, however, waited almost four years to upgrade the position of the BSSO branch chief to reflect division-level status.

On December 4, 1990, the department initiated and approved a position classification change, effective February 19, 1987, reallocating the position of BSSO branch chief from personnel program manager (salary level EM-05) to personnel program administrator (salary level EM-08). The action increased the monthly salary of the incumbent BSSO branch chief from $4,960 to $5,431 and caused a one-time retroactive pay adjustment of $21,713. The retroactive pay was paid on January 31, 1991. Further, although the position classification change was to a position that had not been authorized, the then director certified on Position Evaluation Form, DPS 219, that the position was "not contrary to the approved organization or functional statements."

We believe that there may be grounds for recovering the extra pay that resulted from the unauthorized reorganization and that the department should pursue this possibility. Section 76-53(a), Hawaii Revised Statutes, states that "No state or county disbursing or auditing officer shall make . . . any payment for personal service . . . *unless payroll certification has been made by the director of personnel services or the director's authorized agent that the person named therein has been appointed and employed in accordance with this chapter and the rules, regulations, and orders thereunder* [emphasis added]." Section 76-53(b), further states that "any sum paid contrary to this part or of any rule, regulation, or order thereunder may be recovered."

Recommendations

We recommend that the department take steps to ensure that all organizational changes follow applicable administrative directives and that the organization structure be authorized by the governor.

We also recommend that the department consult with the attorney general to determine whether it is possible to seek restitution of pay made as a result of an unauthorized reorganization.

Need for Reconciliation of Accounts

We found differences between the department's records and those of the Department of Accounting and General Services (DAGS). The accounts with differences included those recording workers' compensation payments, fixed assets, special fund revenues, and payroll expenditures. We were informed that the department does not periodically reconcile its records to those of DAGS. While the differences were not so large that the department's operations were negatively affected, the possibility of significant differences going undetected is increased if accounts are not reconciled.

The Department of Accounting and General Services maintains the official accounting records of the State, while the department maintains the detailed accounting records supporting the DAGS' records. Section 360 of the State of Hawaii Accounting Manual says that departments should reconcile their records to those of DAGS. Periodic reconciliations are necessary to identify and correct any miscodings or other differences.

Recommendation

We recommend that the department follow Section 360 of the State of Hawaii Accounting Manual and periodically reconcile its accounting records with DAGS' records.

Chapter 3
Financial Audit

This chapter presents the results of the financial audit of the State of Hawaii, Department of Personnel Services for the year ended June 30, 1991. It displays financial statements of all fund types and account groups administered by the department, together with explanatory notes. It also includes the reports on the internal control structure and compliance with laws and regulations.

Summary of Findings

In the opinion of Deloitte & Touche, based on their audit, the financial statements present fairly, in all material respects, the financial position of the department as of June 30, 1991, and the results of its operations and the cash flows of its proprietary fund type for the year then ended in conformity with generally accepted accounting principles.

Deloitte & Touche noted matters involving the internal control structure and its operation that they considered to be reportable conditions as defined in the report on the internal control structure. They also noted, with respect to items tested, that the department has complied, in all material respects, with applicable laws and regulations.

Independent Auditors' Report

Deloitte & Touche's report filed with the Auditor is as follows:

To the Auditor
State of Hawaii

We have audited the following financial statements of the State of Hawaii, Department of Personnel Services:

Combined balance sheet—all fund types and account groups, June 30, 1991 (Exhibit A);

Combined statement of revenues, expenditures, and changes in fund equity—governmental fund type, year ended June 30, 1991 (Exhibit B);

Statement of revenues and expenditures—budget and actual (budgetary basis)—general fund type, year ended June 30, 1991 (Exhibit C);

Statement of revenues, expenses and changes in retained earnings—proprietary fund type, year ended June 30, 1991 (Exhibit D);

Statement of cash flows—proprietary fund type, year ended June 30, 1991 (Exhibit E);

These financial statements are the responsibility of the department'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 accompanying financial statements present only the activities of the State of Hawaii, Department of Personnel Services, as included in the fund type categories and are not intended to present the financial position and results of operations of the State of Hawaii in conformity with generally accepted accounting principles.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the State of Hawaii, Department of Personnel Services as of June 30, 1991, and the results of its operations and the cash flows of its proprietary fund type for the year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The Combining balance sheet—State Deferred Compensation Plan, June 30, 1991 (Schedule I)—and the Combining statement of changes in assets and liabilities—State Deferred Compensation Plan, year ended June 30, 1991 (Schedule II)—which are also the responsibility of the management of the State of Hawaii, Department of Personnel Services, are presented for purposes of additional analysis and are not a required part of the financial statements of the State of Hawaii, Department of Personnel Services. Such additional has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

/s/ Deloitte & Touche

Honolulu, Hawaii
November 18, 1991

Descriptions and Definitions

This section describes the financial statements audited and definitions of technical terms used in this chapter.

Descriptions of financial statements and schedules

The following is a brief description of the financial statements and schedules audited by Deloitte & Touche. Financial statements and schedules are attached at the end of this chapter.

Combined balance sheet—all fund types and account groups (Exhibit A). This statement presents assets, liabilities, and fund balances of all fund types and account groups used by the department on an aggregate basis.

Combined statement of revenues, expenditures, and changes in fund equity—governmental fund type (Exhibit B). This statement presents revenues, expenditures, and changes in fund equity for all governmental fund types used by the department on an aggregate basis. Revenues include state appropriations mandated by the General Appropriations Act of 1989 (Act 316, Session Laws of Hawaii 1989), as amended by the Supplemental Appropriations Act of 1990 (Act 299, Session Laws of Hawaii 1990) and other specific appropriations acts.

Statement of revenues and expenditures—budget and actual (budgetary basis)—general fund type (Exhibit C). This statement summarizes revenues and expenditures by source and type on the budgetary basis. Also included is a comparison of estimated and actual revenues and expenditures, on the budgetary basis, which shows the accuracy with which officials have estimated fund operating results.

Statement of revenues, expenses, and changes in retained earnings—proprietary fund type (Exhibit D). This statement presents revenues, expenses and changes in retained earnings of the proprietary fund type used by the department.

Statement of cash flows—proprietary fund type (Exhibit E). This statement presents the cash flow of the proprietary fund type used by the department.

Combining balance sheet—State Deferred Compensation Plan (Schedule I). This schedule presents assets and liabilities of the State Deferred Compensation Plan by agents.

Combining statement of changes in assets and liabilities—State Deferred Compensation Plan (Schedule II). This schedule presents changes in assets and liabilities of the State Deferred Compensation Plan.

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:

Appropriation. An authorization granted by the State Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures.

Allotment. An authorization by the director of finance to a state agency to incur obligations and to make expenditures pursuant to the appropriation made by the State Legislature.

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.

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.

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

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

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 in this section.

Financial statement presentation

General. The accompanying financial statements of the State of Hawaii, Department of Personnel Services present the financial position of the various fund types and account groups, the results of operations of the various fund types, and the cash flow of the proprietary fund type as of and for the year ended June 30, 1991.

Reporting entity. The Department of Personnel Services is a department of the State of Hawaii. The department's financial statements reflect only its activities. The state comptroller maintains the central accounts for all state funds and publishes comprehensive financial statements for the State annually which includes the department's financial activities.

Fund accounting. The financial activities are recorded in individual funds classified by type and described in the following sections, each of which is deemed to be a separate accounting entity. The financial position and operations of each fund are accounted for in separate self-balancing accounts which represent the fund's assets, liabilities, equity, revenues, and expenditures or expenses.

Account groups are used to establish accounting control and accountability for the department's general fixed assets and general long-term obligations. Account groups are not funds since they do not reflect available financial resources and related liabilities.

Governmental fund type. Financial resources which are not accounted for in other funds are accounted for in the general fund. The measurement focus of governmental funds is on determination of financial position and changes in financial position rather than upon net income determination. The budget 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 department 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 department, and the general fund allotments received by the department.

Proprietary fund type. The proprietary fund type is used to account for certain of the department's ongoing operations. The measurement focus is upon determination of net income. The internal service fund is used to account for recovery of costs of various training or educational programs for other state agencies.

Fiduciary fund type. The fiduciary fund type is used to account for assets held by the department as an agent. The agency fund is used to account for receipts and disbursements of amounts collected by the department in a custodial capacity.

Account groups. The general fixed assets account group is used to account for all fixed assets of the department. The general long-term debt account group is used to account for accrued vacation payable and accrued workers' compensation claims.

Total columns on financial statements. Total columns on the accompanying financial statements are captioned *memorandum only* to indicate that they are presented only to facilitate financial analysis. Data in these columns do not purport to present the financial position or results of operations of the department in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation.

Summary of significant accounting policies

Basis of Accounting. The accounts of the governmental fund and fiduciary fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when they become measurable and available to finance operations of the current fiscal year. *Measurable* means that the amount of the transaction can be determined. *Available* means that the amount is collected in the current fiscal year or soon enough after year-end to liquidate liabilities existing at the end of the fiscal year. *Expenditures* are generally recognized when the related liability is incurred, except for accumulated unpaid vacation and accrued workers' compensation claims which are recognized as expenditures when payable from expendable available financial resources. *Encumbrances* are recorded obligations in the form of purchase orders or contracts. The department records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at year-end are reported as reservations of fund equity since they do not constitute expenditures or liabilities.

The accounts of the proprietary fund type are reported using the accrual basis of accounting. Under this method of accounting, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Cash. The State maintains a cash pool used by all agencies. The department's portion of this pool is indicated on the combined balance sheet as *Cash in State Treasury* and is considered to be cash equivalents for purposes of the Statement of cash flows—proprietary fund type.

At June 30, 1991, the department's cash and certificates of deposit ($3,368,504) were included in state pooled funds held in local banks. For disclosure regarding collateralization of such deposits, as required by Section 38-3, Hawaii Revised Statutes, refer to the Comprehensive Annual Financial Report of the State of Hawaii.

General fixed assets. General fixed assets (principally furniture and equipment) have been acquired for general governmental purposes. Assets purchased are recorded as expenditures in the governmental account group. No depreciation has been provided for general fixed assets.

Accrued vacation. Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end, and is convertible to pay upon termination of employment. In the governmental fund type, the amounts expected to be liquidated with expendable available financial resources are accrued in the general fund, and the amounts payable from future resources are recorded as *accrued vacation payable* in the general long-term debt account group.

Sick leave can accumulate an 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. Accumulated sick leave as of June 30, 1991, approximated $2,766,000.

Deferred compensation plan. Investments of the plan are recorded at market value.

Statement of cash flow. For purposes of the statement of cash flow, the internal service fund considers Cash in the State Treasury (cash management pool) to be cash equivalents.

Budgeting and budgetary control

The budget of the department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the program, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented, and controlled. Revenue estimates are provided to the Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected as budgeted revenues in Exhibit C are those estimates as compiled by the department. Budgeted expenditures are derived primarily from the

General Appropriations Act of 1989 (Act 316, SLH 1989) and other specific appropriations acts.

All expenditures of these appropriated funds are made pursuant to the appropriation in the 1989-1991 biennial budget as amended by subsequent supplemental appropriations. The final legally adopted budget in Exhibit C represents the original appropriations, supplemental appropriations, transfers, and other legally authorized legislative and executive changes.

Budgetary control is maintained at the appropriation line item as established in the appropriations acts. The governor is authorized to transfer appropriations within a state agency; however, transfers of appropriations between state agencies generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the department. During the year ended June 30, 1991, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year in which the appropriations were made. The Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

Budgets adopted by the Legislature for the general fund are represented in Exhibit C. The department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to treatment of encumbrances for purchase orders and contract obligations as expenditures for budgetary purposes. These differences represent departures from generally accepted accounting principles (GAAP).

Excess of revenues over expenditures— actual on budgetary basis	$ 352,449
Reserve for encumbrances at June 30, 1991	1,032,374
Expenditures for liquidation of prior year encumbrances	(1,114,998)
Net accrued revenues and expenditures	980,556
Excess of revenues over expenditures actual (GAAP basis)	$ 1,250,381

Deferred compensation plan

The department has the fiduciary responsibility of administering the State Deferred Compensation Plan.

The State of Hawaii offers state and county employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are solely the property and rights of the State, subject only to the claims of the state's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant.

Investments of the plan are recorded at fair market value. Of the $212,569,540 in the plan at June 30, 1991, $189,027,433 was applicable to the State of Hawaii employees, while the remaining $23,542,107 represented the assets of the other counties participating in the plan.

Employee benefits

Defined benefit pension plans. All full-time employees of the department participate in the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing, multiple-employer public employee retirement system.

For the fiscal year ended June 30, 1991, total payroll for the department was approximately $4,476,000. The department's covered payroll, actuarially determined contribution, and actual contributions to the ERS are not available on a departmental basis.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees, in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing contributory plan or join the new noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically became members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute.

In the contributory plan, employees may elect normal retirement at age 55 with 5 years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2 percent of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by state statute to contribute 7.8 percent of their salary to the plan; the State is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due.

In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credited service or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life up to 1.25 percent of their average final salary, as defined, for each year of credited service; retirement benefits are actuarially reduced for early retirement. The State is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

The *pension benefit obligation* is a standardized disclosure measure of the present value of pension benefits, adjusted for the effect of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the ERS' funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems and employers. The ERS does not make separate measurements of assets and pension benefit obligations for individual employers. The pension benefit obligation at June 30, 1990, (the latest date available) for the ERS as a whole, determined through an actuarial valuation performed as of that date, was $5.2 billion. The ERS' net assets available for benefits on that date (valued at market) was $3.8 billion, leaving an unfunded pension benefit obligation of $1.4 billion.

For historical trend information showing the ERS' progress in accumulating sufficient assets to pay benefits when due, see the ERS' June 30, 1990, annual financial report.

Post-employment benefits. In addition to providing pension benefits, the State contributes to the Hawaii Public Employees Health Fund, a state-wide program which provides health and group life insurance for all retired and active employees, their dependents and their beneficiaries. Contributions are based upon negotiated collective bargaining agreements.

Non-imposed employee fringe benefits

Non-imposed employee fringe benefits related to general fund salaries are assumed by the State and are not charged to the department. These costs, totaling approximately $1,391,000 for the fiscal year ended June 30, 1991, have been reported as additional revenues and expenditures of the department's general fund.

General fixed assets account group

Changes in general fixed assets during the year ended June 30, 1991, were as follows:

Balance at July 1, 1990	$ 917,399
Additions	154,808
Retirements	(39,151)
Balance at June 30, 1991	$ 1,033,056

General long-term debt account group

Changes in general long-term debt were as follows:

Balance at July 1, 1990	$ 776,301
Net increase in accrued vacation	162,712
Accrued workers' compensation claims	14,820,000
Balance at June 30, 1991	$15,759,013

Lease commitments

The department leases office space on a month-to-month basis for the Workers' Compensation Division's operations. Lease rent for the year ended June 30, 1991, totaled approximately $138,000.

Workers' compensation reserve

The department, through its Workers' Compensation Division, accounts for the activities of the State of Hawaii self-insured workers' compensation program. Prior to fiscal year ended June 30, 1991, the modified cash basis was used to account for the activities of the program. The modified cash basis is a comprehensive basis of accounting other than generally accepted accounting principles. During 1991, the method of accounting was changed to the modified accrual basis. Under this method, workers' compensation claims accrued during the year that would normally be liquidated with expendable available resources are recognized in the general fund, with the remaining liability being reported in the general long-term debt account group.

The effect on the financial statements of the change in accounting for workers' compensation claims from the modified cash basis to the modified accrual basis should be reported as a prior period adjustment. However, because the effect on the June 30, 1990, financial statements is not reasonably estimable, the entire adjustment has been recorded in the June 30, 1991, financial statements. The adjustment had the effect of increasing the general long-term debt account group by $14,820,000. There was no effect on the general fund, as there were no expendable available resources to liquidate any claims at June 30, 1991. The $14,820,000 adjustment includes the effects of only known claims as of June 30, 1991. No adjustment has been recorded for liabilities incurred but not reported, as management is unable to reasonably estimate the amounts.

Independent Auditors' Report on the Internal Control Structure

To the Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Department of Personnel Services as of and for the year ended June 30, 1991, and have issued our report thereon dated November 18, 1991.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the State of Hawaii, Department of Personnel Services for the year ended June 30, 1991, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of the State of Hawaii, Department of Personnel Services is responsible for establishing and maintaining the internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Revenues/receipts cycle
- Purchases/disbursements cycle
- Payroll cycle

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operations that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions that we noted are described in Chapter 2.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described in Chapter 2 is a material weakness.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department of Personnel Services. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

/s/ Deloitte & Touche

Honolulu, Hawaii
November 18, 1991

Independent Auditors' Compliance Report Based on an Audit of the Financial Statements

To the Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Department of Personnel Services as of and for the year ended June 30, 1991, and have issued our report thereon dated November 18, 1991.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the State of Hawaii, Department of Personnel Services is the responsibility of the department's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the department's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, the State of Hawaii, Department of Personnel Services complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the department had not complied, in all material respects, with those provisions.

We noted certain immaterial instances of noncompliance that are described in Chapter 2.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department of Personnel Services. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

/s/ Deloitte & Touche

Honolulu, Hawaii
November 18, 1991

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Exhibit A

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 1991

	Governmental Fund Type	Proprietary Fund Type	Fiduciary Fund Type	Account Groups		
ASSETS	General	Internal Service	Deferred Compensation Fund	General Fixed Assets	General Long-term Debt	Total (memorandum only)
ASSETS:						
Cash in State Treasury	$ 1,867,671	$ 44,454	$ 1,456,379			$ 3,368,504
Petty cash	6,000					6,000
Accounts receivable	24,818					24,818
Equipment				$ 1,033,056		1,033,056
Assets held by agents for State Deferred Compensation Plan			211,113,161			211,113,161
Amount to be provided for retirement of general long-term debt					$ 939,013	939,013
Amount to be provided for workers' compensation claims					14,820,000	14,820,000
TOTAL ASSETS	$ 1,898,489	$ 44,454	$ 212,569,540	$ 1,033,056	$ 15,759,013	$ 231,304,552
LIABILITIES, FUND EQUITY AND OTHER CREDIT						
LIABILITIES:						
Due to State General Fund	$ 6,000	$ 3,514				$ 9,514
Vouchers payable	860,115					860,115
Accrued vacation payable					$ 939,013	939,013
Accrued workers' compensation claims					14,820,000	14,820,000
Due to State employees under State Deferred Compensation Plan			$ 189,027,433			189,027,433
Due to county employees under State Deferred Compensation Plan			23,542,107			23,542,107
Total liabilities	866,115	3,514	212,569,540		15,759,013	229,198,182
FUND EQUITY AND OTHER CREDIT:						
Investment in general fixed assets				$ 1,033,056		1,033,056
Retained earings		40,940				40,940
Fund balance - reserved for encumbrances	1,032,374					1,032,374
Total fund equity and other credit	1,032,374	40,940		1,033,056		2,106,370
TOTAL LIABILITIES, FUND EQUITY AND OTHER CREDIT	$ 1,898,489	$ 44,454	$ 212,569,540	$ 1,033,056	$ 15,759,013	$ 231,304,552

See notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Exhibit B

COMBINED STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND EQUITY - GOVERNMENTAL FUND TYPE
YEAR ENDED JUNE 30, 1991

	General
REVENUES:	
Allotted appropriations	$ 18,433,254
Non-imposed employee fringe benefits	1,391,494
Workers' compensation assessments	346,630
Total revenues	20,171,378
EXPENDITURES:	
Personal services	5,867,091
Operating and maintenance	1,239,052
Workers' compensation benefits	11,814,854
Total expenditures	18,920,997
EXCESS OF REVENUES OVER EXPENDITURES	1,250,381
OTHER CHANGES IN FUND EQUITY - Lapses	(401,720)
FUND EQUITY AT JULY 1, 1990	183,713
FUND EQUITY AT JUNE 30, 1991	$ 1,032,374

See notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Exhibit C

STATEMENT OF REVENUES AND EXPENDITURES
BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL FUND
YEAR ENDED JUNE 30, 1991

	General Fund		
	Budget	Actual on Budgetary Basis	Variance - Favorable (Unfavorable)
REVENUES:			
Alloted appropriations	$ 18,433,254	$ 18,433,254	
Worker's compensation assessments	500,000	410,083	$ (89,917)
Total revenues	18,933,254	18,843,337	(89,917)
EXPENDITURES:			
Personal services	4,524,461	4,476,792	47,669
Workers' compensation benefits and other operating costs	14,408,793	14,014,096	394,697
Total expenditures	18,933,254	18,490,888	442,366
EXCESS OF REVENUES OVER EXPENDITURES	$ -	$ 352,449	$ 352,449

See notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Exhibit D

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS - PROPRIETARY FUND TYPE
YEAR ENDED JUNE 30, 1991

OPERATING REVENUES - Registration fess	$ 246,135
OPERATING EXPENSES - Other	262,143
OPERATING LOSS	(16,008)
RETAINED EARNINGS AT JULY 1, 1990	56,948
RETAINED EARNINGS AT JUNE 30, 1991	$ 40,940

See notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Exhibit E

STATEMENT OF CASH FLOWS - PROPRIETARY FUND TYPE
YEAR ENDED JUNE 30, 1991

	Internal Service
OPERATING ACTIVITIES:	
Cash received from customers	$ 246,135
Cash payments to suppliers for services	(258,629)
Net cash used for operating activities	(12,494)
CASH, BEGINNING OF YEAR	56,948
CASH, END OF YEAR	$ 44,454

See notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Schedule I

COMBINING BALANCE SHEET -
STATE DEFERRED COMPENSATION PLAN
JUNE 30, 1991

	Great Western Bank	Prudential Insurance Company of America	Great-West Life	Total
ASSETS:				
Cash in State Treasury		$ 1,410,918	$ 45,461	$ 1,456,379
Assets held by agents for State Deferred Compensation Plan	$ 137,736,095	49,684,500	150,459	187,571,054
Assets held by agents for counties under the State Deferred Compensation Plan	16,961,265	6,570,762	10,080	23,542,107
TOTAL ASSETS	$ 154,697,360	$ 57,666,180	$ 206,000	$ 212,569,540
LIABILITIES -				
Due to employees under State Deferred Compensation Plan	$ 154,697,360	$ 57,666,180	$ 206,000	$ 212,569,540
TOTAL LIABILITIES	$ 154,697,360	$ 57,666,180	$ 206,000	$ 212,569,540

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Schedule II

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES -
STATE DEFERRED COMPENSATION PLAN
YEAR ENDED JUNE 30, 1991

	Balance July 1, 1990	Additions	Deductions	Balance June 30, 1991
GREAT WESTERN BANK				
Assets:				
Cash in State Treasury	$ 1,168,100	$ 20,020,957	$ 21,189,057	
Assets held by agents for State Deferred Compensation Plan	113,141,341	33,177,456	8,582,702	$ 137,736,095
Total assets	$ 114,309,441	$ 53,198,413	$ 29,771,759	$ 137,736,095
Liabilities -				
Due to employees under State Deferred Compensation Plan	$ 114,309,441	$ 53,198,413	$ 29,771,759	$ 137,736,095
Total liabilities	$ 114,309,441	$ 53,198,413	$ 29,771,759	$ 137,736,095
PRUDENTIAL INSURANCE COMPANY OF AMERICA				
Assets:				
Cash in State Treasury	$ 126,259	$ 13,748,599	$ 12,463,940	$ 1,410,918
Assets held by agents for State Deferred Compensation Plan	32,763,184	19,037,398	2,116,082	49,684,500
Total assets	$ 32,889,443	$ 32,785,997	$ 14,580,022	$ 51,095,418
Liabilities -				
Due to employees under State Deferred Compensation Plan	$ 32,889,443	$ 32,785,997	$ 14,580,022	$ 51,095,418
Total liabilities	$ 32,889,443	$ 32,785,997	$ 14,580,022	$ 51,095,418
GREAT WEST-LIFE				
Assets:				
Cash in State Treasury		$ 57,993	$ 12,532	$ 45,461
Assets held by agents for State Deferred Compensation Plan		150,459		150,459
Total assets		$ 208,452	$ 12,532	$ 195,920
Liabilities -				
Due to employees under State Deferred Compensation Plan		$ 208,452	$ 12,532	$ 195,920
Total liabilities		$ 208,452	$ 12,532	$ 195,920

(Continued)

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES

Schedule II

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES -
STATE DEFERRED COMPENSATION PLAN
YEAR ENDED JUNE 30, 1991

	Balance July 1, 1990	Additions	Deductions	Balance June 30, 1991
COUNTIES				
Assets -				
Assets held by agents for State Deferred Compensation Plan	$ 18,374,939	$ 7,063,042	$ 1,895,874	$ 23,542,107
Total assets	$ 18,374,939	$ 7,063,042	$ 1,895,874	$ 23,542,107
Liabilities -				
Due to employees under State Deferred Compensation Plan	$ 18,374,939	$ 7,063,042	$ 1,895,874	$ 23,542,107
Total liabilities	$ 18,374,939	$ 7,063,042	$ 1,895,874	$ 23,542,107
TOTAL - STATE DEFERRED COMPENSATION PLAN				
Assets:				
Cash in State Treasury	$ 1,294,359	$ 33,827,549	$ 33,665,529	$ 1,456,379
Assets held by agents for State Deferred Compensation Plan	164,279,464	59,428,355	12,594,658	211,113,161
Total assets	$ 165,573,823	$ 93,255,904	$ 46,260,187	$ 212,569,540
Liabilities -				
Due to employees under State Deferred Compensation Plan	$ 165,573,823	$ 93,255,904	$ 46,260,187	$ 212,569,540
Total liabilities	$ 165,573,823	$ 93,255,904	$ 46,260,187	$ 212,569,540

(Concluded)

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Personnel Services on December 12, 1991. A copy of the transmittal letter to the department is included as Attachment 1. The response of the department is included as Attachment 2.

The department agrees with our recommendations. It is currently assessing its organizational structure and, upon completion, will submit a reorganization request for the governor's approval as required by administrative directive. The department is also seeking restitution of pay made as a result of its unauthorized reorganization. Also, it has reconciled its accounting records with those of the Department of Accounting and General Services.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813

(808) 548-2450
FAX: (808) 548-2693

December 12, 1991

COPY

The Honorable Sharon Y. Miyashiro, Ph.D.
Director
Department of Personnel Services
830 Punchbowl Street
Honolulu, Hawaii 96813
HFDC

Dear Dr. Miyashiro:

Enclosed are three copies, numbered 6 through 8, of our draft report, *Financial Audit of the Department of Personnel Services*. We ask that you telephone us by Monday, December 16, 1991, on whether you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Friday, December 27, 1991.

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

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Newton Sue

Newton Sue
Acting Auditor

Enclosures

JOHN WAIHEE
GOVERNOR OF HAWAII

SHARON Y. MIYASHIRO
DIRECTOR

LAWRENCE ISHIMI
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF PERSONNEL SERVICES
830 PUNCHBOWL STREET
HONOLULU, HAWAII 96813

December 23, 1991

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

Mr. Newton Sue
Acting Auditor
Office of the Legislative Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Dear Mr. Sue:

Thank you for bringing to my attention the matters contained in your recent "Financial Audit of the Department of Personnel Services."

The following are the Department's comments concerning the findings and recommendations contained in Chapter 2 of the audit:

1. The DPS is currently assessing its operations and has been working with the Department of Budget and Finance to reorganize its structure to more efficiently and effectively provide its services; and, when finalized, a reorganization request will be submitted to the Governor for approval.

   We are now seeking restitution of pay made as a result of the unauthorized reorganization, which should rectify the error.

2. The DPS has reconciled its accounting records to those of the Department of Accounting and General Services.

Very truly yours,

Sharon Y. Miyashiro, Director
Department of Personnel Services