93-17

Financial Audit of the Department of Budget and Finance

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

THE AUDITOR
STATE OF HAWAII

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* are conducted of professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with a schedule and 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* are conducted on bills which 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. *Special studies* are conducted when they are requested by 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, Suite 500
Honolulu, Hawaii 96813

Report No. 93-17 December 1993

OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Department of Budget and Finance

Summary

The office of the Auditor and the certified public accounting firm of Deloitte & Touche conducted a financial audit of the Department of Budget and Finance for the fiscal year July 1, 1992 to June 30, 1993. The audit examined the department's financial records and its system of accounting and internal controls and tested these for compliance with applicable laws and regulations.

In the opinion of Deloitte & Touche, except for keeping balances of revenues received for computer and telecommunication services provided by the Information and Communication Services Division in special revenue funds instead of transferring the balances to the general fund, the department's financial statements present fairly its financial position as of June 30, 1993, and the results of its operations for the year then ended in conformity with generally accepted accounting principles. Deloitte & Touche noted no matters involving the internal control structure and its operation that would be material weaknesses as defined in the report on the internal control structure. It also noted, with respect to items tested, that the department has complied, in all material respects, with laws and regulations applicable to the department.

We found that the department has no written procedures for evaluating the underwriting firms with which it negotiates in issuing state bonds. We also found that the department often deposited more than 60 percent of its available funds with one financial institution in violation of statutory requirements. Additionally, excess funds collected from other state agencies and departments for using the state's computer system and as reimbursements for using the state's telecommunications system should be lapsed to the general fund. We found that the department's dealings with financial institutions subject it to unnecessary risks. Specifically, deposits with paying agents are not collateralized, advances are made to agents on behalf of trustees, and unauthorized releases of securities are made by custodial banks. Lastly, we found that the department's policy for collateral requirements for state fund deposits are inconsistently enforced and may be restrictive.

Recommendations and Response

We recommend that the department continue to use the request for proposal process in selecting underwriting firms. It should develop a formal process and criteria to evaluate the performance of underwriting firms. Further, we recommend that the department seek an opinion from the Attorney General on the legality of its practice of depositing more than 60 percent of available funds with one institution. We also recommend that the department transfer the balances in the special fund accounts of the Information and Communications Services Division to the State's general fund.

We recommend that the department consider the need for collateralization of deposits with paying agents, review its trust agreements to assure that the schedule for maturing investments allows adequate time for trustees to transmit funds to paying agents, and that the department enforce its tri-party agreements with custodial banks. We also recommend that the department consistently enforce its collateral requirements and perform periodic checks for accuracy of collateral data. In addition, we recommend that the department review its collateral requirements to determine the appropriateness of the percentages used to value the collateral.

The department states that it is not industry practice to prepare formal evaluations of underwriters used for bond offerings and that it will have to look into the merits of such a process. We stand by our recommendation that services of underwriters should be formally evaluated. Evaluations should use criteria developed by the department, just as proposals for services are evaluated with criteria developed by the department.

The department agrees to seek an opinion from the Attorney General on its practice of depositing more than 60 percent of its cash with one bank. The department offered several reasons in defense of this practice. The department also agrees with our recommendation to transfer excess funds held in special revenue accounts to the general fund, and has begun doing so. It also agrees that dealings with institutions could be tightened insofar as they concern advances to agents on behalf of trustees and the unauthorized release of securities by custodial banks. The department feels, however, that it has taken all prudent steps feasible to minimize the risk of loss of deposits with paying agents. In addition, the department agrees with our recommendations to review its collateral requirements for depositing the state's cash with financial institutions and to consistently enforce those requirements.

Marion M. Higa
State Auditor
State of Hawaii

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

Financial Audit of the Department of Budget and Finance

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. 93-17
December 1993

Foreword

This is a report of our financial audit of the Department of Budget and Finance for the fiscal year July 1, 1992 to June 30, 1993. 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 Budget and Finance.

Marion M. Higa
State Auditor

Table of Contents

List of Tables

List of Exhibits

List of Schedules

Chapter 1
Introduction

This is a report of our financial audit of the State of Hawaii, Department of Budget and Finance. 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 financial statements of the department.

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.

4. Ascertain the extent to which recommendations contained in Chapter 3 of the State Auditor's Report No. 84-8, *Financial Audit of the Department of Budget and Finance for the Fiscal Year Ended June 30, 1983*, have been implemented.

Scope and Methodology

We audited the financial records and transactions and the related systems of accounting and internal controls of the department for the fiscal year July 1, 1992 to June 30, 1993. Included in our audit were all funds and accounts related to the Administrative and Research Office; the Financial Administration Division; the Budget, Program Planning and Management Division; and the Information and Communication Services Division. We did not audit the general fixed assets accounts. We also reviewed those transactions, systems and procedures for compliance with applicable laws and regulations.

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

The accountants' opinion as to the fairness of the financial statements presented in Chapter 3 is that of Deloitte & Touche. The audit was conducted from June 1993 through September 1993 in accordance with generally accepted government auditing standards.

Background

In the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959), the Legislature created the Department of Budget and Finance. Section 26-8, Hawaii Revised Statutes, describes the department's responsibilities:

> The department shall undertake the preparation and execution of the executive budget of the state government; conduct a systematic and continuous review of the finances, organization, and methods of each department of the State to assist each department in achieving the most effective expenditure of all public funds and to determine that such expenditures are in accordance with the budget laws and controls in force; have custody of state funds and be responsible for the safekeeping, management, investment, and disbursement thereof; and administer state debts.
>
> The department of budget and finance shall develop and operate an information network in conjunction with its overall plans for establishing a communication backbone for state government. The state communication system shall be established to facilitate implementation of the State's distributed information processing and information resource management plans; improve data, voice, and video communications in state government; provide a means for connectivity among the state, university, and county computer systems; and provide a long-term means for public access to public information.
>
> The functions and authority heretofore exercised by the bureau of the budget (except for insurance management, surplus property management, and central purchasing transferred to the department of accounting and general services) and the funds custody, cash management, debt management, and administering of veterans loan functions of the treasurer as heretofore constituted are transferred to the department of budget and finance established by this chapter.

Organization of the Department

The department is headed by the director of finance. The Office of the Director plans, organizes, directs and coordinates the various activities of the department within the scope of laws, rules, and established policies. The scope of the audit covered the following office and divisions:

Administrative and Research Office

This office provides administrative and research services for other divisions within the department. These services include budgeting, accounting, personnel, data processing, purchasing, administrative research, and other functions.

Divisions

Three divisions administer a variety of financial, budgetary, and data processing services to state government agencies.

Financial Administration Division. This division administers the financial affairs of the State through its management of the state treasury, financial planning and research, and debt issues.

Budget, Program Planning and Management Division. This division assists in the preparation of the State's six-year program and financial plan and the executive budget and provides various departments and agencies with technical management support and evaluation services.

Information and Communication Services Division. This division plans, develops, and supports the State's integrated information processing and telecommunication systems.

Other agencies

The audit did not include the following seven agencies that are attached to the Department of Budget and Finance for administrative purposes:

Office of the Public Defender. This office provides statutorily entitled legal services for criminal and related cases to those individuals financially unable to obtain such services.

Public Utilities Commission. This commission regulates all franchised or certified public service companies operating in the State of Hawaii.

Hawaii Information Network Corporation. This corporation supports, promotes, and encourages the private and public sector information industry in the State of Hawaii.

Employees' Retirement System. This agency administers a retirement and survivor benefits program for State and county employees.

Hawaii Public Employees' Health Fund. This agency contracts, implements, and administers the health benefits and group life insurance plans for State and county employees.

Housing and Finance Development Corporation. This corporation provides housing development and services to residents of the State of Hawaii.

Rental Housing Trust Fund. This fund provides loans or grants for the acquisition, pre-development, development, construction, preservation, and substantial rehabilitation of rental housing units.

Chapter 2

Internal Control Practices

Internal controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the Department of Budget and Finance. We are pleased to note that most of the recommendations made in our 1984 report have been implemented. The department now transfers the balance from the Veterans' Loans Fund to the general fund and has improved processing and review procedures. However, we find that improvements are still needed.

Summary of Findings

We find that the department does not exercise adequate internal controls that are standard practices for private sector and ensure fiduciary integrity and accountability for the public sector. More specifically, we find that:

1. The department should document its procedures for evaluating underwriting firms with whom it negotiates on issuing state bonds.

2. The department's allocation of state deposits to financial institutions does not conform with statutory requirements.

3. Excess funds collected in the department's special revenue accounts should be lapsed to the general fund.

4. The department should improve its dealings with financial institutions to reduce risk.

5. The department's policy for collateral requirements for state fund deposits are inconsistently enforced and may be restrictive.

Evaluation Process for Underwriting Firms Is Not Formalized

The department issues bonds to finance state capital improvement projects including airports, harbors, housing projects, schools, and offices. It hires underwriting firms to assist with each bond issue. Total bonds issued and the related underwriters' fees for each fiscal year ended June 30, 1993, 1992 and 1991 are summarized as follows:

Fiscal Year Ended	Bonds Issued	Underwriters' Fees
June 30, 1993	$ 1,490,400,000	$ 8,036,434
June 30, 1992	879,840,000	8,664,357
June 30, 1991	980,970,000	9,577,583

Table 2.2 at the end of this chapter presents, by type of bond, bonds issued since 1990, the names of the underwriters used, and the underwriting fee for each issuance.

Chapter 39, Hawaii Revised Statutes, gives the director of finance the responsibility for the sale of these bonds. Section 39-5 gives the director a significant amount of flexibility in selecting the underwriting firms. The director may use either a competitive bid or a negotiated process in selecting the underwriting firm.

The statutes governing competitive bid or negotiation are uneven. Sections 39-5(c) and (d), HRS, delineate in great detail the process of selling bonds under a competitive sale. The sections are designed to assure that bonds are sold to the underwriting firm that offers to purchase them at the lowest interest cost. However, these sections allow very little flexibility to the director of finance.

In contrast, Section 39-5(b), HRS, outlines a negotiated sale process in one sentence. This section allows the director to sell bonds to an underwriting firm at terms, conditions and rates agreed upon by the director and approved by the governor. It gives the director maximum flexibility.

Prior to December 1988, the department generally sold its bonds using the competitive bid process. This process had significant disadvantages. The State lacked the flexibility to change the date, structure, price, or distribution of the bonds to be issued. Once the bid process began, the State was obligated to complete the issuance as originally planned, regardless of changing economic conditions, interest rates, or program priorities.

To gain greater flexibility, the department began using the negotiated sale process in 1988. The department negotiated directly with specific underwriting firms for each bond issue. This gave the department more flexibility in the timing and amount of bonds to be issued. It could take advantage of better interest rates and more favorable borrowing terms. The director appointed firms based on his past experience and knowledge of their qualifications and capabilities. However, we were unable to locate written documentation supporting the director's selection and appointment of firms.

In July 1992, the department modified the negotiated sale process. It required interested underwriting firms to submit written proposals for bonds to be issued. The director evaluated proposals and selected underwriters for pending bond issues based on the proposals.

The proposal process blends the flexibility of a negotiated sale with the lower costs commonly associated with competitive bids. It gives the department the flexibility to take advantage of changes in interest rates and changing state needs. It has resulted also in reduced underwriting fees. Table 2.2 shows that underwriting costs dropped when the proposal process was used.

The department documents its evaluation of proposals and its selection of underwriters. However, it has no formal documentation of the performance of the underwriting firms selected. The department states that it evaluates the performance of underwriters through feedback from participants involved with the bond issue including bond counsel, paying agents, and participating underwriting firms. It also states that it receives data on similar bond issues priced near the bond issuance date to assure that the bonds were competitively priced. Clearly documented evaluation criteria are necessary to properly evaluate performance. Evaluations provide feedback on performance as well as provide support for subsequent evaluations of proposals. The evaluation criteria and the actual evaluations made should be formally documented and consistently followed.

Recommendations

We recommend that the department continue to use the request for proposal process in selecting underwriting firms. It should develop and document procedures used to evaluate the performance of underwriting firms.

Allocation of State's Deposits May Not Be In Compliance With Law

Chapter 38-2, HRS, states that no more than 60 percent of the State's deposits may be deposited in any one depository, unless the depository offers yields greater than those offered by other depositories.

We note that as of the end of each month between July and December 1992, and at June 30, 1993, the department had exceeded the 60 percent limit of its deposits with Bank of Hawaii. Surpassing the statutory limit was common knowledge. According to the State Comptroller's report for the year ended June 30, 1992, cash deposited with Bank of Hawaii represented 76 percent of total deposits with local depositories.[1]

It was not possible to determine if Bank of Hawaii offered greater yields. The department did not document the interest rates of all banks and savings and loan institutions in the State. It documents the rates for only four banks: Bank of Hawaii, First Hawaiian Bank, City Bank, and Central Pacific Bank. We reviewed the average interest rates of the four banks and found the interest rate differentials to be insignificant. The average interest rates based on certificate of deposit maturities for the six months July through December, 1992 at the four banks are shown in Table 2.1.

Table 2.1
SUMMARY OF AVERAGE INTEREST RATES

As of	Bank of Hawaii	First Hawaiian Bank	Central Pacific Bank	City Bank
July 31, 1992	3.4930	3.1571	3.4393	3.4393
August 31, 1992	3.1607	3.0071	3.1607	3.1750
September 30, 1992	2.8571	2.6986	2.9714	2.7714
October 31, 1992	2.7714	2.6964	2.7714	2.7714
November 30, 1992	3.3571	2.6964	2.7714	2.7714
December 31, 1992	3.3571	3.2179	2.8715	2.7714

Departmental personnel reported that they do not document the interest rates of savings and loan institutions and the other banks, but they do monitor these rates via telephone conversations. They also indicated that they could not deposit greater amounts with other institutions due to the strict collateral requirements.

Recommendation

We recommend that the department seek an opinion from the Attorney General on the legality of its practice of depositing more than 60 percent of available funds with one institution.

Excess Funds Are Collected In Special Revenue Accounts

The department assesses other state agencies and departments for using the State's computer system. These assessments, based on actual time spent on the system at standard billing rates, are recorded in special revenue fund accounts. Assessments to users have exceeded expenditures from these accounts and have resulted in an accumulation of approximately $2 million as of June 30, 1993.

In addition, the department receives reimbursements from state agencies, departments, and employees for using the State's telecommunications system. The reimbursements exceeded actual telecommunications expenses because general fund appropriations to specific agencies were used to pay for some of the expenses. These excess funds amounted to approximately $348,000 at June 30, 1993, and are being held in a special fund account.

Accounting for these funds in special revenue fund accounts has resulted in misrepresenting the financial statements of the department. Because the account balances are held in special revenue fund accounts, the auditors have declared an exception as to the fairness of the department's financial statements. This practice also hides available moneys from legislative scrutiny that could finance other state programs. These account balances should not be held in special revenue fund accounts but should be transferred to the general fund.

Recommendation

We recommend that the department transfer the balances in the special fund accounts of the Information and Communications Services Division to the State's general fund.

Dealings With Institutions Should Be Tightened

The department engages the services of different financial institutions to act as paying agents for bonds, trustees for certain bond proceeds, and as custodians of collateral securities. Improvements are needed in the way the department deals with these institutions because deposits with paying agents are not secured by collateral, trust agreement provisions often result in the State advancing funds to paying agents on behalf of trustees, and collateral securities have been released without the department's approval or knowledge.

Deposits with paying agents are not collateralized

The director of finance appoints agents to facilitate the purchase and redemption of state bonds and the payment of interest on bonds. Moneys placed with these fiscal agents (primarily mainland banks) are not considered deposits as defined by Chapter 38. Therefore, they are not subject to collateralization requirements.

The reason for not requiring fiscal agents to have collateral is that transfers of funds to them and their payments to bondholders should normally occur within a short period of time. However, significant delays often occur before all principal and interest checks are cashed, or interest coupons are presented for payment. Consequently, these banks often have large balances for several weeks.

We computed an average balance for the 1993 fiscal year based on bi-weekly or monthly balances for the three largest bank accounts. We found average balances of $6.6 million, $7.9 million, and $8.3 million. At June 30, 1993, the bank balances with fiscal agents were $104,211,618.

Since these fiscal agents do not pledge collateral as security for deposits, the State takes the risk of losing its deposits with them. Should a paying agent fail to make the required payments to bond holders, the State may be liable for redemption of bonds and interest payments even though it has already deposited such moneys with the fiscal agents.

Advances are made to agents on behalf of trustees

Because of favorable interest rates, the Department of Budget and Finance, with the proper approval of the governor, has issued refunding series bonds to refund numerous series of outstanding bond obligations of the State. The department places portions of the proceeds from the sale of these refunding series bonds with trustees under refunding trust agreements. The trustees invest the proceeds so that they can repay the original bond obligations as they become due.

In certain situations, the investment strategies stipulated in the trust agreements result in securities maturing on or near the maturity dates of the bond obligations to be paid with the investment proceeds. Because of time-zone differences between the trustees and paying agents (generally five to six hours), the trustees are sometimes unable to transfer the required funds to the paying agents in time for payment to bond holders.

In these situations, the department has advanced funds to the paying agents on behalf of the trustees in order to ensure timely payments to bondholders. During the year the department advanced $6.1 million on behalf of the trustees. These advances to paying agents have several disadvantages. First, cash advanced to paying agents is not collateralized by securities under Section 38-3, Hawaii Revised Statutes. Second, the department reduces its available cash balance that may be invested in interest-bearing securities. And third, the accounting for advances has resulted in an overstatement of department expenditures by $3,493,014, which the department must recover.

The department should review its trust agreements to avoid these advances. This could be done by requiring trustees to develop investment strategies that would make funds available at the appropriate times.

Unauthorized release of securities made by custodial banks

Section 38-3, HRS, requires financial institutions to pledge securities as collateral for state deposits. The collateral is generally placed with a custodial bank, under an "Agreement for Safekeeping of Securities Deposited to Protect Deposits of Funds of the State of Hawaii (tri-party agreement)." This is done to reduce access to collateral by depository financial institutions and to reduce risk of the loss of state deposits. The tri-party agreement requires the custodial banks to obtain authorization from the Department of Budget and Finance before they release securities to depository financial institutions.

During the year two custodial banks released a total of $10.1 million of collateral without the department's authorization. In addition, the withdrawals were not reported to the department until months after they were released.

The department should not tolerate a custodial bank's failure to perform in accordance with the tri-party agreement. The release of collateral securities without departmental approval significantly increases the risk of losing deposits maintained at financial institutions.

Recommendations

We recommend that the department consider the need for collateralization of deposits with paying agents. We also recommend that the department review its trust agreements to assure that the schedule for maturing investments allows adequate time for trustees to transmit funds to paying agents. We further recommend that the department enforce the tri-party agreement by requiring the custodial banks to obtain proper authorization from the department prior to releasing securities to depository financial institutions.

Collateral Requirements Should Be Reviewed

The department is responsible for the cash management function of the State. The department generally keeps the state's cash in checking accounts and time certificates of deposit at financial institutions. Section 38-3, HRS, requires financial institutions to pledge securities as collateral against the deposits, valued at market value (but not in excess of par value).

At June 30, 1993, deposits of $337,416,654 were collateralized by securities held by the State or its custodial banks in the name of the State. Also, at June 30, 1993, repurchase agreements of $2,515,805,719 were fully collateralized by securities. Finally, cash and investments of $1,026,252,745, primarily consisting of cash in the U.S. Treasury, cash with fiscal agents, and U.S. securities were not required to be collateralized.

The department is required to monitor the adequacy of the collateral balances. Due to the difficulty of monitoring collateral balances on a daily basis, the department's policy is to value the collateral at a reduced percentage of par value to ensure collateral adequacy. Collateral securities backed by federal mortgage association certificates are valued at 70 percent of face value. All other securities accepted by the State are valued at 91 percent of par or face value.

This policy does not relieve the department of its responsibility to monitor the adequacy of the collateral balances. In reviewing the department's monitoring process, we noted the department's enforcement of its policy is inconsistent and that the collateral requirements may be unduly restrictive.

Inconsistent enforcement of the policy

The department does not consistently enforce the policy that collateral be valued at the 70 and 91 percentages. For example, two financial institutions did not meet the department's collateral requirements (at the reduced percentages of par value) on at least three occasions in fiscal year 1993. The department did not appear to follow up on this in a timely manner. In at least eight other instances, the department allowed banks to withdraw securities serving as collateral when this resulted in a deficiency in their collateral requirements (at the reduced percentages of par value). We also noted nine instances of erroneous information being added into the department's collateral data base in fiscal year 1993.

Restrictive collateral requirements

The department does not regularly monitor the appropriateness of the 70 and 91 percentages used to value the collateral. The use of overly conservative percentages can result in higher than necessary collateral balance requirements. This could cause financial institutions to lower their yields on the State's deposits or to be unable or unwilling to meet the more conservative requirements.

Recommendations

We recommend that the department consistently enforce its collateral requirements and perform periodic checks for accuracy of collateral data. In addition, we recommend that the department review its collateral requirements to determine the appropriateness of the percentages used to value the collateral.

TABLE 2.2

STATE OF HAWAII, DEPARTMENT OF BUDGET & FINANCE

SUMMARY OF SELECTION OF UNDERWRITING FIRMS
JUNE 30, 1993

Issue Date	Bond Series	Amount	Underwriter(s)	Co-Manager(s)*	Selection Process	Underwriting Fee Total	Underwriting Fee Per $1,000 of Principal
GENERAL OBLIGATION							
June 7, 1990	Series BR	$ 100,000,000	Merrill Lynch		Appointment	$ 773,612	$ 7.736
August 21, 1990	Series BS	150,000,000	Merrill Lynch		Appointment	1,130,394	7.536
February 13, 1991	Series BT	250,000,000	Merrill Lynch		Appointment	1,846,513	7.386
November 7, 1991	Series BU	100,000,000	Merrill Lynch		Appointment	698,594	6.986
	Refunding Series BV	92,180,000			Appointment	659,075	7.150
February 21, 1992	Series BW	100,000,000	Merrill Lynch		Appointment	644,156	6.442
	Refunding Series BX	30,690,000			Appointment	160,952	5.244
October 1, 1992	Taxable Series BY	120,000,000	Merrill Lynch	Hawaiian	Proposal	462,000	3.850
	Series BZ	200,000,000			Proposal	770,000	3.850
January 8, 1993	Series CA	90,000,000	Merrill Lynch	Hawaiian	Proposal	405,000	4.500
	Refunding Series CB	107,845,000			Proposal	497,165	4.610
February 22, 1993	Refunding Series CC	334,860,000	Merrill Lynch	Hawaiian	Proposal	1,453,292	4.340
	Refunding Series CD	137,935,000			Proposal	598,638	4.340
May 24, 1993	Series CE	130,245,000	Merrill Lynch	Hawaiian, Paine, Prudential and Smith	Proposal	520,980	4.000
TOTAL		$ 1,943,755,000				$ 10,620,371	

Issue Date	Bond Series	Amount	Underwriter(s)	Co-Manager(s)*	Selection Process	Underwriting Fee Total	Underwriting Fee Per $1,000 of Principal
AIRPORT REVENUE BONDS							
May 16, 1990	Series 1990	$ 100,000,000	Goldman, Sachs	Paine and Dean	Appointment	$ 1,160,000	$ 11.600
October 3, 1990	2nd Series 1990	200,000,000	Goldman, Sachs	Paine, Shearson, Boston and Dean	Appointment	2,272,000	11.360
June 4, 1991	Series 1991	200,000,000	Goldman, Sachs	Paine, Lehman, Boston and Dean	Appointment	2,314,000	11.570
December 3, 1991	2nd Series 1991	400,000,000	Goldman, Sachs	Paine, Lehman, Boston, Dean and Hawaiian	Appointment	4,384,000	10.960
October 13, 1992	Refunding Series 1992	19,400,000	Goldman, Sachs	Paine and Hawaiian	Proposal	161,602	8.330
	Refunding Series 1993	131,035,000			Proposal	1,310,350	10.000
May 17, 1993	Refunding Series 1994	63,455,000	Goldman, Sachs		Proposal	475,912	7.500
	2nd Refunding Series 1994	79,070,000			Proposal	593,025	7.500
TOTAL		$ 1,192,960,000				$ 12,670,889	

Issue Date	Bond Series	Amount	Underwriter(s)	Co-Manager(s)*	Selection Process	Underwriting Fee Total	Underwriting Fee Per $1,000 of Principal
HARBOR REVENUE BONDS							
December 7, 1990	Series 1990	$ 57,890,000	Paine Webber		Appointment	$ 709,152	$ 12.250
May 28, 1992	Series 1992	19,450,000	Paine Webber		Appointment	272,112	13.990
October 13, 1992	Refunding Series 1992	13,195,000	Goldman, Sachs	Paine and	Proposal	124,297	9.420
	Refunding Series 1993	16,525,000		Hawaiian	Proposal	158,475	9.590
		$ 107,060,000				$ 1,264,036	
HOUSING FINANCE AND DEVELOPMENT CORPORATION							
July 13, 1990	Rental Housing System Revenue Bonds Series 1990 A	$ 33,500,000	Merrill Lynch		Appointment	$ 266,493	$ 7.955
	1990 B	35,700,000			Appointment	283,993	7.955
September 10, 1990	Single Family Mortgage Purchase Revenue Bonds Series 1990 A	50,000,000	Dean Witter	Merrill	Appointment	648,338	12.967
November 20, 1991	Single Family Mortgage Purchase Revenue Bonds Series 1991 A	57,105,000	Dean Witter	Merrill and Paine	Appointment	1,542,506	12.906
	Series 1991 B	62,415,000			Appointment		
March 16, 1993	Affordable Rental Housing Program Revenue Bonds 1993 Series A	30,700,000	Dean Witter	Merrill	Appointment	268,598	8.749
		$ 269,420,000				$ 3,009,928	

Issue Date	Bond Series	Amount	Underwriter(s)	Co-Manager(s)*	Selection Process	Underwriting Fee Total	Underwriting Fee Per $1,000 of Principal
HAWAIIAN HOME LANDS							
October 8, 1991	Revenue Bonds Series 1991	$ 18,000,000	Merrill Lynch		Appointment	$ 302,962	$ 16.831
UNIVERSITY OF HAWAII							
July 30, 1992	University System Revenue Bonds, Series G	$ 16,135,000	Merrill Lynch		Appointment	$ 237,100	$ 14.695
HAWAII COMMUNITY DEVELOPMENT CORPORATION							
August 1, 1990	HCDA-Improvement District 3	$ 3,880,000	Merrill Lynch		Appointment	$ 106,700	$ 27.500

*** LEGEND:**

Boston = The First Boston Corp.
Dean = Dean Witter Reynolds, Inc.
Hawaiian = Hawaiian Capital Securities
Lehman = Lehman Brothers
Merrill = Merrill Lynch Capital Markets
Paine = Paine Webber, Inc.
Prudential = Prudential Securities, Inc.
Shearson = Shearson Lehman Hutton, Inc.
Smith = Smith Barney, Harris Upham & Co.

Chapter 3
Financial Audit

This chapter presents the results of the financial audit of the State of Hawaii, Department of Budget and Finance (B&F) for the year ended June 30, 1993. It displays financial statements of all fund types and account groups included in the scope of the audit, 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, except for the general fixed asset account group and accounting for intergovernmental revenues, the combined financial statements present fairly, in all material respects, the financial position of the department as of June 30, 1993, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Deloitte & Touche noted no matters involving the internal control structure and its operation that they considered to be material weaknesses 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 laws and regulations applicable to the department.

Independent Auditors' Report

To the Auditor
State of Hawaii

We have audited the following financial statements of the State of Hawaii, Department of Budget and Finance (department):

Combined balance sheet--all fund types and account groups, June 30, 1993 (Exhibit A);

Combined statement of revenues, expenditures, and changes in fund equity--all governmental fund types and expendable trust funds, year ended June 30, 1993 (Exhibit B);

Combined statement of revenues and expenditures and other financing uses - budget and actual (budgetary basis)--general and special revenue funds, year ended June 30, 1993 (Exhibit C).

These financial statements are the responsibility of the management of the State of Hawaii, Department of Budget and Finance. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, 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.

In accordance with the terms of our engagement, our audit of the combined financial statements did not include the financial activities of the department's general fixed assets account group, which had total assets of $25,624,204 as of June 30, 1993.

Intergovernmental revenues received for services provided by the Information and Communication Services Division and telecommunication reimbursements have been accounted for in special revenue funds, although such funds are not legally restricted for specified purposes. The balances in such funds should be transferred to the general fund. At June 30, 1993, the accumulated fund balances approximated $2,391,000.

As discussed in the notes to the combined financial statements, the accompanying combined financial statements present only the activities of the State of Hawaii, Department of Budget and Finance's Administrative and Research Office, Financial Administration Division, Budget, Program Planning and Management Division, and Information and Communication Services Division, 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, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to audit the financial statements of the general fixed assets account group as discussed in the fourth paragraph, and except for the effects of accounting for intergovernmental revenues in special revenue funds rather than in the general fund as discussed in the fifth paragraph, such combined financial statements present fairly, in all material respects, the financial position of the State of Hawaii, Department of Budget and Finance at June 30, 1993, and the results of its operations 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 combined financial statements taken as a whole. The following combining fund financial statements, which are also the responsibility of the management of the State of Hawaii, Department of Budget and Finance, are presented for purposes of additional analysis and are not a required part of the combined financial statements of the State of Hawaii, Department of Budget and Finance:

Combining balance sheet--special revenue funds, June 30, 1993 (Schedule I);

Combining statement of revenues, expenditures and changes in fund equity--special revenue funds, year ended June 30, 1993 (Schedule II);

Combining balance sheet --trust and agency funds, June 30, 1993 (Schedule III);

Combining statement of revenues, expenditures and changes in fund equity--expendable trust funds, year ended June 30, 1993 (Schedule IV); and

Combining statement of changes in assets and liabilities--agency funds, year ended June 30, 1993 (Schedule V).

Such additional information has been subjected to the auditing procedures applied in our audit of the combined financial statements and, in our opinion, except for the effects of accounting for intergovernmental revenues in special revenue funds rather than in the general fund as discussed in the fifth paragraph, is fairly presented in all material respects when considered in relation to the combined financial statements taken as a whole.

/s/ Deloitte & Touche

Honolulu, Hawaii
September 17, 1993

Independent Auditors' Report on the Internal Control Structure Based on the Audit of the Combined Financial Statements

To the Auditor
State of Hawaii

We have audited the combined financial statements of the State of Hawaii, Department of Budget and Finance as of and for the year ended June 30, 1993, and have issued our report thereon dated September 17, 1993.

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 combined financial statements of the State of Hawaii, Department of Budget and Finance for the year ended June 30, 1993, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control structure.

The management of the State of Hawaii, Department of Budget and Finance 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:

- Treasury cycle
- Revenue/Receipts cycle
- Purchases/Disbursements cycle
- Payroll personnel 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.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more 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. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department of Budget and Finance. However, this report is a matter of public record and its distribution is not limited.

/s/ Deloitte & Touche

Honolulu, Hawaii
September 17, 1993

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

To the Auditor
State of Hawaii

We have audited the combined financial statements of the State of Hawaii, Department of Budget and Finance as of June 30, 1993 and for the year then ended, and have issued our report thereon dated September 17, 1993.

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

The results of our tests indicate that, with respect to the items tested, the State of Hawaii, Department of Budget and Finance 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.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department of Budget and Finance. However, this report is a matter of public record and its distribution is not limited.

/s/ Deloitte & Touche

Honolulu, Hawaii
September 17, 1993

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 equity 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--all governmental fund types and expendable trust funds (Exhibit B). This statement presents revenues, expenditures, and changes in fund equity for all governmental fund types and expendable trust funds used by the department on an aggregate basis. Revenues include state appropriations mandated by various appropriations acts of the Legislature.

Combined statement of revenues, expenditures and other financing uses--budget and actual (budgetary basis) - general and special revenue funds (Exhibit C). This statement summarizes revenues and expenditures by source and type on the budgetary basis and compares such amounts to the budget as adopted by the Legislature.

Combining balance sheet--special revenue funds, June 30, 1993 (Schedule I). This schedule presents assets, liabilities and fund equity of the special revenue funds of the department.

Combining statement of revenues, expenditures and changes in fund equity-- special revenue funds, year ended June 30, 1993 (Schedule II). This schedule presents revenues, expenditures and changes in fund equity of the special revenue funds of the department.

Combining balance sheet--trust and agency funds, June 30, 1993 (Schedule III). This schedule presents assets, liabilities and fund equity of the trust and agency funds of the department.

Combining statement of revenues, expenditures and changes in fund equity-- expendable trust funds, year ended June 30, 1993 (Schedule IV). This schedule presents revenues, expenditures and changes in fund equity of the expendable trust funds of the department.

Combining statement of changes in assets and liabilities--agency funds, year ended June 30, 1993 (Schedule V). This schedule presents changes in assets and liabilities of the agency funds of the department.

Definition of terms

Technical terms are used in the combined financial statements and in the notes to the combined 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 combined financial statements and financial condition of the funds included in the scope of the audit are discussed in this section.

Financial statement presentation

General. The accompanying financial statements of the State of Hawaii, Department of Budget and Finance (department) present the financial position of the various fund types and account groups and the results of operations of the various fund types for the year ended June 30, 1993.

Reporting entity. The Department of Budget and Finance is a department of the State of Hawaii. The department's financial statements reflect only activities related to the Administrative and Research Office, Financial Administration Division, Budget, Program Planning and Management Division, and Information and Communication Services Division. 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.

Account groups are financial reporting devices designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net available financial resources.

Governmental fund types. Financial resources which are not accounted for in other funds are accounted for in the general fund. The measurement focus of governmental funds (general and special revenue funds) is on current financial resources. The budget adopted by the Legislature provides the basic framework within which the resources and obligations of the general fund are accounted for. The general fund of the department is a part of the State's general fund, and the general fund reported on the combined financial statements is limited to and reflects only the appropriations, expenditures, and obligations of the general fund account used by the department, and the general fund allotments received by the department.

Financial resources obtained from specific revenue sources and used for restricted purposes are accounted for in special revenue funds.

Fiduciary fund type. The measurement focus of the expendable trust funds is also on current financial resources. The agency funds are 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 a capital lease obligation.

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 funds 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 which is recognized as an expenditure 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 balance since they do not constitute expenditures or liabilities.

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

Investments. Investments are carried at cost.

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 and sick leave. Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end, and is convertible to pay upon termination of employment. In the governmental funds, the amounts expected to be liquidated with expendable available financial resources are accrued in the respective funds, 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 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. Accumulated sick leave as of June 30, 1993 was $7,233,319.

Cash and investments

The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The State Director of Finance may invest any moneys of the State which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

Cash

The State maintains approximately 20 bank accounts for various purposes at locations throughout the State and the nation. Bank deposits are under the custody of the State Director of Finance.

For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances. The use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

The carrying amount of the State's total deposits as of June 30, 1993 was $770,525,204 (which includes cash in banks of $337,416,654, cash with fiscal agents of $104,211,618, and cash in the U.S. Treasury of $328,896,932) and the corresponding bank balances which are represented were $763,660,070. The difference between the carrying amount and the corresponding bank balances is principally due to outstanding checks and deposits in transit.

The portion of such bank balances covered by Federal deposit insurance or by collateral held either by the State Treasury or by the State's fiscal agents in the name of the State totaled $335,171,996. The remaining bank balances of $427,859,624, which represent deposits with the U.S. Department of the Treasury for the State's Unemployment Trust Fund and cash balances held by fiscal agents in the State's name for the purpose of satisfying outstanding bond obligations, were uncollateralized.

Investments

The State holds investments both for its own benefit and as an agent for other parties. The State's investment of funds not required for immediate payment are comprised of repurchase agreements and U.S. Government securities.

Investments are categorized to give an indication of the level of risk assumed by the State at year end. These categories include:

1. Investments which are insured or registered, or securities held by the State or its agent in the State's name.

2. Investments which are uninsured and unregistered, with securities held by the counterparty's trust department or agent in the State's name.

3. Investments which are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

At June 30, 1993, investments consisted of repurchase agreements of $2,515,805,719 and U.S. Government securities at amortized cost of $593,144,195 (market values of $2,515,805,719 and $597,369,437, respectively). All investments at June 30, 1993, were classified in the first category of risk described above.

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 State appropriations in Exhibit C are those compiled by the department. Budgeted expenditures are derived primarily from the General Appropriations Act and other specific appropriations acts.

All expenditures of these appropriated funds are made pursuant to the appropriation in the 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, 1993, 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 and special revenue fund types 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).

A reconciliation of the budgetary to GAAP basis operating results for the fiscal year ended June 30, 1993 follows:

	General Fund	Special Revenue Funds
Excess (deficiency) of revenues over expenditures and other financing uses - actual on a budgetary basis	$ (1,293,915)	$ 772,631
Reserved for encumbrances	3,146,524	92,145
Expenditure for liquidation of prior year encumbrances	(4,870,953)	(932,882)
Net accrued revenues and expenditures	391,108	(89,030)
Deficiency of revenues over expenditures and other financing uses - GAAP basis	$ (2,627,236)	$ (157,136)

Employee benefits

Employees' Retirement System

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

For the year ended June 30, 1993, total payroll for the department was $12,789,155. Total pension contributions to the System approximated 7.09 percent of payroll costs.

Information on covered payroll, actuarially determined contribution and actual contributions to the System is not available on a departmental basis.

The plan consists of a contributory option and a noncontributory option. Eligible employees, in service and a member of the plan on June 30, 1984, were given an election to remain with the existing contributory option or to select the new noncontributory option, effective January 1, 1985. Most new eligible employees hired after June 30, 1984 automatically become members under the noncontributory option. Both options provide death and disability benefits and cost of living increases. Benefits are established by State statute.

Under the contributory option, employees may elect normal retirement at age 55 with five 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.

Employees covered under the contributory option 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 retirement benefits when due. Under the noncontributory option, 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% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early retirement. The State is required by statute to contribute all amounts necessary to pay retirement benefits when due.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects 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 System's 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 System does not make separate measurements of assets and pension benefit obligations for individual employers. The pension benefit obligation at June 30, 1992 (the latest date available) for the System as a whole, determined through an actuarial valuation performed as of that date, was $6.1 billion. The System's net assets available for benefits on that date (valued at market) was $4.5 billion, leaving an unfunded pension benefit obligation of $1.6 billion.

For historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due, see the System's June 30, 1992 annual financial report.

Post-retirement health care and life insurance benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all employees who retire from the State (including the department) on or after attaining age 62 with at least 10 years of service or age 55 with at least 30 years of service under the noncontributory option and age 55 with at least 5 years of service under the contributory option. There are currently approximately 15,000 State retirees receiving such benefits. Retirees credited with at least 10 years of service excluding sick leave credit qualify for free medical insurance premiums; however, retirees with less than 10 years must assume a portion of the monthly premiums. All disability retirees who retired after June 30, 1984, with less than 10 years of service also qualify for free medical insurance premiums. Free life insurance coverage and dental coverage for dependents under age 19 are also available. Retirees covered by Medicare are eligible to receive a reimbursement of the basic medical coverage premiums. Contributions are based upon negotiated collective bargaining agreements and are funded by the State as accrued. During fiscal 1993, expenditures of approximately $47,655,000 were recognized for post-retirement health care and life insurance by the State of Hawaii.

General fixed assets account group (unaudited)

The following is a summary of changes in general fixed assets for the year ended June 30, 1993:

Balance at July 1, 1992	$ 25,576,052
Additions	360,333
Retirements	(312,181)
Balance at June 30, 1993	$ 25,624,204

General long-term debt account group

The changes in general long-term debt for the year ended June 30, 1993 were as follows:

	Capital Lease Obligation	Accrued Vacation Payable	Total
Balance at July 1, 1992 (unaudited)	$ 133,715	$ 2,640,778	$ 2,774,493
Net increase (decrease) in general long-term debt	(114,110)	124,400	10,290
Balance at June 30, 1993	$ 19,605	$ 2,765,178	$ 2,784,783

Insurance coverage

Insurance coverage is maintained primarily at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Special purpose revenue bonds

The department is authorized under Chapter 39A of the Hawaii Revised Statutes to issue special purpose revenue bonds. Proceeds from these bonds are loaned to certain enterprises for projects deemed to be in the public interest. Fees are assessed for all administrative and processing costs incurred. The bonds are not general obligations of the department or the State and are payable solely from moneys received by the department under project agreements with the recipient of the bond proceeds. Accordingly, these bonds are not reflected in the accompanying combined financial statements.

As of June 30, 1993, special purpose revenue bonds outstanding were as follows:

	Date of Issue	Interest Rate	Amount
The Queen's Medical Center	10/29/85	Variable	$ 35,900,000
	2/2/87	Variable	5,000,000
	6/15/89	6.4-7.0	77,005,000
	10/2/92	3.0-6.2	8,275,000

Kaiser Permanente Medical Care Program	4/12/84	9.5-10.125	23,000,000
	4/12/84	Variable	30,000,000
	11/1/85	8.5-9.25	12,800,000
	11/8/91	6.25-6.5	26,565,000
St. Francis Hospital	6/24/92	4.5-6.5	41,110,000
Hawaiian Electric Company, Inc.	3/1/87	6.875	42,580,000
	12/2/88	Variable	30,000,000
	12/10/92	6.55	40,000,000
	1/10/90	7.35	16,000,000
	7/25/90	7.6	21,000,000
	12/12/90	7.375	25,000,000
Citizen's Utilities Company	11/14/85	Variable	9,400,000
	11/14/85	Variable	3,400,000
	10/6/88	7.25-7.9	24,000,000
	12/22/88	7.375	10,000,000
	7/1/91	6.750	32,000,000
	7/1/92	6.6	10,000,000
Wailuku River Hydroelectric Power Company, Inc.	12/18/91	Variable	25,000,000
Ewa Plain Water Development Corp.	12/17/85	Variable	18,200,000
Kuakini Medical Center	4/1/84	Variable	14,200,000
	49/1/85	Variable	4,500,000
Kapiolani Health Care System	9/2/88	6.55-6.9	2,445,000
	3/20/91	6.1-7.0	5,735,000
	2/2/93	4.6-6.4	75,210,000
	2/2/93	4.6-6.4	31,025,000
G.N. Wilcox Memorial Hospital	2/2/87	Variable	700,000
	3/17/88	Variable	14,600,000
Wahiawa General Hospital	3/1/85	9.75-10.2	615,000
	3/4/92	7.125-7.5	16,225,000
Hawaii Electric Light Company, Inc.	12/5/84	Variable	11,400,000
	3/1/87	6.875	7,200,000
	12/2/88	Variable	11,000,000
	12/10/92	6.55	12,000,000
	1/10/90	7.35	3,000,000
	7/25/90	7.6	4,000,000
	12/12/90	7.375	10,000,000
Kamaoa Wind Energy Partners	11/2/87	7.75-8.8	8,030,000

Maui Electric Company, Limited	3/1/87	6.875	7,720,000
	12/2/88	Variable	9,000,000
	12/10/92	6.55	8,000,000
	1/10/90	7.35	1,000,000
	12/12/90	7.375	20,000,000
Adventist Health System	9/6/84	Variable	5,600,000
The Evangelical Lutheran Good Samaritan Society	11/1/82	10-10.5	6,370,000
	9/11/85	7.75-9.25	2,525,000
			$ 858,335,000

As of June 30, 1993, special purpose revenue bonds which were authorized but unissued included:

Company	Amount
Health care facilities provided to the general public by not-for-profit corporations:	
Castle Medical Center	$ 9,000,000
Episcopal Homes of Hawaii, Inc.	135,000,000
G.N. Wilcox Hospital	10,500,000
Kaiser Foundation Hospital	1,400,000
Kapiolani Children's Medical Center	14,000,000
Rehabilitation Hospital of the Pacific	20,000,000
St. Francis Hospital	26,640,000
The Queen's Medical Center	30,725,000
Wahiawa General Hospital	6,000,000
Waianae Coast Comprehensive Health Center	7,000,000
Utilities serving the general public:	
Hawaii Electric Light Co.	25,000,000
Hawaiian Electric Co., Inc.	90,000,000
Kauai Electric Division	40,820,000
Maui Electric Co.	32,000,000
Industrial enterprises:	
Aloha Studios, Inc.	10,000,000
C. Brewer and Company, Limited	50,000,000
Cyanotech Corporation	3,000,000
ETV Hawaii/Elephant Television, Inc.	6,000,000
Encogen Hawaii	10,000,000
Ewa Plain Water Development Corp.	6,800,000
Hanalei Power Company	12,000,000
Hawaiian Abalone Farms Limited Partnership	6,000,000
Hui 'Enekinia Hawaii	10,000,000

International Pacific Energy Consortium, Inc.	15,000,000
Island Power Company, Inc. (Hydro-Electric, Honolii, Hawaii)	20,000,000
Island Power Company, Inc. (Hydro-Electric, Lower Wailua, Kauai)	10,000,000
Island Power Company, Inc. (Hydro-Electric, Upper Wailua, Kauai)	5,000,000
Kamakani Ikaika, Inc. (Kamaoa Wind Energy Partners)	930,000
Kawaihae Cogeneration Partners	50,000,000
Magnetics Research International Corp. of Hawaii	10,000,000
Mauna Kea Power Company	15,000,000
Olokele Sugar Company	10,000,000
Puna Geothermal Venture	12,500,000
Sand Island Business Association	25,000,000
Wailuku River Hydroelectric Power Company, Inc.	6,000,000
Waimana Enterprises, Inc.	10,000,000
Zions Securities Corporation	8,000,000
Processing enterprises:	
Hawaiian Development Company	10,000,000
Hawaiian Entrepreneurs	5,000,000
Manufacturing enterprises:	
Elexs, Ltd.	15,000,000
Energy Conversion Devices, Inc. & Chronar Corporation	30,000,000
Hawaiian Sun Products, Inc.	8,000,000
Total special purpose revenue bonds, authorized but unissued	$ 827,315,000

Lease commitments

The department leases equipment, as provided for in a lease agreement expiring in 1994, which has been accounted for as a capital lease. Minimum future payment under the lease is $19,777 (including interest of $172) for the year ending June 30, 1994.

Litigation

The department has been named as a defendant in lawsuits arising in the normal course of operations. These lawsuits may possibly result in adverse judgments against the state; however, the claim amounts cannot be reasonably estimated at this time. In the opinion of the State Attorney General, however, these cases will be defended vigorously, and the outcome of all litigation against the department will not have a material adverse effect on the department's financial position.

EXHIBIT A

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 1993

	Governmental Fund Types		Fiduciary Fund Type	Account Groups		
ASSETS	General	Special Revenue	Trust and Agency	General Fixed Assets (Unaudited)	General Long-Term Debt	Total (Memorandum Only)
Cash and short-term investments:						
Cash on hand	$ 7,175		$ 212,763			$ 219,938
Cash in banks including certificates of deposit	5,878,563	$2,621,606	328,916,485			337,416,654
Cash with fiscal agents			104,211,618			104,211,618;
Cash in U.S. Treasury			328,896,932			328,896,932
Investments:						
U.S. Treasury securities			593,144,195			593,144,195
Repurchase agreements			2,515,805,719			2,515,805,719
Interest receivable			9,302,717			9,302,717
Notes receivable		10,015				10,015
Due from other State agencies		89,876				89,876
Fixed assets - furniture and equipment				$25,624,204		25,624,204
Amount to be provided for the retirement of general long-term obligations					$2,784,783	2,784,783
TOTAL	$5,885,738	$2,721,497	$3,880,490,429	$25,624,204	$2,784,783	$3,917,506,651

EXHIBIT A (Continued)

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS (Continued)
JUNE 30, 1993

LIABILITIES, FUND EQUITY AND OTHER CREDIT	Governmental Fund Types		Fiduciary Fund Type	Account Groups		Total (Memorandum Only)
	General	Special Revenue	Trust and Agency	General Fixed Assets (Unaudited)	General Long-Term Debt	
LIABILITIES:						
Vouchers payable	$2,685,457	$ 150,344				$ 2,835,801
Accrued payroll	46,582					46,582
Due to other State agencies			$3,858,336,526			3,858,336,526
Due to State General Fund	7,175					7,175
Capital lease obligation					$ 19,605	19,605
Accrued vacation payable					2,765,178	2,765,178
Total liabilities	2,739,214	150,344	3,858,336,526		2,784,783	3,864,010,867
FUND EQUITY AND OTHER CREDIT:						
Investment in general fixed assets				$25,624,204		25,624,204
Fund balances:						
Reserved for encumbrances	3,146,524	92,145				3,238,669
Reserved for compound interest bonds			21,831,215			21,831,215
Reserved for refunding bond costs			293,688			293,688
Reserved for special purpose revenue bond issues			29,000			29,000
Reserved for notes receivable		10,015				10,015
Unreserved		2,468,993				2,468,993
Total fund equity and other credit	3,146,524	2,571,153	22,153,903	25,624,204		53,495,784
TOTAL	$5,885,738	$2,721,497	$3,880,490,429	$25,624,204	$2,784,783	$3,917,506,651

See accompanying notes to combined financial statements.

EXHIBIT B

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND EQUITY - ALL GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS YEAR ENDED JUNE 30, 1993

	Governmental Fund Types		Fiduciary Fund Type	
	General	Special Revenue	Expendable Trust	Total (Memorandum Only)
REVENUES:				
State appropriations	$623,612,395	$194,818,435		$ 818,430,830
Intergovernmental and other revenues		2,162,455	$ 1,208,605	3,371,060
Total revenues	623,612,395	196,980,890	1,208,605	821,801,890
EXPENDITURES:				
Personal services	12,098,273	690,882		12,789,155
Other	457,283,151	131,789,314		589,072,465
Total expenditures	469,381,424	132,480,196		601,861,620
EXCESS OF REVENUES OVER EXPENDITURES	154,230,971	64,500,694	1,208,605	219,940,270
OTHER FINANCING SOURCES (USES):				
Operating transfer in			5,000,000	5,000,000
Operating transfers out	(66,737,492)	(12,156,107)	(241,711)	(79,135,310)
Lapsed appropriations	(90,120,715)	(52,501,723)		(142,622,438)
Total other financing sources (uses)	(156,858,207)	(64,657,830)	4,758,289	(216,757,748)
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	(2,627,236)	(157,136)	5,966,894	3,182,522
FUND EQUITY, JULY 1, 1992 (Unaudited)	5,773,760	2,728,289	16,187,009	24,689,058
FUND EQUITY, JUNE 30, 1993	$ 3,146,524	$ 2,571,153	$22,153,903	$ 27,871,580

See accompanying notes to combined financial statements.

EXHIBIT C

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND OTHER FINANCING USES - BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL AND SPECIAL REVENUE FUNDS
YEAR ENDED JUNE 30, 1993

	General Fund			Special Revenue Funds		
	Budget	Actual on a Budgetary Basis	Variance - Favorable (Unfavorable)	Budget	Actual on a Budgetary Basis	Variance - Favorable (Unfavorable)
REVENUES:						
State appropriations	$623,612,395	$623,612,395	$ -	$201,073,435	$194,818,435	$ (6,255,000)
Intergovernmental and other revenues			-	3,564,603	2,340,436	(1,224,167)
Total revenues	623,612,395	623,612,395	-	204,638,038	197,158,871	(7,479,167)
EXPENDITURES:						
Personal services	12,902,351	12,098,318	804,033	1,752,033	690,882	1,061,151
Other	532,195,344	455,949,785	76,245,559	188,318,095	131,121,923	57,196,172
Total expenditures	545,097,695	468,048,103	77,049,592	190,070,128	131,812,805	58,257,323
EXCESS OF REVENUES OVER EXPENDITURES	78,514,700	155,564,292	77,049,592	14,567,910	65,346,066	50,778,156
OTHER FINANCING USES:						
Operating transfers out	(78,514,700)	(66,737,492)	11,777,208	(14,567,910)	(12,071,712)	2,496,198
Lapsed appropriations		(90,120,715)	(90,120,715)		(52,501,723)	(52,501,723)
Total other financing uses	(78,514,700)	(156,858,207)	(78,343,507)	(14,567,910)	(64,573,435)	(50,005,525)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES AND OTHER FINANCING USES	$ -	$ (1,293,915)	$ (1,293,915)	$ -	$ 772,631	$ 772,631

See accompanying notes to combined financial statements.

SCHEDULE I

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINING BALANCE SHEET - SPECIAL REVENUE FUNDS
JUNE 30, 1993

	Electronic Data Processing Services Fund	Telecom-munications Fund	OHA Bond Fund	Other Funds	Total
ASSETS					
Cash in banks including certificates of deposit	$2,038,176	$413,299	$139,531	$30,600	$2,621,606
Notes receivable				10,015	10,015
Due from other State agencies	46,442	43,434			89,876
TOTAL	$2,084,618	$456,733	$139,531	$40,615	$2,721,497
LIABILITIES AND FUND EQUITY					
Liabilities - vouchers payable	$ 41,344	$109,000			$ 150,344
Fund Equity:					
Reserved for encumbrances	92,145				92,145
Reserved for notes receivable				$10,015	10,015
Unreserved	1,951,129	347,733	$139,531	30,600	2,468,993
Total fund equity	2,043,274	347,733	139,531	40,615	2,571,153
TOTAL	$2,084,618	$456,733	$139,531	$40,615	$2,721,497

SCHEDULE II

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND EQUITY - SPECIAL REVENUE FUNDS YEAR ENDED JUNE 30, 1993

	Electronic Data Processing Services Fund	Telecommunications Fund	Collective Bargaining Fund	Mass Transit Fund	OHA Bond Fund	Other Funds	Total
REVENUES:							
State appropriations			$14,567,910	$50,000,000	$130,245,000	$ 5,525	$194,818,435
Intergovernmental and other revenues	$1,010,651	$1,147,071				4,733	2,162,455
Total revenues	1,010,651	1,147,071	14,567,910	50,000,000	130,245,000	10,258	196,980,890
EXPENDITURES:							
Personal services	690,882						690,882
Other	558,392	1,124,140			130,105,469	1,313	131,789,314
Total expenditures	1,249,274	1,124,140			130,105,469	1,313	132,480,196
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(238,623)	22,931	14,567,910	50,000,000	139,531	8,945	64,500,694
OTHER FINANCING USES:							
Operating transfers out			(12,071,712)			(84,395)	(12,156,107)
Lapsed appropriations			(2,496,198)	(50,000,000)		(5,525)	(52,501,723)
Total other financing uses			(14,567,910)	(50,000,000)		(89,920)	(64,657,830)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES AND OTHER FINANCING USES	(238,623)	22,931			139,531	(80,975)	(157,136)
FUND EQUITY, JULY 1, 1992 (Unaudited)	2,281,897	314,802				121,590	2,728,289
FUND EQUITY, JUNE 30, 1993	$2,043,274	$ 347,733	$ -	$ -	$ 139,531	$ 40,615	$ 2,571,153

SCHEDULE III

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINING BALANCE SHEET - TRUST AND AGENCY FUNDS
JUNE 30, 1993

	Expendable Trust Funds			Agency Funds			
	Compound Interest Bond Reserve Fund	Refunding Bond Proceeds Fund	Special Purpose Revenue Bond Fund	Cash and Investments in State Treasury	Land Grant College Aid Fund	Temporary Deposits and Other	Total
ASSETS							
Cash and short-term investments:							
Cash on hand				$ 212,763			$ 212,763
Cash in banks including certificates of deposit	$11,119,090	$293,688	$29,000	317,363,663	$ 7,369	$103,675	328,916,485
Cash with fiscal agents				104,211,618			104,211,618
Cash in U.S. Treasury				328,896,932			328,896,932
Investments:							
U.S. Treasury securities	10,551,200			577,200,364	5,392,631		593,144,195
Repurchase agreements				2,515,805,719			2,515,805,719
Interest receivable	160,925			9,141,792			9,302,717
TOTAL	$21,831,215	$293,688	$29,000	$3,852,832,851	$5,400,000	$103,675	$3,880,490,429
LIABILITIES AND FUND EQUITY							
Liabilities - due to other State agencies				$3,852,832,851	$5,400,000	$103,675	$3,858,336,526
Fund equity:							
Reserved for compound interest bonds	$21,831,215						21,831,215
Reserved for refunding bond costs		$293,688					293,688
Reserved for special purpose revenue bond issues			$29,000				29,000
Total fund equity	21,831,215	293,688	29,000				22,153,903
TOTAL	$21,831,215	$293,688	$29,000	$3,852,832,851	$5,400,000	$103,675	$3,880,490,429

SCHEDULE IV

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND EQUITY - EXPENDABLE TRUST FUNDS
YEAR ENDED JUNE 30, 1993

	Compound Interest Bond Reserve Fund	Refunding Bond Proceeds Fund	Special Purpose Revenue Bond Fund	Total
REVENUES - Other	$ 906,917	$ 293,688	$ 8,000	$ 1,208,605
EXPENDITURES				
EXCESS OF REVENUES OVER EXPENDITURES	906,917	293,688	8,000	1,208,605
OTHER FINANCING SOURCES (USES):				
Operating transfer in	5,000,000			5,000,000
Operating transfers out		(241,711)		(241,711)
Total other financing sources (uses)	5,000,000	(241,711)		4,758,289
EXCESS OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	5,906,917	51,977	8,000	5,966,894
FUND EQUITY, JULY 1, 1992 (Unaudited)	15,924,298	241,711	21,000	16,187,009
FUND EQUITY, JUNE 30, 1993	$21,831,215	$ 293,688	$29,000	$22,153,903

STATE OF HAWAII, DEPARTMENT OF BUDGET AND FINANCE

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES - AGENCY FUNDS
YEAR ENDED JUNE 30, 1993

	Balance July 1, 1992 (Unaudited)	Additions	Deductions	Balance June 30, 1993
ASSETS				
Cash on hand	$ 188,837	$ 23,926		$ 212,763
Cash in banks including certificates of deposit:				
Cash in State Treasury	1,690,048,210		$1,372,684,547	317,363,663
Land Grant College Aid Fund	13,969		6,600	7,369
Temporary deposits and other	14,525	102,331	13,181	103,675
Cash with fiscal agents	49,575,998	54,635,620		104,211,618
Cash in U.S. Treasury	400,272,489		71,375,557	328,896,932
U.S. Treasury securities:				
Investments in State Treasury	792,683,358		215,482,994	577,200,364
Land Grant College Aid Fund	5,392,631			5,392,631
Repurchase Agreements - Investments in State Treasury	1,160,339,155	1,355,466,564		2,515,805,719
Interest receivable		9,141,792		9,141,792
TOTAL	$4,098,529,172	$1,419,370,233	$1,659,562,879	$3,858,336,526
LIABILITIES				
Due to other State agencies:				
Cash and investments in State Treasury	$4,093,108,047	$1,419,267,902	$1,659,543,098	$3,852,832,851
Land Grant College Aid Fund	5,406,600		6,600	5,400,000
Temporary deposits and other	14,525	102,331	13,181	103,675
TOTAL	$4,098,529,172	$1,419,370,233	$1,659,562,879	$3,858,336,526

Notes

Chapter 2

1. Hawaii, the Comptroller, State of Hawaii Department of Budget and Finance, Financial Administration Division, Independent Auditor's Report, June 30, 1992.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Budget and Finance on November 16, 1993. A copy of the transmittal letter is included as Attachment 1. The department's response is included as Attachment 2.

The department's response pointed out that it has a written policy for selection of underwriters and we have modified our report to reflect that. During the audit we were unable to verify that the evaluations of underwriters' proposals were formally documented. Subsequent to issuance of the draft we were provided with evidence of the documentation of evaluations and have also revised our report accordingly. The department also pointed out a correction to underwriting fee information it had provided us.

The department states that it is not industry practice to prepare formal evaluations of underwriters used for bond offerings and that it will have to look into the merits of such a process. We stand by our recommendation that services of underwriters should be formally evaluated. Evaluations should use criteria developed by the department, just as proposals for services are evaluated with criteria developed by the department.

The department did agree to seek an opinion from the Attorney General on its practice of depositing more than 60 percent of its cash with one bank. The department offered several reasons in defense of this practice. It also pointed out one computational error in developing average interest rates in Table 2.1. We corrected Table 2.1.

The department agreed with our recommendation to transfer excess funds held in special revenue accounts to the general fund, and has begun doing so. It also agrees that dealings with institutions could be tightened insofar as they concern advances to agents on behalf of trustees and the unauthorized release of securities by custodial banks. The department feels, however, that it has taken all prudent steps feasible to minimize the risk of loss of deposits with paying agents.

The department also agrees with our recommendations to review its collateral requirements for depositing the State's cash with financial institutions and to consistently enforce those requirements.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

November 16, 1993

COPY

The Honorable Yukio Takemoto
Director of Finance
Department of Budget and Finance
Hemmeter Building, 3rd Floor
Honolulu, Hawaii 96813

Dear Mr. Takemoto:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Department of Budget and Finance.* We ask that you telephone us by Thursday, November 18, 1993, 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 Tuesday, November 30, 1993.

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,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

JOHN WAIHEE
GOVERNOR

YUKIO TAKEMOTO
DIRECTOR
EUGENE S. IMAI
DEPUTY DIRECTOR
BARBARA KIM STANTON
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM
HAWAII INC
HAWAII PUBLIC EMPLOYEES HEALTH FUND
HOUSING FINANCE AND DEVELOPMENT CORPORATION
OFFICE OF THE PUBLIC DEFENDER
PUBLIC UTILITIES COMMISSION
RENTAL HOUSING TRUST FUND COMMISSION

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
INFORMATION AND COMMUNICATION SERVICES DIVISION

November 30, 1993

RECEIVED
NOV 30 4 17 PM '93
STATE OF HAWAII

Ms. Marion Higa
State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

Thank you for the opportunity to review and respond to the Financial Audit of the Department of Budget and Finance prepared by your office. We appreciate your observations and suggestions which will be invaluable in our continuous effort to improve our financial management program. We are pleased to note that the auditor has found the Department's financial internal control structure and operations to be in compliance with applicable laws and regulations. We do, however, need to point out certain omissions, corrections and matters of clarification regarding the findings of your report. We hope that our responses will be viewed as a constructive discussion toward addressing the findings of the audit. The comments which follow address the specific audit findings identified in Chapters 2 and 3 of the report.

<u>Selection Process for Underwriting Firms is Not Formalized</u>

We are encouraged that the request for proposal process the department has developed and uses to select underwriting firms for the State's bond business has been well received by the auditors and affirmed as a process worth continuing. Their findings acknowledge that the process has resulted in reduced underwriting fees and thereby, overall cost to the State. We note, however, that the specific recommendation on page 7 and the summary of findings on page 5 of the report regarding the selection process for underwriting firms <u>do not recognize that the department has written policies, procedures and criteria for the selection and appointment of underwriting firms for State bond issues.</u>

In fact, the Department's policies and procedures are explicitly expressed in the following: (1) a written policy document, dated December 19, 1991, which states that "[t]he selection of underwriters shall be based on the underwriter's financial ability to underwrite the issue, their distribution network and willingness to utilize other underwriters and/or selling groups to sell the bonds, cost of issuance, proposed maturity structure and debt service, commitment to the State's long term interest, their ability to interact with the State's personnel, the underwriter's personnel assigned to the bond transaction, and the underwriter's product capability to provide the State with a variety of options in structuring the bond sale"; and (2) the Department's request for proposal process, which requires underwriting firms to submit their qualifications and bond structuring proposals in response to specific areas of concern (excess net capital, experience and national ranking in tax-exempt underwriting work, marketing and distribution capability, gross spread, etc.). These areas of concern are then utilized as selection criteria in the evaluation of the proposals.

Contrary to the finding in the audit which states "we were unable to locate written documentation supporting the director's selection and appointment of firms," all selection and appointment of firms are evidenced by appointment letters, signed by the director, which formally establish the financing team (underwriting firm, bond counsel and paying agents, as required) for each issue. This requirement is reflected in the December 19, 1991 policy which includes a bond documents checklist which has been developed to assure that complete documentation for each issue is received and filed appropriately.

The audit additionally states that "[the] department has no formal documentation of the proposal evaluation and selection process." This is not true. Each request for proposal that has been issued has resulted in a written analysis and evaluation which has been submitted for the director's final approval prior to the appointment of financing team participants.

There are several significant points regarding the table of bond issues and underwriting fees on pages 13 through 16 of the report which require clarification. The listing does not accurately discuss the process and benefits of the State's current bond program. (1) The bonds issued for entities such as the Airports, the Housing Finance Development Corporation and the Hawaii Community Development Authority and the selection of firms to underwrite the bonds result from the entities' consultation and recommendations to the Department.

(2) The listing should point out the $154 million of savings realized by the State through the issuance of the bonds, against the corresponding $8 million paid in fees. The resultant savings is twenty times more than the fees incurred. While fees are paid to undertake the issue, it is a good investment and return on the money spent. Also, as a note of clarification, the representation of underwriting fees identified on page 6 and detailed in Table 2.2 does not accurately reflect fees realized solely by the underwriter of the issue. Payment of fees to other entities, for example, to the Public Service Association (PSA) and the Municipal Securities Rulemaking Board (MSRP) for the registration of each bond issue; to CUSIP to register each individual bond of the issue; for the use of federal funds; for underwriter's legal counsel; and for co-managers and other firms in the selling group; are netted out of the total underwriting fees. Direct underwriting compensation ranges from 50% - 82% of the total fees, depending on the size and complexity of the issue. Additionally, the underwriting fee for the December 3, 1991 airport revenue bond issue was $4,384,000 or $10.96 per bond and not $6,709,000 or $16.773 per bond as noted on page 14.

We acknowledge that we do not undertake an evaluation of the performance of the financing team at the conclusion of each bond sale. In principle, such an evaluation appears to be reasonable, and we understand that the auditor's office performs this sort of evaluation at the end of each of its audits. However, since it is not a standard industry practice, we will need to look into the merit and value of establishing such a process for the bond program.

Allocation of State's Deposits May Not Be In Compliance With Law

Chapter 38-2, HRS, provides that no more than 60% of State Treasury deposits may be deposited in any one depository, unless the depository offers yields that are greater than those offered by other depositories. The Department acknowledges the fact that more than 60% of Treasury funds are deposited in one depository, Bank of Hawaii. However, we believe that we are complying with the statutes as a result of the following:

1. The Bank of Hawaii is offering the State a yield significantly greater than the yield offered by the other local depositories, and

2. Section 38-2(d), HRS, encourages the use of depositories within the State.

The Bank of Hawaii developed a new repurchase agreement in October of 1992, that yields to the State 103% of the interest rate of a U.S. Treasury security or a certificate of deposit, whichever is higher. This means that at a minimum, the State will receive 10 basis points (.10%) more than the highest rate offered by other depositories. As of June 30, 1993, the amount of deposits in Bank of Hawaii in excess of 60% yielded additional annual interest of $569,000 over and above what other depositories have offered. We consider this premium in yield significant, more so, in a stagnant economy and low interest rate environment.

(We would like to note a correction in Table 2.1, SUMMARY OF AVERAGE INTEREST RATES. The table reflects identical interest rates for Bank of Hawaii and Central Pacific Bank as of December 31, 1992. The average interest rate for State investments with Central Pacific Bank as of December 31, 1992 was 2.8715 percent and not 3.3571 percent as reflected in the table.)

During the past year, other depositories were unwilling to pledge the additional securities required to collateralize the deposits. The Bank of Hawaii is the only local depository that is willing to accept the additional deposits under the current collateral requirements in addition to providing a higher yield. The audit report recommends that the Department request an opinion from the Attorney General regarding the practice of depositing more than 60% of available Treasury funds with one depository. We will initiate the request for such an opinion.

Anticipating that the Department may need to deposit funds out-of-State, we are exploring the feasibility of investing Treasury funds out-of-State to relieve the problem of concentrating an excessive amount of State deposits with a single depository. However, our inquiry with out-of-State financial institutions has indicated that the Hawaii financial institutions are offering a higher yield. In order to attract a higher yield from financial institutions out-of-State, we will probably need to re-examine our collateral policies.

Excess Funds Are Collected in Special Revenue Accounts

The auditors have recommended that the Department transfer the balances in the special fund accounts of the Information and Communications Services Division to the State's General Fund.

We concur with the finding and recommendation regarding the transfer of excess balances in the Inter-departmental Transfer special fund accounts of the Information and Communication Services Division to the General Fund. For your information, $2,221,686 in excess funds has already been transferred to the General Fund as of July 31, 1993, and the excess balance of $28,644 was transferred on September 10, 1993. Further, procedures will be developed to insure that fund balances of these accounts are reviewed at the end of each fiscal year and excess funds are transferred to the General Fund.

Dealings With Institutions Should Be Tightened

The auditors have noted three specific internal control exceptions in this area. The exceptions are addressed separately as follows:

a. Deposits with Paying Agents are not Collateralized

The audit report recommends that the State consider collateralization of deposits with paying agents to adequately protect those funds.

While we agree that collateralization of deposits with paying agents would provide protection against loss of funds, we note the following:

1. Sections 39-13 and 39-68, HRS, specifically exempt moneys deposited with paying agents from collateralization.

2. The prevailing practice among financial institutions serving as paying agents is that no collaterals are pledged to secure debt service funds.

3. The Director of Finance has taken other measures to secure the deposits of debt service funds deposited with paying agents.

The Director of Finance has taken precautions to appoint paying agents which are highly qualified and maintain an excellent credit rating with the two nationally recognized rating agencies, Standard and Poor's and Moody's Investors Service. The following three financial institutions that serve as paying agents for over 90% of the State's debt service funds enjoy strong credit rating and are among the ten largest banks in the United States:

Bank of America
Chemical Bank
Bankers Trust

Further, the registrar and paying agency agreements entered into by the State generally provide that the funds held by the paying agents are trust funds for the benefit of the bondholders. Also, the agreements provide that the State shall be indemnified for misapplication of such funds by the paying agents.

b. Advances are Made to Agents on Behalf of Trustees

To insure that the bondholders receive their interest payments on a timely basis, the Department has advanced funds to the paying agents on behalf of the trustees.

The auditors have recommended that we avoid the practice of advancing debt service funds by developing investing strategies that will make the funds available at the appropriate times. We will be reviewing our current practice of advancing debt service funds with a view toward maximizing the investment opportunity of those funds.

We note that to mitigate the loss in investment revenues, the Department has been able to arrange for two of the paying agents to pay the State interest on the advances. We are also negotiating with the other paying agents who are not paying interest on our advances to develop other compensating arrangements.

c. Unauthorized Release of Securities made by Custodial Banks

The "Agreement for Safekeeping of Securities Deposited to Protect Deposits of Funds of the State of Hawaii" requires the authorization of the Director of Finance before any collateral security may be released to the depository. The audit report cited two instances when the custodial bank released securities without the Director of Finance's approval.

We have immediately contacted both custodial banks about the release of the securities without proper authorization from the Director of Finance. We have received their assurances that measures have been taken so that those occurrences should not happen again. Steps will be taken to regularly monitor pledged securities against unauthorized release.

Collateral Requirements Should Be Reviewed

a. Inconsistent Enforcement of the Policy

The audit report identifies occasions when the collateral policy was not enforced by the Department.

Section 38-3, HRS, requires depositories to pledge securities as collateral for State deposits valued at market value but not to exceed its par value. Due to the difficulty of monitoring the adequacy of the collateral, the Department has adopted an administrative policy to value the collateral at a reduced percentage of the par value to ensure collateral adequacy. All mortgaged-backed "pass-through" federal securities are valued at 70% of par value and all other collateral securities are valued at 91% of par value.

The Department's policy was established to ensure compliance with the statutory requirements of Section 38-3, HRS. Adherence to the policy relies significantly on the institutions themselves. However, we feel that the policy (over 100% collateralization) provides us with the safety margin required to ensure compliance with the statutory requirement of Section 38-3, HRS.

The auditors' observation is well taken and we will review our management of collateral requirements to assure compliance with the Department's policies.

b. Restrictive Collateral Requirement

The report claims that the collateral policy established by the Department may be overly restrictive and that we should review the appropriateness of the Department's valuation standards.

While we have been very conservative with our collateral policy to satisfy our criteria of maintaining safety in the deposits of State funds, we appreciate the auditors' observation that we need to revisit this policy, in view of the improvements in banking regulations and the banking industry itself.

The Department is currently reviewing not only its valuation policy but also the requirement of Section 38-3, HRS, to determine the appropriate collateral securities required to protect the deposit of State funds. The type of acceptable securities as well as the valuation of the securities are being addressed in our evaluation of the State's collateral program.

Again, we would like to thank you for the opportunity to provide our comments on the audit report and to have worked with your auditors in examining our Department's procedures and practices. We feel the audit has resulted in positive observations and recommendations which will lead to continued improvements of the Department's operations.

Sincerely,

YUKIO TAKEMOTO
Director of Finance