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# Management and Financial Audit of the Department of Hawaiian Home Lands

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

Report No. 93-22  
December 1993



**THE AUDITOR**  
STATE OF HAWAII

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## The Office of the Auditor

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

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

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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



## THE AUDITOR STATE OF HAWAII

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# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Management and Financial Audit of the Department of Hawaiian Home Lands

### Summary

The Legislature requested this audit of the Department of Hawaiian Home Land's (DHHL) to determine its progress in meeting its mission to manage the Hawaiian home lands trust effectively and to develop and deliver land to native Hawaiians.

DHHL is responsible for carrying out the Hawaiian Homes Commission Act of 1920 that was enacted by Congress to benefit native Hawaiians. DHHL is headed by an executive board, the Hawaiian Homes Commission. The chair of the commission is also the director of the department. The mission of both the department and commission is to administer Hawaiian home lands for the benefit of native Hawaiians, primarily through homestead awards.

We found that the department is far from fulfilling this purpose. The majority of beneficiaries are still waiting to receive their homestead. Since it was established over 70 years ago, DHHL has awarded less than 6,000 homesteads. As the executive board heading DHHL, the Hawaiian Homes Commission has a significant responsibility to direct and hold the department accountable. The commission, however, has yet to assert its authority and policymaking responsibilities.

The department lacks a current strategic plan to accomplish its mission. DHHL is weakened by the lack of written policies and plans to direct its programs. Long-standing problems with records management and security are just beginning to be addressed.

The failure of the commission and department to assume their appropriate responsibilities has also led to ineffective delinquent loan collections. DHHL's collection policy is not enforced and commission orders have not been followed. In addition, the department's loan guarantees are not in compliance with the law. DHHL continues to guarantee loans even though it has exceeded the statutory limit by more than \$5.8 million.

### Recommendations and Response

To exercise stronger leadership, we recommend that the Hawaiian Homes Commission clarify its authority, establish a committee structure to address important policy issues, and ensure that the department's programs receive

systematic review, evaluation and input from the commission. The chair should compile the commission's policy decisions. We recommend that the director of the department follow through with the development of a comprehensive strategic plan, and give priority to developing a management system for recordkeeping. In addition, the commission and department should work together to support delinquent loan collections. The department should refrain from guaranteeing additional loans until the balance falls within statutory limits. The department should also accurately record its cash on deposit with FHA.

The chair agreed with our recommendations to compile the commission's policy decisions. She disagreed with the recommendations on establishing oversight authority and a committee structure for the commission. The chair agreed with the recommendation to prioritize records management practices. The chair says that the department does not have a written strategic plan but it does have strategic planning efforts. In our exit conference, the department informed us that it planned to present a strategic plan to the commission in January.

The chair agrees with our recommendation to support the department's loan collection procedures. However, she disagreed that the department has exceeded the statutory limit on contingent liability. She also disagreed that its cash deposit with FHA is not properly recorded.

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Submitted by

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STATE OF HAWAII

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## Foreword

This report was prepared in response to Act 289, the General Appropriations Act of 1993, which directed the auditor to conduct a management and financial audit of the Department of Hawaiian Home Lands.

The department has its origins in the Hawaiian Homes Commission Act of 1920. The mission of the department is to develop and deliver Hawaiian home lands to native Hawaiians. The Legislature requested this audit to better understand the department's programs.

We wish to acknowledge the cooperation and assistance extended to us by the Hawaiian Homes Commission, the Department of Hawaiian Home Lands, and others whom we contacted during the course of the audit.

Marion M. Higa  
State Auditor



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# Chapter 1

## Introduction

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In Act 289, the 1993 Legislature requested the State Auditor to perform a management and financial audit of the Department of Hawaiian Home Lands. The department has its origins in the Hawaiian Homes Commission Act of 1920 (hereafter referred to as the 1920 Act) enacted by Congress to protect and improve the lives of native Hawaiians. The 1920 Act created a Hawaiian Homes Commission to administer certain public lands, called Hawaiian home lands, for homesteads. The purpose of the act was to:

Enable native Hawaiians to return to their lands in order to fully support self-sufficiency...self-determination...and the preservation of the values, traditions, and culture of native Hawaiians.<sup>1</sup>

The 1920 Act was incorporated as a provision in the State Constitution in 1959 when Hawaii was granted statehood. Responsibility for the commission and the Hawaiian home lands was transferred to the State. Under the 1959 State Government Reorganization Act, the powers of the commission were transferred to the newly created Department of Hawaiian Home Lands (DHHL). Except for provisions that increase benefits to lessees, or relate to administration of the 1920 Act, however, the law can be amended only with the consent of Congress.

Today, DHHL manages approximately 187,413 acres of land on the islands of Hawaii, Kauai, Maui, Molokai, and Oahu. The department's clientele are native Hawaiians who have at least 50 percent Hawaiian blood. In accordance with the 1920 Act, DHHL leases homesteads up to 199 years for an annual rental fee of one dollar. The department is also authorized to lease land and to issue revocable permits, licenses and rights-of-entry for lands, not in homestead use, to any individual, as well as public or private entities.

As of June 30, 1993, the department has awarded 5,968 homestead leases. The department, however, has about 24,683 applications for homestead leases. Some applicants have been on the waiting lists for over 20 years. Between fiscal years 1985 and 1987, DHHL initiated an accelerated awards program that granted over 2,500 leases. Since then, it has awarded an average of 67 new homestead leases per year. The Legislature requested this audit in 1993, requiring the State Auditor to conduct a management and financial audit of the Department of Hawaiian Home Lands in an effort to better understand the department's programs.

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## Objectives of the Audit

The objectives of this audit were to:

1. Determine whether the functions, roles and responsibilities of the Hawaiian Homes Commission provide direction and oversight for the Department of Hawaiian Home Lands.
2. Assess the effectiveness of DHHL's strategic plans to accomplish its mission and carry out its responsibility as caretaker of the Hawaiian Home Lands trust.
3. Evaluate the adequacy and security of DHHL's recordkeeping processes and systems.
4. Determine the adequacy of DHHL's internal control structure in safeguarding assets, including its investment practices; its loan collection procedures; and the proper recording and reporting of cash on deposit with fiscal agents, U.S. Department of Housing and Urban Development, or other parties.
5. Determine the adequacy, effectiveness and efficiency of the financial accounting system in reporting the financial activity of DHHL funds.
6. Determine whether expenditures, transfers, and other disbursements are in accordance with the proper use of DHHL funds as prescribed by statute, appropriations acts, or other authority.

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## Scope and Methodology

We reviewed the mission, organization, operations, and management of the commission and DHHL. We examined the relationship between the commission and the department and attended the July 1993 commission meeting. We also reviewed the department's management of programs, such as its homestead awards program, and its records, accounting, and database systems. We reviewed its operations in Honolulu and its district offices on the neighbor islands. Our review focused on DHHL activities from 1991 to the present.

We interviewed commission members, DHHL management and staff, and representatives of homestead associations. We reviewed and analyzed DHHL's strategic and long-term plans, reports, commission minutes, policy and procedures manuals, and program files. We also documented relevant laws, rules, and functional statements.

To assess DHHL's controls over assets, we reviewed financial and compliance audits, management letters, agreements, funding sources, and budget documents. We interviewed DHHL's fiscal officer and staff and examined its accounting system and recordkeeping processes.

We did not test the program data provided by the department. Our work was performed from June 1993 to October 1993 in accordance with generally accepted government auditing standards.



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# Chapter 2

## Findings and Recommendations

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The efforts of the Department of Hawaiian Home Lands (DHHL) to return native Hawaiians to the land have been reviewed in several reports and audits over the past decade. However, the department's management and financial practices for accomplishing its mission and fulfilling its trust responsibilities continue to be of concern to the Legislature. In this chapter, we examine these practices.

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### Summary of Findings

Both the Hawaiian Homes Commission and the Department of Hawaiian Home Lands have not effectively carried out their respective responsibilities under the Hawaiian Homes Commission Act of 1920 to return native Hawaiians to the land.

1. The commission has not given sufficient policy direction to guide the department, and it has not exercised the necessary oversight to hold the department accountable for its programs.
2. The Department of Hawaiian Home Lands is weakened by the lack of written policies and formal plans to direct its programs. In addition, the department has not developed effective management systems to properly implement and manage its programs. Of particular concern is the department's poor management of records and beneficiary files.
3. The inadequacies of the commission and the department are well illustrated by the department's poor collection on delinquent loans.
4. The department has assumed a potential liability that exceeds the limit permitted by statute.
5. DHHL's cash deposit with the Federal Housing Administration is not properly recorded.

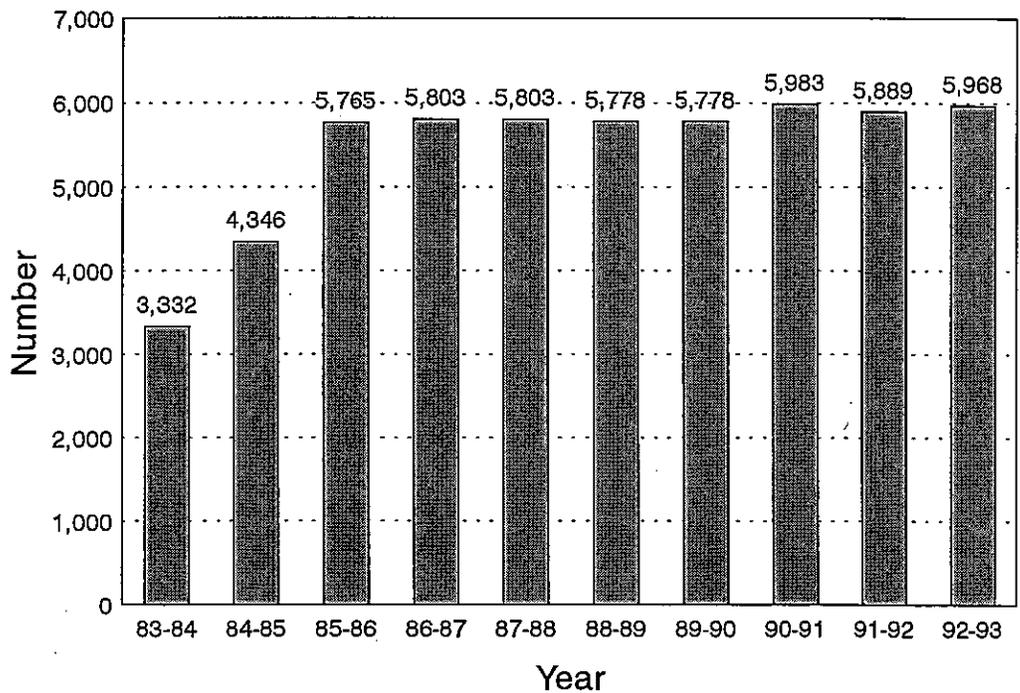
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### Majority of Beneficiaries Are Still Waiting

The mission of both the commission and the department is to administer Hawaiian home lands for the benefit of native Hawaiians. The purpose is to improve the self-sufficiency of native Hawaiians by providing them with land. The commission and the department are far from fulfilling this purpose.

The department has awarded a total of only 5,968 homestead leases since it was established over 70 years ago (see Exhibit 2.1). It currently has 24,683 applications on its waiting lists (see Exhibit 2.2). The growth in the number of applications has far outpaced the number of awards given. The number of occupied leases is actually even less than the reported total of 5,968 homestead leases. As of June 30, 1993, 1,596 leases remain unimproved raw land where currently housing cannot be built.

**Exhibit 2.1  
Homestead Lease Awards  
Cumulative Totals FY84-FY93**

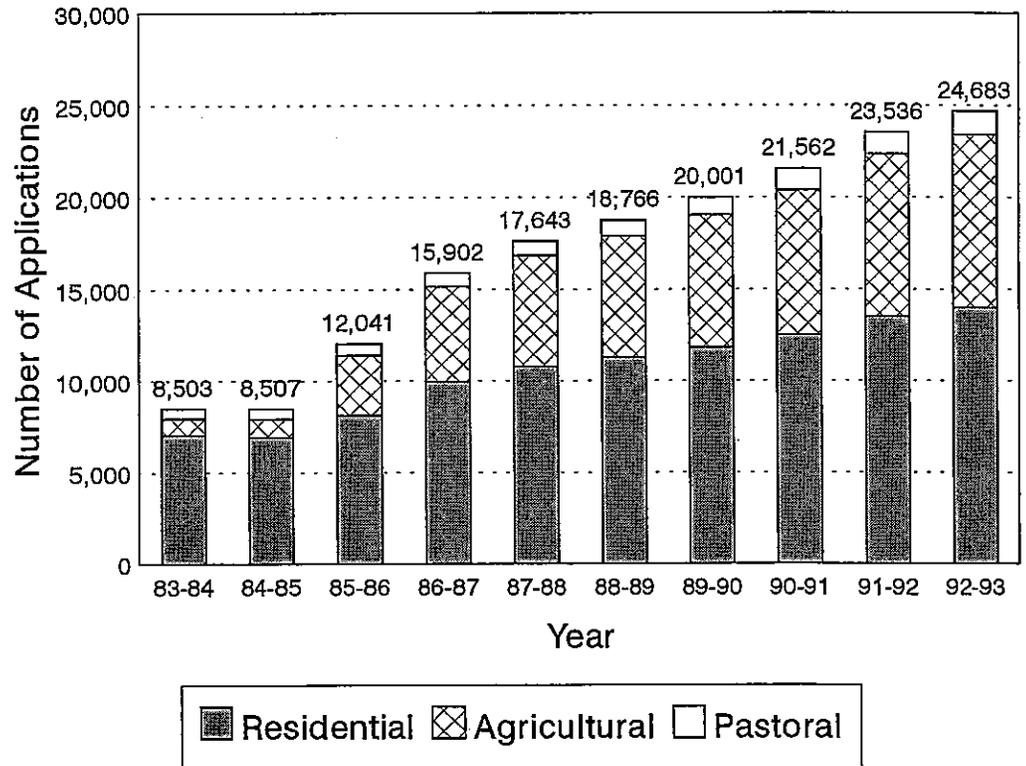


Totals include residential, pastoral, and agricultural homestead leases.

Note: According to DHHL, variances in homestead lease totals can be attributed to the following: 1) re-awards, 2) lease cancellations, 3) rescissions, 4) voluntary surrenders, and 5) new awards.

Source: DHHL annual reports (FY84-FY92), and FY93 Homestead Lease Report.

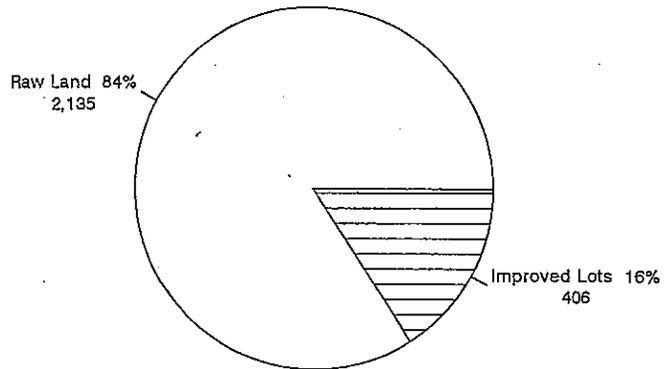
### Exhibit 2.2 Homestead Applications Cumulative Totals FY84-FY93



Source: DHHL annual reports (FY84-FY92), and FY93 homestead applications totals.

The 5,968 number includes homesteads awarded under the department's accelerated awards program. In response to pressure from beneficiaries, as well as specific recommendations from the 1983 Federal-State Task Force, the department launched an accelerated awards program that awarded 2,541 homesteads between fiscal years 1985 and 1987. But most of these homesteads were raw, unimproved lots without infrastructure. Only 16 percent were lots that could be used for housing (see Exhibit 2.3). Today, almost ten years later, 63 percent of these awards remain as raw land that is unavailable for housing. Only 945 lots have been improved, and only about 300 of the 945 homesteads have houses built on them.

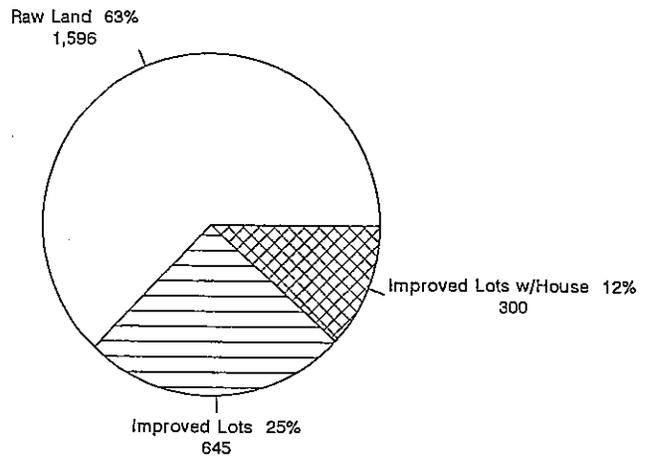
**Exhibit 2.3  
Accelerated Awards Program  
Status at Time of Award  
(Total Lots Awarded = 2,541)**



Raw Land = 2,135 Lots  
Improved Lots = 406 Lots

Source: HHC minutes and Office of the Governor, *An Action Plan to Address Controversies Under the Hawaiian Land Trust and the Public Land Trust*, January 1991.

**Accelerated Awards Program  
Status as of 06/30/93  
(Total Lots Awarded = 2,541)**



Raw Land = 1,596 Lots  
Improved Lots = 645 Lots  
Improved Lots w/House = 300 Lots

Source: HHC minutes, DHHL Development Activity Report, and Completed Houses on Hawaiian Home Lands Report

The accelerated awards program raised false expectations and hopes. Today, its legacy is an obligation for infrastructure improvements which will consume a substantial portion of DHHL revenues and energies for years to come.

The department has also pursued unrealistic goals and overstated the progress it has made to place waiting list applicants on homesteads. In 1991, DHHL established a goal to provide 14,000 housing units for native Hawaiian beneficiaries by the year 2000. The department set a short term goal of 700 completed homes by June 30, 1993, with an intermediate goal of 4,000 completed lots by 1994. The department will not be able to meet these goals. According to some in the department, a more realistic timeframe would be 20 or 30 years.

***Misleading reports of completed homes***

The department's reports are misleading because of its definition of new homes completed. According to DHHL, "completed homes" include: (1) actual homes completed, (2) home lots under construction, and (3) loans in process. According to DHHL, loans in process include raw lots without houses where homesteaders are waiting for interim construction loans. Including lots without homes in its report of completed homes misleads the public on the actual progress made for beneficiaries.

In testimony to the 1993 Legislature, DHHL reported that it would complete the building of 700 housing units by June 30, 1993. It was difficult to get accurate data from the department, but our analysis of completed home sites indicates that only 408 homes were actually built. DHHL should restrict its definition of completed new homes to those that are ready for occupancy and accurately report this number to the Legislature and public.

The outlook for beneficiaries continues to be poor unless the commission takes the necessary steps to assume leadership. The commission must make the necessary policy decisions that would direct the department's programs and hold the department accountable for their outcomes. As trustees for the Hawaiian home lands, the commissioners must ensure that the department's programs do indeed operate in the interests of the beneficiaries.

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**The Commission Must Assume Leadership**

As the executive board heading the Department of Hawaiian Home Lands and, as trustees of the Hawaiian home lands trust, the commission has a significant responsibility to direct and hold the department accountable. We find that the commission has yet to assert its authority and policymaking responsibilities.

The nine members of the commission are appointed by the governor with the consent of the Senate and serve on an unpaid, volunteer basis. The governor also appoints the chair of the commission who also serves as full-time, paid director of the department. According to department functional statements, the commission is responsible for *establishing policies* to guide departmental programs and activities. The department is responsible for *implementing and managing* programs in accordance with the policies established by the commission.

We find that the commission has not asserted its authority to set policy for the department and consequently, is unable to exercise appropriate oversight of the department's programs. It has not systematically reviewed DHHL initiatives to help native Hawaiian beneficiaries.

***Commission authority  
not established***

It is incumbent upon the commission to establish its authority as the executive board heading the department. It is particularly important that the commissioners identify and recognize their leadership responsibilities over the department. Because the chair heads both the commission and the department, the commission must establish and assert itself as the executive board.

As chair of the commission as well as the director of the department, the chair's two responsibilities may not always be in agreement. As commission chair, she is responsible for developing and making policy decisions with her fellow commissioners. Her responsibilities as a trustee also requires oversight of the department. As the director of the department, she is responsible for managing its programs so that they meet the commission's objectives. The chair currently has the difficult task of balancing and faithfully carrying out both responsibilities without any formalized checks and balances in place.

Commission members hold the current chair in high regard as a good leader. However, they need more support and written guidance if they are to assert their policy responsibilities as an executive board. The statutes creating the commission and the department's administrative rules offer little guidance. In addition, the commission has no manual or by-laws that govern its own operations.

***Written guidance  
needed***

We found all commissioners sincerely dedicated to serving the native Hawaiian beneficiaries. However, commissioners have few written documents to support their authority and guide them in setting policies and overseeing the department's programs.

The 1920 Hawaiian Homes Commission Act merely states that the commission may delegate to the chair such duties, powers, and authority as may be lawful or proper for performing the functions vested in the

commission. The department's administrative rules merely say that it is the desire of the commission to retain those duties requiring the exercise of judgment or discretion and to delegate administrative functions to the chair. Among the duties delegated to the chair are the power to preside over meetings of the commission, to approve and sign vouchers, to screen matters referred by staff and select items for consideration on the commission agenda, and to sign commission resolutions, licenses, leases, and contracts.

The department's administrative rules and functional statements also fail to clarify how the commission is to fulfill its trust responsibility for Hawaiian home lands. They are silent on the authority and oversight responsibilities of the commission and how it is to oversee the department's activities.

The commission's weakness is aggravated by the absence of any compilation of their policy decisions. Policy decisions, past and present, can be located only by examining the minutes of each commission meeting. The lack of a historical compilation of policy decisions hampers the ability of new commissioners to learn their responsibilities and obtain information on past initiatives. Newly appointed commissioners must rely on oral accounts of commission policies from other commissioners and department staff.

To be effective, commissioners must quickly familiarize themselves with their duties and those of the department. As a start, the department should prepare a manual for commissioners that they could use as a reference. For example, the Department of Commerce and Consumer Affairs has manuals for all members of its boards and commissions. The manual contains the relevant statutes (including statutes such as the Sunshine Law), administrative rules, standards of conduct, attorney general opinions, departmental organization and support services to board members, and information on rulemaking, hearings, travel and other commission activities. The manual could be used to orient new commissioners and familiarize them with the areas under their jurisdiction, their powers, and how the commission is organized to carry out its responsibilities.

### ***Policy decisions needed***

The department is badly in need of written policies that would establish a philosophical basis and direction for its programs. We reviewed commission minutes from June 30, 1992 to June 30, 1993 and found that the commission had not made important and basic policy decisions needed to guide the department. The governor has also questioned the lack of a clear plan and operating philosophy. At a July 1993 DHHL retreat, the governor noted that there is no clear philosophical basis for what DHHL is doing for native Hawaiian beneficiaries. He questioned whether DHHL was a welfare program or a trust for Hawaiians.

The commission spends most of its time on administrative matters, such as individual beneficiary claims and lease disputes. A review by a Federal-State Task Force in 1983 concluded that the commission should spend less time on "minutiae," and establish and articulate long term goals and priorities instead.<sup>1</sup> Without adequate written policies to guide action, the department spends much of its resources fighting daily fires. Policy decisions are badly needed on such issues as the following:

- Whether the department should be operated more like a business or a welfare program;
- Whether applicants who cannot qualify for mortgage loans should receive a homestead;
- Whether priority should be given to the most needy beneficiaries;
- What should be done to close the gap between the shortage of land for homesteads on Oahu and the demand for homesteads on Oahu; and
- The extent to which DHHL should be a developer given its limited resources.

The commission has monthly meetings, other special meetings, as well as meetings with homestead communities. However, without guiding policies, the commission is not structured to operate effectively. The commission has no subcommittees to address important policies or issues. It also lacks authority to set the agenda for these monthly meetings. In theory, the commission controls policy and exercises oversight when members review and vote on agenda items at monthly commission meetings. However, the agenda and access to information are restricted and controlled by the chair.

### ***Control of Agenda Restricted***

The chair and her deputy decide on the agenda that will be discussed at commission meetings. Several commissioners expressed serious concern over their inability to bring up new business or conduct discussions not listed on the agenda. One commissioner said that it is difficult to resolve matters when they are not discussed. Another commissioner stated that most of the commission's decisions are merely rubber stamp decisions.

Commissioners should consider reorganizing the commission to be more effective. It could establish standing committees that would set the agenda, so that important issues are discussed at commission meetings.

For example, an executive committee could work with the chair on the agenda. Committees on the budget, programs, and planning are other examples. The commission should also consider revising the administrative rules to clearly establish its authority for overseeing the Hawaiian home lands trust.

***No systematic review of programs or initiatives***

DHHL has initiated programs to place native Hawaiian beneficiaries on the Hawaiian home lands. The commission and the department have yet to systematically review or evaluate these beneficiary programs. For example, DHHL has awarded raw land, land with infrastructure, and lots with homes. Minutes of commission meetings during FY1992-93 show that it discussed individual projects but conducted no regular review or monitoring of the performance of the department's programs.

The commission is to be commended for its active interest in concerns raised by individual beneficiaries at commission meetings. However, we believe it needs to take a larger view and exercise more systematic oversight of the department's performance to ensure that the department's programs meet the needs of native Hawaiians.

Commissioners need more relevant information from the department on program performance to carry out their trust responsibilities. Systematic status reports on all of the department's programs would enable the commission to make better informed decisions and to ensure agency goals are met. The commissioners and the chair should determine the kinds of information and analysis they need from the department on a regular basis. Establishing a program committee would be an important step towards carrying out this initiative.

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**DHHL Lacks Appropriate Direction and Management**

The lack of direction and oversight from the commission has weakened the department. Strong management is based on a clear philosophy and mission for the organization, realistic goals to be achieved, reasonable strategies for accomplishing these goals, effective communication with staff, and systematic methods to monitor actions and outcomes.

In addition to the lack of a clearly stated philosophy the department also lacks a current strategic plan to accomplish its mission. Only when the commission has set a clear direction can the department then develop a strategic plan that would guide the design of programs to achieve its mission.

***No current strategic plan***

DHHL lacks a current strategic plan to guide its programs. Its last plan, the 1976 *General Plan*, is now outdated. The 1976 plan established land management goals, objectives, policies, and priorities. It presented

explicit priorities. At that time, the Hawaiian Homes Commission expressed a clear rationale and intent to attain the objectives set out in the plan. The 1976 plan called for a review every five years but the department has never reviewed or evaluated the plan.

Since then, many changes have occurred that the department should be addressing strategically. They include:

- Creation of the Office of Hawaiian Affairs in 1978;
- Recommendations of the 1983 Federal-State Task Force regarding the Hawaiian Homes Commission Act;
- Accelerated homestead awards made between FY1985 to FY1987;
- General fund appropriations for administration and operating expenses beginning in FY1989; and
- A settlement of \$9.7 million in 1992 for the wrongful use of Hawaiian home lands.

DHHL officials acknowledge the need for a strategic plan. They recently announced that the commission will be presented with a strategic plan in January. In the past, the department had developed planning initiatives and various reports. However, these were not strategic plans, although some could generate useful information that could be part of a future strategic plan. For example, in 1991 the department began a six-part study to identify and document all existing holdings of Hawaiian home lands and to assess the land use potential of all lands. At the time of our fieldwork, the study had yet to be completed.

### ***Good data lacking***

The department lacks the data needed to develop adequate plans and goals. For example, the department's goal to supply 14,000 homesteads by the year 2000 is based strictly on the number of beneficiaries on DHHL's waiting lists in 1989. The department's goal was not based on an assessment of housing needs for beneficiaries nor on the suitability of available lands for homesteads.

Currently, the department has 41 different waiting lists. The lists are differentiated by island, area, and type of homestead wanted—agricultural, pastoral, or residential. The department has not developed a written plan, timetables, objectives, or goals on how it will accomplish the 14,000 awards.

The department has plans to develop large master planned communities on Hawaii, Kauai, Maui, and Oahu. The department expects these 1,000 to 3,500 unit developments to contribute to the department's efforts to achieve the 14,000 goal. In view of the department's limited funding, however, the success of these projects is uncertain.

***Weak management oversight***

The department is centrally managed in Honolulu, with support offices on the islands of Hawaii, Kauai, Maui, and Molokai. The current director receives praise from fellow commissioners, administrators and homestead association representatives for her open and direct management style. The department would benefit, however, from stronger and more formal controls over program implementation and evaluation.

DHHL's policies and procedures manual for its staff needs to be organized and updated. Most communication between management and staff takes place verbally. The director conducts weekly meetings with division managers. The meetings are informal with no record of discussions. We found minimal staff reporting requirements and no formal monitoring of progress that would keep the director informed of departmental operations. Furthermore, management does not document its directives or decisions.

To effectively manage the department, the director should routinely receive written management information and analysis of departmental programs and activities. A continuous written record should be maintained of important directives, decisions, and milestones attained so that the commission, management and staff all clearly understand expectations and acknowledge accomplishments.

***Limited management controls over records***

The department lacks an adequate internal control system for its records. We found no policies, procedures, or any standard guidance for staff to follow in managing records. Thus the department has no system to protect the security and integrity of its records. According to one DHHL official, recordkeeping was not a priority of the department until recently.

The majority of DHHL records relate to applications for homesteads. The records have significant legal and confidential information, including beneficiaries' financial data and family history. Beneficiaries are required to verify their Hawaiian ancestry. We found little security and centralized accountability over these and other important DHHL records. Each division in the department varied in how it handled its important records.

### **Varying practices**

Without departmental policy and procedures, DHHL divisions vary in their methods for handling records, including original documents of significant importance to beneficiaries such as leases, loans, and applications. For example, several divisions maintained files on a numerical basis, while others maintained them alphabetically. Some locked their files, others did not. An agency official acknowledged the need for better and more standardized controls over department documents.

Each division has its own security procedures. Most divisions use a sign-in and -out card to track their files. However, the system was not always followed. In several instances we were unable to locate files that had not been signed out. In almost all divisions, original files, such as leases and loans, were neither locked in fire proof cabinets nor maintained in files that could be locked.

The Department of Accounting and General Services' Archives Division has established state standards for maintaining and protecting vital records. According to state archive standards, vital records must be protected because they are direct and original evidence of legal status, ownership, accounts receivable, and other obligations incurred by a government agency. The standards emphasize that vital records are irreplaceable, and in some cases must be kept in their original form for legal purposes.<sup>2</sup> However, at the time of our fieldwork, DHHL officials had not taken steps to duplicate or fire proof original files.

### **Poor controls over applications**

As of June 1993, DHHL applications for Hawaiian homesteads exceeded 24,000. The Homestead Services Division's Applications Branch processes all homestead applications. Each neighbor island district office collects and forwards applications to the Honolulu office. In reviewing the application process, we found that applications were not immediately recorded nor adequately secured.

The current process does not ensure protection or security over applications and the supporting documents. When an application is submitted to DHHL, it is time/date stamped at the district office or in the applications branch. The applications branch staff places it in a box until it is logged into DHHL's system on Fridays. When an application has been approved—which could take up to 30 days—the applications log sheet is forwarded and signed by both the Homestead Services Division and the department director.

Depending on the date of receipt, an application can remain in an unsecured box for up to seven days before it is officially recorded. The applications branch relies on student help to monitor the files. Applications were filed either on shelves or in boxes, neither of which are fire proof. The boxes were not secured from public access and were stacked on top of each other. One DHHL staff stated that the division uses boxes because of insufficient shelf space. Another staff acknowledged that the division has no way of knowing if a new application, waiting to be logged in, had lost any of its supporting documents. Several beneficiaries have said that their records have been lost by DHHL.

The department needs better management controls over all original documents such as beneficiary applications. It should log and secure documents such as applications immediately upon receipt. Without such controls, it cannot ensure protection or security over the confidential information in the records. In the event of a fire or theft, DHHL would not be able to replace vital beneficiary information.

### ***Problems of long-standing***

Recordkeeping is a problem that has plagued DHHL for more than a decade. Several independent audits have identified management weaknesses with DHHL's records system.

The 1983 Federal-State Task Force also reported weaknesses with the department's land records. The task force found that there was no central docket which recorded all data related to parcels of Hawaiian Home lands.<sup>3</sup> In both 1991 and 1992, an independent accounting firm hired by the department recommended that original loan and lease documents be filed at an off-site storage facility. The firm noted that storing documents off-site would prevent the loss of original records which document legal ownership of the department's assets. The firm also recommended that the department develop a policy to fire proof file cabinets and limit their access only to upper management.<sup>4</sup>

At the time of our fieldwork, DHHL was looking into off-site storage facilities but had not complied with the other recommendations.

### **Efforts to address weaknesses**

DHHL has taken steps to improve its recordkeeping. It established a records management task force to work with the State Archives in inventorying all agency documents, both originals and duplicates. The task force, composed of representatives from each agency division, will determine the importance of its records and develop a retention schedule using archive standards. According to an archives official, by taking an

inventory of its files, DHHL has taken the first step in organizing its records. However, the official noted that it will be a long time before an adequate management control system is in place.

In addition to working with the archives division, DHHL received a total of \$400,000 for fiscal years 1993-94 and 1994-95 from the 1993 Legislature to improve its management information system. An agency official said DHHL plans to upgrade its management information system to provide more timely information on beneficiary files and bring integrity to the application and lessee automated systems.

The need for improved management information systems is especially important to neighbor island offices. Currently, neighbor island offices do not have computer accessibility to central operations in Honolulu. As a result, neighbor island offices cannot provide immediate information to questions asked by local beneficiaries.

The commission has also recognized the need to protect vital physical records and improve management information systems. One commissioner noted that there is sufficient technology locally available, such as scanners and CD-ROMs to help manage agency records. We urge the commission to make recordkeeping and management information systems priority programs for the department. It should establish written policies for the programs and require the department to develop procedures to protect the integrity of their original and automated records.

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## **Delinquency Collection Process Is Ineffective**

The failure of the commission and the department to effectively direct and manage their financial responsibilities is evident by their poor collections on delinquent accounts. The result is a high delinquency rate and the risk of losing funds needed by other beneficiaries.

As of June 30, 1993, 644, or 36 percent, of DHHL's direct loans were delinquent for a total of \$14,666,000. Of these delinquent accounts, 85 percent were over 90 days past due. In contrast, the mortgage delinquency rate for Hawaii's private sector was 2.12 percent in the same period. A commissioner stated that DHHL's delinquency rate was "astronomical." Allowing this high rate of delinquency limits the department's ability to provide loans to other beneficiaries.

According to DHHL procedures, a loan collection officer must request permission from the commission to conduct a citation hearing when an account becomes 120 days delinquent. Upon commission approval, a hearing is conducted and a hearings officer recommends appropriate action to the commission based on the evidence presented. Should the

commission decide to cancel the lease, the department begins eviction proceedings. This process may take more than a year. If at any point the lessee makes an effort to pay on the loan, the cancellation process may be stopped or delayed.

Problems in collecting delinquent loans are due to several factors. Department administrators do not enforce the agency's written loan collection procedures. The department actively undermines collection efforts by making numerous exceptions to established policy. It also does not execute commission orders in a timely manner. The commission also undermines collection efforts by continuing to extend individual leases when beneficiaries have not made loan payments.

***Collection policy not enforced***

Management is responsible for establishing appropriate controls and procedures that safeguard assets and for ensuring that they are followed. DHHL management has not done this.

We found that some procedures are not followed consistently or in a timely fashion. For example, in FY1991-1992, the department took 14 cases before the commission with recommendations that the leases be cancelled because the lessees were overdue on their loan payments. Although the procedures call for the department to take action when an account becomes 120 days delinquent, in two cases, one lessee had not made a loan payment in about 3 1/2 years, and in the other case a lessee had not paid for nearly 8 years.

***Commission orders not followed***

Once the commission makes the decision, the department is responsible for carrying out the commission's order. We found that in 5 of the 14 delinquency cases, the department did not carry out the commission's orders. In four of the remaining cases, the department took from 6 to 14 months to execute the commission's orders.

A DHHL Loan Services Branch officer is responsible for implementing the commission's orders relating to delinquent cases. We were informed that agency management has unofficially delayed the execution of commission orders in some cases. The delays undermine the authority of the commission and negatively impact on any departmental effort to keep delinquencies at a minimum.

***Repeated extensions by commission***

Repeated extensions on delinquent loans by the commission have further weakened loan collections. The cancellation of a lease is the only leverage DHHL has in collecting delinquent funds. Cases are sent to the commission only after staff has exhausted all efforts to work out a solution with the lessee and after an independent hearing officer has heard the case. When the commission fails to cancel the lease, it undermines the efforts of the staff.

The department recommended cancellation of 14 leases but the commission gave 8 lessees another opportunity before lease cancellation. The commission cancelled 6 leases as recommended, but then it later reinstated two. According to one commissioner, the commission serves as a shield and last resort between the beneficiaries and the department. An agency official, however, expressed frustration with the commission's granting of numerous extensions to lessees.

The department and commission should work together to control high delinquency rates and to support their respective efforts. The lack of coordination results in lost opportunities for other beneficiaries who could pay on loans if they were given awards, but who remain on waiting lists instead.

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## **Loan Guarantees Are Not in Compliance With Law**

Loan guarantees that the department has made on behalf of Hawaiian home lands beneficiaries exceed limits imposed by the Hawaiian Homes Commission Act. The 1920 Act limits loan guarantees to \$21 million. As of June 30, 1993, the department's balance on outstanding loan guarantees totalled \$26.8 million. Although it has exceeded the statutory loan limit, the department continues to guarantee loans. Agreements with governmental agencies and private lending institutions have increased DHHL's potential liability. The department is in noncompliance with the act.

### ***Potential liability exceeds statutory limit***

Section 214-(b)(5) of the 1920 Act allows DHHL to guarantee loans to lessees provided that the State's liability, contingent (or potential) or otherwise, shall at no time exceed \$21 million. However, DHHL's liability as of June 30, 1993 exceeded the limit by more than \$5.8 million.

The department is acting as an agent of the State in making the loan agreements. When it exceeds statutory limits on its contingent liability or fails to make the stipulations required by law, the State is ultimately liable for defaults and subject to financial loss.

### ***Liability grows with new agreements***

DHHL has loan agreements with numerous governmental agencies and private lending institutions. Under these agreements, DHHL assumes responsibility for paying the unpaid principal and interest owed on loans if the borrower defaults. The principal borrowers are native Hawaiian lessees on Hawaiian home lands. With the exception of Federal Housing Administration (FHA) loans, DHHL's loan agreements hold the department fully liable in the event of a loan default.

Under FHA loans, borrowers pay an insurance premium into a mortgage insurance account. FHA also required DHHL to deposit an initial \$150,000 into this insurance account. Loan defaults are paid from the mortgage insurance account before the department assumes full direct responsibility for amounts owed. So far, the net mortgage insurance premiums amount to only \$35,020.

As of June 30, 1993, the outstanding FHA loan balances stood at \$13,051,000. Thus, outstanding FHA loan balances for which the department was potentially liable was \$13,015,980 (\$13,051,000 minus \$35,020). The outstanding balances of loans acquired under DHHL agreements with others stood at \$13,815,000. Therefore, DHHL was potentially liable for \$26,830,980 in guaranteed loans as of June 30, 1993.

The increases in DHHL's outstanding guaranteed loan balances also increase the risk of financial loss to the State. Between June 30, 1990 and June 30, 1993, the outstanding balances for loans acquired from lenders other than FHA increased from \$8,243,000 to \$13,815,000 or 68 percent. During the same period, outstanding balances for loans acquired under the FHA increased from \$2,145,000 to \$13,051,000 or 508 percent. DHHL believes that the quality of these loans are high and they will not be at great risk. DHHL has also entered into agreements with the Veterans Administration (VA) and the Office of Hawaiian Affairs (OHA). The estimated loan guarantees under the VA agreement could exceed \$160 million. The loan guarantees under the OHA agreement could reach \$20 million. In the event of a major recession or natural disaster, the State would be liable for paying off any defaulted loans.

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### **Cash Deposit With FHA Is Not Properly Recorded**

DHHL has not fully reported its assets. The department has not recorded its cash deposit with FHA on its accounting records nor is it presented on its balance sheet. The proper recording of assets is a fundamental requirement to safeguard assets from loss or misuse. It is also necessary for the preparation of financial statements in accordance with generally accepted accounting principles.

As a reason for not recording the \$150,000 cash deposit, a DHHL official told us that the deposit is not available to DHHL or under its control. It does not consider the money as DHHL's. We believe the money is an asset of the agency until it is used to cover defaults for lessees whose loans are guaranteed by DHHL.

DHHL's agreement with FHA stipulates that the deposit could be returned to the department when the mortgage insurance account

becomes actuarially sound. DHHL's practice of placing cash with an outside party and eliminating it from its records undermines internal accounting controls designed to safeguard assets against loss from unauthorized use or disposition. DHHL should record its deposit with FHA on its accounting records and balance sheet to ensure that all agency assets are protected.

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## Recommendations

1. We recommend that the Hawaiian Homes Commission assume its appropriate responsibilities by:
  - a. Clarifying the administrative rules relating to the oversight authority of the commission and that delegated to the chair of the commission.
  - b. Establishing a committee structure to address important policy issues facing the department.
  - c. Requiring the chair to compile the commission's policy decisions and a manual for commissioners on their functions and responsibilities and on the operations of the department.
  - d. Creating an executive committee to work with the chair in improving commission operations and approving agenda for commission meetings.
  - e. Requiring the director of the department to regularly submit management information to the commission on the programs of the department.
  - f. Rigorously support the department's loan collection procedures.
  - g. Refrain from guaranteeing any additional loans until the outstanding balance of guaranteed loans falls within statutory limits.
2. We recommend that the Director of the Department of Hawaiian Home Lands make the following improvements:
  - a. Prepare a comprehensive strategic plan as a guide for agency programs. The plan should include goals, milestones, and monitoring controls over agency initiatives and programs. The director should submit the plan to the Hawaiian Homes Commission for approval.

- b. Give priority to developing a recordkeeping system and adopting written management control policies and procedures to ensure that records are properly stored and secured.
- c. Enforce its collection policy expeditiously.
- d. Accurately record its deposit with the Federal Housing Administration as an asset on its accounting records as “cash on deposit with other parties” or a similar descriptive title. The deposit should also be presented as an asset on the department’s balance sheet.



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## Notes

### Chapter 1

1. Hawaiian Homes Commission Act, 1920, Section 101, as amended, Act 349, SLH 1990.

### Chapter 2

1. U.S., Department of Interior, *Federal-State Task Force on the Hawaiian Homes Commission Act*, August 1983, p. 364.
2. Hawaii, Department of Accounting and General Services, State Archives Division, *Records Management Manual for the State of Hawaii*, Honolulu, 1988, p. 38.
3. U.S., Department of Interior, *Federal-State Task Force on the Hawaiian Homes Commission Act*, p. 61.
4. Ernst & Young management letters to DHHL, October 1991, p. 2, and October 1992, p. 2.



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## Response of the Affected Agency

### Comments on Agency Response

We transmitted a draft of this report to the Department of Hawaiian Home Lands on December 1, 1993. A copy of the transmittal letter to the Chair of the Hawaiian Homes Commission is included as Attachment 1. The response of the chair is included as Attachment 2.

The chair of the commission agrees with our recommendations to compile the commission's policy decisions and to prioritize record management practices. The chair disagreed with our recommendation to establish a committee structure within the commission. She says that this would be an imposition on commissioners and an inefficient use of their time. We believe that a committee structure would be a more organized and effective use of the volunteer commissioners' time and effort. It would also help to ensure that the department's programs and initiatives receive systematic review, evaluation, and input from commissioners.

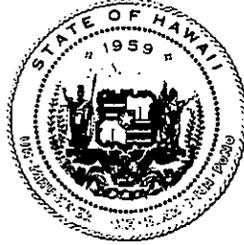
With respect to our recommendation that the department develop a strategic plan, the chair says that DHHL retreats are strategic planning efforts. In our exit conference, the department said it planned to present a strategic plan to the commission in January. We believe that the department has a responsibility to the 14,000 native Hawaiian beneficiaries on its waiting lists to develop a comprehensive strategic plan on how it will accomplish its mission.

The department agrees with our recommendation to support the department's loan collection procedures. However, the department disagreed that it has exceeded the \$21 million statutory limit on contingent liability. It makes the distinction between *guaranteed* loans that it says fall within the statutory limits and *insured* FHA loans that do not. This interpretation is not pertinent to the interpretation of contingent liability in the Hawaiian Homes Commission Act. The available balance of \$35,000 in its insurance account is insignificant when its outstanding FHA insured loans exceed \$13 million and its other loans exceed \$13.8 million. Furthermore, the department's audited financial statement identifies its loans as contingent liabilities.

The chair also disagreed that the department's cash deposit with FHA is not properly recorded. We note that the \$150,000 is not carried as an asset in its records. The cash deposit is also not used as a reconciling item on its records to the state treasury.

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

December 1, 1993

The Honorable Hoaliku L. Drake, Chairperson  
Department of Hawaiian Home Lands  
Old Federal Building  
335 Merchant Street  
Honolulu, Hawaii 96813

Dear Mrs. Drake:

Enclosed for your information are eleven copies, numbered 6 to 16 of our draft report, *Management and Financial Audit of the Department of Hawaiian Home Lands*. We ask that you telephone us by Monday, December 6, 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 Wednesday, December 15, 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  
State Auditor

Enclosures

JOHN WAIHEE  
GOVERNOR  
STATE OF HAWAII



HOALIKU L. DRAKE  
CHAIRMAN  
HAWAIIAN HOMES COMMISSION

STATE OF HAWAII  
DEPARTMENT OF HAWAIIAN HOME LANDS

P. O. BOX 1879  
HONOLULU, HAWAII 96805

December 15, 1993

Ms. Marion M. Higa  
State Auditor  
State of Hawaii  
465 South King Street, Room 500  
Honolulu, Hawaii 96813

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OFF. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

The exit conference that was held with your auditors on November 16, 1993, at which your staff summarized five major findings, was a most cordial meeting. We indicated at the end of the meeting that we looked forward to receiving the audit report and constructive recommendations.

Therefore it was with great dismay that we found your draft report to be one which unfairly criticizes the Hawaiian Homes Commission and the Department of Hawaiian Home Lands by misconstruing conversations held with Commissioners, staff, and others; by providing opinions that are not substantiated by facts; and by failing to obtain complete and accurate information. The auditors have also chosen to cast the department in the most unfavorable light without justification!

When I was appointed to chair the Hawaiian Homes Commission in November of 1989, the charge given to me was to expedite placing our beneficiaries on their land. At my confirmation hearing I remarked that the department would be action oriented, and one of the Senators, in comments made on the Senate floor, indicated pleasure in learning that DHHL would be an action department rather than one engaged in planning.

At that point in time it was critical that priority be given to improving the lots that had been awarded during the 1984-1986 acceleration of awards program. Other issues, such as making the trust whole, also needed attention. A third area of concern was internal management because many key staff positions were filled on an acting basis.

With the help of a very supportive Commission and a dedicated staff, we have made a number of significant achievements and I will highlight only a few.

- More homestead lots have been and are being developed than in any other period in the department's history.

- A total of 206 pastoral lots on Hawaii were awarded beginning in 1990.
- Past compensation for the illegal use of Hawaiian home lands since statehood has been provided by the Legislature, land claims have been researched and submitted, and a foundation has been laid for pursuing claims against the federal government for breaches that occurred before statehood.
- The department has aggressively asserted its rights to water critical to the development of Hawaiian home lands; these efforts thus far have resulted in the establishment of firm water reserves for Hawaiian home lands on Oahu and Molokai.
- In 1991, for the first time in its history, the department issued revenue bonds, to be repaid from the general leasing of land, to finance the construction of infrastructure on homestead lands.
- Reorganization of the Land Development Division was completed in 1990 and a new Land Management Division was created in 1993. All key administrator positions have been filled.
- The department has developed new mortgage loan financing sources. A high proportion (about 40%) of loans is now financed by external, rather than DHHL sources with two new programs recently added: by the U. S. Department of Veterans Affairs and by the Office of Hawaiian Affairs.

It is against this backdrop that we note the omission of a major recommendation by your office. The mission of the department is to manage the Hawaiian Home Lands Trust effectively and to develop and deliver land to native Hawaiians. What will drive the department to the successful accomplishment of this mission is not the forming of committees to handle the work of the Commission, more planning, or more paperwork. ***The basic ingredient that drives accomplishment of the mission is money, — funds for developing and improving homestead lands!***

In the past three years, the department has not lapsed any of its General Fund, General Obligation Bond Fund, or Reimbursable General Obligation Bond Fund appropriations. (Only a part of Revenue Bond Fund appropriations was lapsed because the stream of projected earnings from general leasing would not be sufficient to repay the amount of revenue bonds authorized by the Legislature.) The full use of CIP funds has enabled the department to design and construct infrastructure for homestead lands at a record level and at a pace unmatched since 1921! ***Your report overlooks this vital activity and in so doing, has failed to identify the need for funding, a basic need which the Legislature should be made aware.***

We do not profess to be a department without flaws. However, without continued funding support the department will not be as successful as it would like to be in putting

Ms. Marion M. Higa  
December 15, 1993  
Page 3

large numbers of beneficiaries on the land. The Commissioners and I are aware that in the long history of the Hawaiian Homes Commission Act our predecessors have tried, but were severely limited by marginal lands that are costly to develop and by a decidedly lack of funds — limitations that still exist today.

Previous reports of your office and the Legislative Reference Bureau have noted that the Hawaiian Homes Commission Act does not specify a purpose. The Attorney General, by letter opinion of November 13, 1951, provided an interpretation of the Act's purpose. Court decisions have stated that the purpose of the Act is to rehabilitate native Hawaiians on lands given the status of Hawaiian home lands.

However, the first paragraph of your report cites as the purpose of the Hawaiian Homes Commission Act the statement that appears in Section 101 of the Act, a new section provided by Act 349, Session Laws of Hawaii 1990.

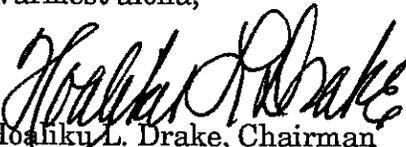
Act 349, SLH 1990, was enacted to incorporate a purpose statement in the Hawaiian Homes Commission Act. That purpose statement is much broader than the interpretation given the Act by the Attorney General and the courts. Act 349 takes effect upon consent of the U. S. Congress, and to date that consent has not been given. The understanding of the purpose of the Act is essential to knowing what the DHHL is supposed to be doing.

Deficiencies in loan collection and records management noted in your report will be addressed, but we take exception to your finding that DHHL has assumed a potential liability that exceeds the limit stated in the Act, and that an accounting item is not properly recorded. We also find it counter-productive to form those committees that your report suggests.

Your report will be of great interest to our beneficiaries, to the general public, and of course, the media. It is for this reason that the Commissioners and I feel strongly that any inaccuracies or misunderstandings be corrected. A discussion of our concerns is attached and made a part of this letter. Unfortunately, the short deadline given us to respond has prevented our addressing other inaccuracies in the report.

We would be pleased to meet with you and your staff if you find that such a meeting would be helpful.

Warmest aloha,

  
Hoaliku L. Drake, Chairman  
Hawaiian Homes Commission

Attachment

## ATTACHMENT

### DHHL COMMENTS ON AUDITOR'S DRAFT REPORT OF DECEMBER 1, 1993 <sup>1/</sup>

1. *The auditors' misunderstanding of the purpose of the Hawaiian Homes Commission Act may have led them to conclude that a clearly stated philosophy and a strategic plan are needed to accomplish the DHHL mission.*

The auditors recommend that the Chairman prepare a comprehensive strategic plan as a guide for DHHL programs and to submit the plan to the Commission for approval. (Page 22)

The mission of the department is stated in a very straightforward manner: "To manage the Hawaiian Home Lands Trust effectively, and to develop and deliver land to native Hawaiians." This mission statement differs substantially from the Act's purpose as cited by the auditors. (Page 1)

The success of the DHHL mission can be measured by the number of lessees placed on Hawaiian home lands. To that extent a strategic plan for DHHL would differ markedly from that developed by a corporation concerned with such questions as: What business are we in? What kinds of products and services should we provide and what are the future markets for such products and services? What are the resources required? What are the risks? What returns on investment can be expected? What are the margins in terms of costs/benefits?

Although the DHHL does not have a document labeled "Strategic Plan," the auditors were informed that DHHL retreats were in fact strategic planning efforts. The 1991 retreat focused on what needed to be done to provide 14,000 housing units over a 10-year period. The 1992 retreat took up a number of subjects, including the role of the Chairman and the Commission, communications, and other topics. It led to the Commission's determination that earnings from income properties needed to be increased and greater utilization made of idle or under-utilized land suitable for industrial, commercial, or other business purposes. The Commission's vision is that of a self-sufficient agency able to use income from its own land holdings to develop land for homesteading purposes instead of relying solely on external sources.

The Commission's direction to staff resulted in a reassessment of the Land Development Division and the subsequent transfer of land management functions from the LDD into a new Land Management Division to provide a focus on maximizing returns from income properties. The reorganization was approved in 1993.

The 1993 retreat was also a long-range planning session that considered a number of issues: illegal occupation of Hawaiian home lands, utilization of lands now under general leases that will be expiring soon, DHHL's management information system, and accelerating homestead awards. There was a great deal of interaction between Commissioners and staff that provided direction to staff, including the exploration of different approaches to carrying out the work of the department.

No decisions were made at the retreat, but the discussions form the basis for the staff's further studies of major issues and recommendations for the formulation of policies and procedures. One of the proposals incorporating new approaches to accelerating homestead awards was taken to the Commission in November 1993, (Item D-10), a copy of which was provided the auditors.

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<sup>1/</sup> Except as otherwise cited, page numbers in the text and in parentheses refer to pages of the Auditor's draft report.

**2. *Auditors erroneously attribute the absence of written policies to mean that there is no philosophical basis and direction for DHHL programs.***

From a reading of the audit report it is not possible to ascertain what findings led to the auditors' opinions stated at the bottom of page 11 and the top of page 12 that written policies are needed to establish a philosophical basis and direction for DHHL programs. The auditors state that policy decisions are badly needed on the issues identified below. (Page 12)

The first identified issue is whether the department should be operated more like a business or a welfare program. There is no doubt that the department must be operated like a business, and the Commission's discussions and actions on funding, contracting, general leases, lease reopeners, revocable permits, and other land dispositions leave no question in the staff's mind that income properties form a significant source of revenues, that the trust responsibilities require due diligence in acting on land management matters, that DHHL must operate as a prudent landowner, and that the costs of operations and capital projects must bear a reasonable relation to benefits derived.

The high delinquency rate in loans is recognized and staff is aware of the need to step up collection efforts. Monthly status reports on loans are required by the Commission. The Commission's actions not to automatically cancel the leases of all delinquent lessees, however should not be construed as "welfare" since it is clear to the Commissioners and staff that we do not operate a welfare program.

The second issue cited by the auditors deals with whether applicants who cannot qualify for mortgage loans should receive a homestead. In cases where the department builds turn-key houses, the applicant who cannot qualify for a mortgage loan would not be awarded the house and lot. Lots without a house have been awarded without regard to the applicant's financial means.

Also, under the present rules an applicant without the financial means would not be able to lease a lot with an existing home with an outstanding loan. Section 209 of the Hawaiian Homes Commission Act requires the successor to a lease to repay advances made from the Hawaiian Home Loan Fund in disbursing the net proceeds to a previous lessee or the estate of a deceased lessee after the improvements have been appraised at fair market value. However, the auditors were aware of two developments that would address this issue. The first is the joint agreement between the Office of Hawaiian Affairs and DHHL which provides loans for a down payment to qualify a lessee to take out a mortgage. Secondly, the Kuleana Hou program (acted upon by the Commission in November 1993) would award undeveloped lots without regard to an applicant's financial status.

As to the auditors' opinion that a policy decision is "badly needed" to determine whether priority should be given to the most needy beneficiaries, that issue has been decided. The current Administrative Rules replace previous rules that excluded beneficiaries with means from receiving a homestead. Awards are now made by rank order on waiting lists, with those on Priority I, II, and III lists and area lists given preference until such lists are used up. (See DHHL Administrative Rules Section 10-3-7(a). Also see DHHL paper, "Discussion of Issues" dated November 16, 1992, revised November 20, 1992, on housing for the homeless. Briefly, DHHL's position is that the native Hawaiian homeless should receive the full help of government that is provided all other homeless people. The department's responsibility is to provide permanent homes and land for native Hawaiian beneficiaries; it is not to house the homeless. To house the homeless first would deprive other native Hawaiians at the top of the waiting list from being served.)

The auditors also believe that what should be done to close the gap between the shortage of land for homesteads on Oahu and the demand for homesteads on Oahu is an issue for which a policy decision is also "badly needed."

It is clear to the Commission and to staff that the demand for homesteads on Oahu can be met most effectively by the exchange/acquisition of land in resolving DHHL land claims and claims for past compensation. This has been indicated in DHHL reports and testimony. Recent testimony before U.S. Senate committees also point out the high demand for Oahu residential homesteads and how the return of Lualualei lands can meet that need. It is also clear to the Commission and staff that the master-planned communities in Kawaihae and Kula would provide the means for relocation of Oahu families to Hawaii and Maui. (An analysis of the present waiting lists has substantiated the fact that many Oahu residents have applied for homesteads on the neighbor islands.)

As to the auditors' identified issue of the extent to which DHHL should be a developer given its limited resources, this issue was addressed by legislation initiated by DHHL, approved by the Commission, and enacted in 1986. Act 75 and Act 84, SLH 1986, both provide for the use of developer agreements. Act 75 is pending approval by Congress, but Act 84 does not require consent. At the November 1993 meeting, the Commission approved submission of a legislative proposal to amend Act 75. DHHL is negotiating an agreement to build 270 homes in Lualualei under a development agreement.

**3. *Auditors have failed to understand the role of the Commission and have chosen to denigrate the Commissioners' contributions.***

We do not believe unsupported statements should be included in the report. The last two paragraphs that appear on page 9 give the erroneous impression that the Commission does not assume leadership, does not make policy decisions, does not ensure that programs operate in the interests of beneficiaries, and that the Commission has not asserted its authority and policymaking responsibilities.

The auditors reviewed Commission minutes from June 30, 1992 to June 30, 1993 and reported that the Commission had not made important and basic policy decisions needed to guide the department. (Page 11) (In the same paragraph, the auditors attribute quotes to the Governor that are decidedly taken out of context to support an erroneous conclusion.)

The auditors' discussion also contains inaccuracies. For example, the auditors state: "The department's administrative rules and functional statements also fail to clarify how the commission is to fulfill its trust responsibility for Hawaiian home lands. They are silent on the authority and oversight responsibilities of the commission and how it is to oversee the department's activities." (Page 11)

Section 10-2-16(a) of DHHL Administrative Rules states:

"It is the desire of the commission that functions and duties, administrative in nature, be delegated to the chairperson and duties requiring the exercise of judgment or discretion continue to reside with the commission."

Section 10-2-16(d) states:

"The chairperson or a designee may approve and sign contracts under \$25,000 which are included in the commission's prior approved budget."

Section 10-2-17 states:

"The chairperson shall report to the commission for ratification of any actions taken as permitted under section 10-2-16(c)."

Section 10-2-18(a) states:

"It is the responsibility of each commissioner to:

- (1) Attend all meetings of the commission unless excused.
- (2) Undertake all duties assigned by the commission.
- (3) Keep generally informed of all matters pertinent to the determination of policy by the commission and effectuation thereof.
- (4) Be available to lessees in the representative area at reasonable times.
- (5) Be present at hearings affecting the rights of a lessee from the representative area.
- (6) Have a working knowledge of (the Hawaiian Homes Commission Act)."

Section 10-2-19 spells out the duties of Commissioners as trustees.

"As trustees, it shall be the duty of commissioners to:

- (1) Act exclusively in the interest of beneficiaries under the act;
- (2) Hold and protect the trust property for beneficiaries under the act;
- (3) Exercise such care and skill as a person of ordinary prudence would exercise in dealing with one's own property in the management of Hawaiian Home Lands; and
- (4) Adhere to the terms of the trust as set forth in the Act."

Section 10-3-52 provides for the quarterly transfer of all moneys in the Hawaiian Home Interest Fund as authorized by the Hawaiian Homes Commission Act. This section allows the department or the Commission on its own motion, to approve a plan for transfer of all moneys in the fund. "The plan for transfer shall take into consideration the department's budget projections as well as priorities established by the commission for the moneys." If the Commission does not approve a plan for transfer, this section provides for an established method of transfer to other DHHL funds.

Other portions of Subchapter 4, Loans and Funds, state the authority delegated to the department and other policy guidelines. As an example, Section 10-3-47 deals with loan conditions, including loan ceilings.

In 1984 and 1985 the Commission reviewed a number of proposals to revise policies incorporated in its Administrative Rules. Among significant policy changes were the following:

- In making homestead lease awards, the department shall give preference to an applicant who is not a lessee, or whose spouse is not a lessee.
- Because of shortage of available lands on Oahu, a lessee of an agricultural lot on Oahu shall not be allowed to hold any other homestead lease.
- Residences may be built on agricultural and pastoral lots.
- A lessee of a residential lot may subdivide and transfer a portion of the lot.
- The requirement that a homestead lessee apply to DHHL for approval of a leave of absence from the homestead was repealed.

In 1990 the Commission approved the adoption of policies relating to pastoral leases.

The department recognizes that the rules need to be reviewed and in many instances revised, and this has been identified as a priority project. Certainly the Commission will be very much involved in the review and articulation of policy and procedures to be incorporated in the administrative rules.

The auditors state that the Commission meets only during the monthly formal Commission meetings. (Page 12) This statement is not true. In the period from July 1, 1992 through June 30, 1993, the Commission held a number of meetings and participated in a number of activities, with many scheduled in proximity to the date of the regular meeting.

Number of scheduled public meetings: 12  
Number of meetings with homestead communities: 10  
Number of special meetings: 5  
Number of informational meetings: 14  
Number of groundbreaking ceremonies: 5

In addition to these meetings the auditors were informed that a retreat was held with both Commissioners and key staff (including branch chiefs) in 1991, that a retreat was held in 1992 attended only by Commissioners and selected staff, and a retreat held in 1993 attended by Commissioners and DHHL administrators.

It is unfortunate that the audit report does not reflect several truths: (1) The Commissioners are dedicated to moving the department forward and each Commissioner has a personal commitment to act in the best interest of all beneficiaries. (This fact is contrasted with the auditors' opinion stated on page 9, that the outlook for beneficiaries continues to be poor!); (2) The Commissioners themselves note that much progress has been made and the department is moving ahead, particularly in developing infrastructure for homestead lands; and, (3) The Commissioners reflect diverse skills and abilities and have made invaluable contributions.

The audit report paints an erroneous picture of the Commission passively rubber-stamping staff recommendations and not asserting itself in a leadership role. The contrary is true. The Commissioners have asserted strong leadership and have been candid in making known their direction for the department. An example is the Commission's stance on the Kalaupapa lease agreement with the National Park Service. The Commission acted forcefully in asserting that the trust should be given the very best price for use of those lands and rejected staff's recommendation on the appraised value. Other examples can be cited.

Although the auditors reviewed minutes of the last fiscal year and found no policy decisions, in fact there were. The Commission is very much involved in formulating the administration's legislative package. In the November 1992 meeting the Commission reviewed five draft legislative proposals. Three dealt with policy matters affecting homestead lessees, one dealt with developer agreements, and one dealt with departmental staffing. With a change initiated by the Commission, the package was submitted for consideration in the 1993 session and three proposals were enacted. Throughout the legislative session the department provided the Commissioners with testimony and progress on these and other bills.

At its June 29, 1993 meeting the Commission acted to set the loan ceiling for home repair loans and for relocation of homes. A policy decision on home repair loans was needed because Act 145, SLH 1993, removed the \$15,000 ceiling in the law.

**4. *Auditors have misconstrued the role of the Chairman in compiling the Commission's meeting agenda.***

Subsection 10-2-16(b)(6) of DHHL Administrative Rules states:

"(b) The commission shall be deemed to have delegated to the chairperson duties, powers and authority as may be lawful or proper for the performance of functions vested in the commission, including the following:

\* \* \* \* \*

- (6) To screen matters referred to the chairperson by staff and to select those of sufficient importance to place on the agenda for consideration by the commission...."

Approximately three weeks before a scheduled meeting, DHHL administrators identify by subject matter the agenda items they propose be taken to the Commission. The items include matters deferred from a previous meeting, follow-up action on a previous matter, items requiring Commission action, status reports, and items submitted for informational purposes. The list is reviewed by the Deputy to the Chairman or by the Chairman to determine if the matter is of sufficient importance, or if sufficient staff work has been done so that complete information is provided to the Commission for its consideration, or if other contemplated actions or developments make it inappropriate to take to the Commission for that particular meeting. About two weeks before the meeting DHHL administrators prepare the submittals for those items that are to be taken up.

This practice has been characterized by the auditors as "controlling" and "restricting" the agenda. The auditors believe that to be more effective, the Commission could "establish standing committees that would set the agenda, so that important issues are discussed at commission meetings. For example, an executive committee could work with the chair on the agenda." (Pages 12 and 13)

We are aware that the auditors conducted telephone interviews with most of the Commissioners and personally interviewed at least one member. However, we do not know if the auditor's statement about several Commissioners expressing "serious concern over their inability to bring up new business or conduct discussions not listed on the agenda" is factual. We also do not know if the auditors are aware of the procedural requirements of HRS Chapter 92 governing the conduct of public meetings.

To comply with requirements of HRS Chapter 92, DHHL must give written public notice of Commission meetings. The notice must include an agenda which lists all of the items to be considered at the meeting. Besides placing the notice in the newspaper, DHHL must also file the meeting notice in the Lieutenant Governor's Office at least six calendar days before the meeting, and to post the meeting notice at the meeting place. The law allows the Commission to change the agenda, once filed, by adding items to it upon a two-thirds recorded vote of all members to which the Commission is entitled, but an item that is of "reasonably major importance" and an action on a matter that will affect a significant number of persons cannot be added, but can be considered only at a meeting continued to a "reasonable day and time."

Commission members are aware that items can be added to the agenda, and have done so, as shown in minutes. Moreover, Commissioners know that they can contact the Chairman to request the Chairman to have an issue or item taken up at a meeting and many have done so.

In light of the present Administrative Rule and current practices, we find the auditors' characterization of the Chairman's role in setting the agenda to be seriously misconstrued. The auditors have imparted devious motives where there are none. It is not true that "...the agenda and access to information are restricted and controlled by the chair." (Page 12)

Indeed, the auditor's statement "(The Commission) lacks authority to set the agenda for these monthly meetings" (Page 12) does not have a factual basis. The Administrative Rule cited above makes clear: (1) the Commission has that authority; and, (2) the Commission has delegated that authority to the Chairman.

**5. *The auditors seem to believe that establishing committees will strengthen the department.***

The auditors suggest establishing an executive committee to work with the Chairman on the agenda. Committees on the budget, programs, and planning are also suggested. To help carry out trust responsibilities, the auditors suggest establishing a program committee. (Page 13)

The audit report does not discuss how the establishment of committees will strengthen an organization. It does not cite the improvements that will accrue by establishing committees made up of non-paid volunteers. Nor does the report identify the deficiencies associated with the absence of committees.

DHHL Commissioners are conscientious and dedicated individuals who contribute much of their personal time to serve as trustees. Unlike OHA or major charitable trusts whose board members are paid, full-time members, Commissioners are unpaid volunteers. It would be an imposition on individual Commissioners to ask that they give up more of their personal time and make economic sacrifices to serve on committees that may not be needed!

Texts on management provide insights as to the advantages and disadvantages of having committees. In a complex organization with a many-faceted operation, committees with ample staff support could be helpful. It is doubtful, however, that a small organization such as DHHL would benefit from an over-structured committee system.

In the past individual Commissioners have been asked to serve on ad hoc committees and will continue to be asked whenever a need arises. It would be extremely cumbersome and counter-productive, however, to form the committees suggested by the auditors, particularly in consideration of the need to staff the committees, the imposition on Commissioners' time, travel and other costs involved, and the notice requirements of HRS Section 92-7. (See Attorney General Opinion 85-27)

**6. *Auditors failed to understand that meeting housing goals require commitment of state and federal funds.***

The auditors state that DHHL has pursued unrealistic goals (Page 9) and that the department will not be able to meet the goals. Further, the auditors state that the goal of 14,000 "homesteads" is based strictly on the number of beneficiaries on the waiting lists in 1989, and not based on an assessment of housing needs. (Page 14)

The auditors were informed of the Commission/key staff retreat held in 1991. That retreat formed the basis for discussing actions that needed to be taken if the DHHL is to set a goal of 14,000 homes by the year 2000. Following the retreat an ad hoc task force of key staff developed a plan that would produce at least 4,000 lots by the end of 1994, requiring about \$187 million over a three-year period.

The goal of providing 14,000 units over a 10-year period is premised on major infusions of funding for construction costs and for interim loan financing. It can be a realistic goal only if the state and federal governments are committed to its realization by providing the necessary financial support. For Fiscal Year 1992-1993 CIP funds appropriated for DHHL statewide land development amounted to \$13,010,000 (not including \$1,470,000 for the Kula Water System), and for Fiscal Year 1993-1994, \$13,880,000. (A preliminary request for \$38 million in CIP funds for the current biennium was not approved.)

It is not true that the 14,000 housing goal was not based on an assessment of housing needs. DHHL's housing goal is in fact a part of a total State effort to address present and future housing needs. Other planning documents provided a basis for determining DHHL's requirements.

The Hawaii State Plan (Chapter 226, Hawaii Revised Statutes) provides a long-range guide for Hawaii's future. It establishes a statewide planning system to achieve State goals, objectives, and policies. The system requires the development of State Functional Plans approved by the Governor, which guide the implementation of state and county actions in a number of areas, one of

which is housing. Priority guidelines in the statewide planning system address areas of high priority concern.

“An estimated pent-up demand for statewide housing as of January 1987 shows a shortfall of over 20,000 units of which 14,000 are needed by low- and moderate-income families. When the pent-up demand is added to the projected housing demand from 1987 to the year 2000, the total housing need is estimated to grow to 86,000 units. The affordable and market shares of the total housing demand are 64,500 and 21,500 units, respectively...”  
(Progress Report, Implementation of Priority Guidelines of the Hawaii State Plan; Office of State Planning; March 1989; page V-2.)

The State Housing Functional Plan was developed with the help of an advisory committee consisting of private sector (including corporate executives, non-profit organizations, labor unions and consultants) and public sector (federal, state, and county officials) involved in dealing with Hawaii's housing issues. The Chairman of the Hawaiian Homes Commission is a member of the advisory committee.

The State Functional Plan for Housing states the problem of homeownership in Hawaii. “The ratio of owner- and renter-occupied units in the State of Hawaii has not materially changed since 1975. Owner-occupied housing units represent roughly 44% of total resident housing stock which compares poorly with the national average owner-occupancy rate of 64 percent in 1986.....the average priced new (or resale) single family home is unaffordable to families earning the median income.” (State Housing Functional Plan approved May 8, 1989. Page 11.)

The State Functional Plan has as one of its objectives homeownership for at least 60% or roughly 248,500 households in Hawaii by the year 2000. One of the strategies is to expand the supply of affordably priced residential units through joint public/private sector efforts. The DHHL's contribution toward those efforts, as shown in the appendix to the functional plan, is the development of houselots on Hawaiian home lands on various islands. An addendum to the State Housing Functional Plan was approved March 6, 1991.

Later studies contribute to housing need assessment. In developing functional plans to carry out its 10-year Master Plan, the Office of Hawaiian Affairs (OHA) obtained the participation of beneficiaries and other organizations serving the Hawaiian population. The planning process sought input on beneficiaries' most pressing concerns. High priority concerns expressed in community meetings underscored the need for affordable housing and the need to develop infrastructure on Hawaiian home lands.

The OHA functional plan for housing identifies a number of objectives and implementing actions for each objective. One of the objectives is: “To promote and advocate for opportunities enabling all Native Hawaiians waitlisted in 1990 to locate on Hawaiian Home Lands by the year 2000.” The rationale supporting this objective is stated as follows: “Since housing is an urgent concern in the Native Hawaiian community and issues related to the Department of Hawaiian Home Lands surfaced in all of OHA's 1990 community input sessions, we want to be as helpful as possible in resolving problems that adversely affect our beneficiaries, while respecting the individual mandates of the (DHHL) and OHA. If infrastructure costs are prohibitive, ways must be found to lower and/or secure them. If it is statutes and codes that bar native Hawaiians from their lands, these regulations must be rethought. We want to work with the (DHHL) on strategies that will resolve the difficulties as quickly as possible.” (I Luna A'e (Moving Onward and Upward) Office of Hawaiian Affairs Functional Plans 1991-1997; Office of Hawaiian Affairs; May 1991. Pages 16-17.)

The Hui 'Imi Task Force for Hawaiian Services, consisting of 18 organizations, including DHHL, filed its report on January 4, 1991. The Task Force was formed in response to State Senate

Concurrent Resolution No. 106, adopted in 1989, requesting the Governor to appoint a Task Force for Hawaiian Services to make findings and recommendations on the coordination of all public and private services available to Hawaiians.

Among five tasks undertaken by the Task Force, Task No. 4 involved an identification of critical needs and requirements to be addressed through future services and programs, and Task No. 5 dealt with recommendations on improving accessibility, coordination, and provision of future services and programs for unmet needs.

The study included extensive sampling, interviews, group meetings, and community meetings involving more than 656 users and 317 service providers throughout the State. The study found education as the most critical need identified by users and providers of services to Hawaiians. "Housing concerns rank a close second among critical needs identified by Hawaiians and service providers. To Hawaiians it is of utmost importance to have a home which can serve as the place where the 'ohana gathers and lives together. The 'aina is also important as the basis for spiritual and social values....The Hawaiian Home Lands Trust is seen by many Hawaiians as their only avenue for acquiring land and a home. Of particular concern among those qualifying for programs from the Hawaiian Home Lands Trust is the uncertainty of when they will receive a homestead with infrastructure, or whether, indeed, they will ever receive a homestead at all. The Hawaiian Homes Commission has established a goal of developing at least 14,000 additional housing units by the year 2000...."

One of seven recommendations for housing services for Hawaiians asks the state executive and legislative branches to "assist the Hawaiian Homes Commission in achieving its vision of developing at least an additional 14,000 housing units by the year 2000." The report states: "It is critical that this goal be achieved."

Another recommendation urges the State, through the Housing Finance and Development Corporation, OHA, and DHHL, to develop multi-family housing options for homeless single-parent families, for single adults, and for the elderly. Other recommendations address the need for these agencies to develop financing sources for low-cost mortgages, and to develop programs for Hawaiians to participate in constructing their own homes if they so desire. (Hui 'Imi Task Force for Hawaiian Services, Volume II, Toward Collective Action (New Approaches/New Directions); Hui 'Imi Task Force; January 4, 1991. Pages 20 and 21.)

In setting the goal of 14,000 housing units, DHHL was aware that attaining the goal must necessarily require external financing, since its own resources and the State's resources would be insufficient. DHHL also recognizes that attaining any significant part of that ambitious goal will require doing things differently, for example, by leveraging financial resources as was done in 1991 by pledging income from general leasing to obtain revenue bond funds to develop homestead lands.

**7. *Auditors recommend giving priority to developing a recordkeeping system and adopting written management control policies and procedures to ensure that records are properly stored and secured. (Page 23)***

The department recognizes the need to provide priority to records management and has begun projects to address deficiencies. However, we do wish to correct a minor error in quoting a Commissioner who notes the availability of scanners and CD-ROM "to adequately microfilm agency records." (Page 18) The Commissioner quoted and the department are aware that such technology is not used in microfilming records.

The department has initiated actions to address deficiencies in records management and to automate data and accounting systems. Both projects have begun and a status report, including

proposed activities, their time-frame, and planned expenditures, has been prepared in response to Section 64 of the General Appropriations Act of 1993 (Act 289, SLH 1993).

Recordkeeping Upgrade and Enhancement Project. Each DHHL division and office is represented in the records management working group formed in September 1993. The group has been meeting regularly to develop and carry out plans to establish a comprehensive records management system that will provide retrieval in a timely manner, provide secure storage of essential records, microfilm permanent and critical records, dispose of obsolete records, and utilize the State Archives for secure storage of certain records. Priority will be given to the management and security of lease, loan and applications records.

Office Automation Upgrade and Enhancement Project. This project consists of four components: telecommunications, development of an on-line Management Information System, upgrade of existing computer equipment, and the acquisition of additional equipment.

A Data Processing Steering Committee comprised of key administrators is providing overall administration over the project. The project will enable DHHL to address concerns relating to the integrity of stored data as well as to produce timely and accurate reports.

Telecommunications with the neighbor island district offices will streamline the processing of payments and inquiries and reduce duplication of records. (In 1992 the executive budget included funds to automate the district offices and to link the neighbor island offices with the Honolulu office, but the funding was not approved.)

We believe that these two projects, when completed, will address fully record management concerns.

Two other administrative matters, which were begun before or during the auditors' review of DHHL will be completed before the end of the fiscal year. One deals with updating the DHHL administrative manual, which was last compiled in 1991. The other deals with indexing Commission minutes and compiling Commission actions that set guidelines for the department.

**8. *The auditors recommend that the Commission "rigorously" support the department's loan collection procedures and that the Chairman "enforce its collection policy expeditiously." (Pages 22 and 23)***

Beginning at page 18 the auditors discuss the high loan delinquency rate found and the process followed in the handling of those accounts taken to the Commission for disposition. The department is aware of the unacceptability of a high delinquency rate and the need to take action in reducing it. However, the statement made at page 5 in summarizing this finding is gratuitous.

With both private and public lending institutions, foreclosure is the last resort in the collection process. The department's contested case hearing ("citation hearing") begins the foreclosure process. It is a time-consuming process. Borrowers must be given due process, proper notifications must be provided to lessees of their legal rights during the cancellation process, and appraisals of improvements must be obtained with lessees consenting to the final valuation. Finally, a successor lessee must be found from the department's waiting lists qualified to assume the indebtedness determined by the contested case proceedings and appraisal.

The Commission holds contested case hearings not only if the account is 120 days delinquent but also if the lessee is not making any effort to cure the delinquency. The question before the Commission at a contested case hearing is for the lessee to show cause why the lease should not be cancelled. If a lessee makes efforts to pay after a hearing has been scheduled or

commenced, the lessee's attitude has shifted from being uncooperative to cooperative. At this point, the Commission is willing to reconsider cancellation, but the practice is to maintain the account under the contested case hearing process until the delinquency is cured. This is to ensure that the commencement of payments is not a short term event. The Commission's practice is not to cancel leases automatically but to try to have the lessee make payments.

In most cases loan amounts in arrears are so large that long term repayment schedules need to be worked out with lessees. Therefore, the practice has been to get lessees to make regular payments and, if maintained for some time, to refinance the balance thereafter.

Coupled with the collection effort on delinquent loans, is the need to ensure that new loans being made would not add to the delinquency problem. Therefore, new loan standards have been implemented and at the time of the audit there were no delinquencies in the department's primary loan source, FHA-insured loans and loan guaranty programs of similar quality. FHA loans and guaranteed loans currently represent over 40% of the department's loan portfolio.

The auditors reviewed fourteen accounts which had been taken before the Commission for contested case hearings. They acknowledged that in four cases the Commission's orders were being carried out and in one case the citation for a contested case hearing was in error on the part of DHHL; two of these five accounts have since been brought current in terms of their loan agreement. One lease was transferred and the account brought current by the transferee.

The case citing an over eight-year delay involves a lessee who refused to make payments due to alleged defects in the construction of his house and the case has been in litigation. The lessee refused to pay DHHL directly and made payments into a bank account originally administered by the court. The lessee continues to make token payments into this account. This case was one of sixteen brought against DHHL for alleged construction defects and all but one were eventually dismissed. The Commission directed staff to work with the sixteen former litigant-lessees in resolving their differences. The lessee rejected the offer. This left the Commission no alternative but to proceed with the cancellation process. The Commission ordered the lease cancelled in July, 1993. This order became effective in September, 1993. The lessee has since filed an appeal of the cancellation order in court. In response, the Attorney General's Office filed a motion to dismiss which it believes will be granted shortly.

The case citing an over three-year delay also involved a lessee who was one of the sixteen lessees who had filed suits against DHHL alleging construction defects. This lessee's case was the only one not to be dismissed and is still pending. An offer to resolve the delinquencies was rejected by this lessee. This refusal of its offer left the Commission no other alternative but to proceed with the cancellation of the lease in July, 1993 effective September, 1993. The lease has been cancelled.

In the remainder of accounts cited, payment adjustments were made in some cases which require Commission approval and in others cancellation orders were unnecessarily delayed. All of these cases are being reviewed and appropriate corrective action will be taken.

**9. *Auditors' finding and recommendation may be based on inadequate knowledge of the distinction between guaranteed loans and insured loans.***

At page 5, the auditors summarized a finding that the department "...has assumed a potential liability that exceeds the limit permitted by statute." The discussion beginning at page 20 alleges that DHHL loan guarantees are not in compliance with law. At page 22 the auditors recommend that the Commission refrain from guaranteeing any additional loans until the outstanding balance of guaranteed loans falls below \$21 million. We disagree with this finding and recommendation.

The crux of this issue turns on the interpretation of subsection 214(b)(5) of the Hawaiian Homes Commission Act, which states:

“(b) In addition the department may:

\* \* \* \* \*

- (5) Secure, pledge, or otherwise guarantee the repayment of moneys borrowed by the department from government agencies or private lending institutions and pay the interim interest or advances required for loans; provided that the State's liability, contingent or otherwise, either on moneys borrowed by the department or on departmental guarantees of loans made to lessees under this paragraph and paragraphs (2), (3), and (4) of this subsection, shall at no time exceed \$21,000,000; the department's guarantee of repayment shall be adequate security for a loan under any state law prescribing the nature, amount, or form of security or requiring security upon which loans may be made.” (Emphasis added.)

At the exit conference the auditors' view was briefly discussed and following the meeting, DHHL provided further information about insured loans, which differ from guaranteed loans.

The auditors maintain that both loans guaranteed by DHHL (amounting to \$13,840,000 in outstanding loans on June 30, 1993) and insured loans made under the agreement between DHHL and the U. S. Housing and Urban Development (HUD) Federal Housing Administration (FHA), (\$13,051,000 as of June 30, 1993) should be counted against the \$21 million limit cited in the subsection quoted above. Thus, in the auditors' view, DHHL has exceeded the limit.

DHHL's position is that the agreement with FHA does not call for the State to guarantee loans insured by FHA. The loans are guaranteed by DHHL with reserves set up for potential losses, if any. If such a loan is in default, the default is made up by a disbursement from the HHL mortgage insurance account administered by FHA, for which DHHL had made an initial payment of \$150,000, and into which borrowers pay a mortgage insurance premium. This account is also backed up by \$850,000 in DHHL funds held as a reserve by DHHL. Both were set up as temporary reserves, with the permanent reserve to be developed from insurance premium collections from loans made by FHA lenders. The insured loan feature of the FHA program shields the State from the need to repay a defaulted loan and provides assurance for DHHL's guaranty.

A careful reading of subsection 214(b)(5) above allows the department to secure, pledge, or otherwise guarantee the repayment of: (1) moneys borrowed or on loans guaranteed by the department under paragraph (5) and paragraphs (2), (3), and (4) of this subsection. Paragraph 2 refers to guaranteed loans made to lessees; paragraph (3) refers to guaranteed loans made to a cooperative association; and paragraph (4) refers to loans made by government agencies or private lending institutions, where the department assures the payment of such loans and for which the department may pay the outstanding balance. None of these paragraphs deal with insured loans. Special enabling legislation was in fact enacted expressly for the FHA insured loan program.

Prior to implementation of FHA-insured financing in 1987, the only source of mortgage funds had been DHHL's direct loan programs financed by DHHL funds and funding through legislative appropriations, loan guarantees under the \$21 million statutory ceiling, and lessees' personal resources. Both the legislative appropriations and guaranty authorizations had major constraint considerations in that they required appropriated funds which would be limited by the State's debt ceiling and required DHHL to compete with other State programs for funding, and the potential impact on the State's bond rating. It was necessary to seek alternative funding sources that not only provided the necessary funds in substantial amounts but also overcame the impediments mentioned above.

Because of its great resource of mortgage funding the initial target for an external source of funding was the FHA insured loan program. Through the efforts of Hawaii's Congressional delegation, Section 421 of the Housing and Urban Rural Recovery Act of 1983 amended Section 247 of Title II of the National Housing Act of 1934 to permit the Secretary of HUD to insure single family mortgages on Hawaiian home lands. Section 247 required, among other things, that DHHL be a co-mortgagor, guarantee the loans, or provide other security acceptable to HUD for any loan insured by HUD.

While the Congressional changes opened up possibilities for DHHL's participation, the program could not be immediately implemented for the following reasons:

1. The State's Attorney General's Office saw legal problems in DHHL's co-making every loan in addition to the processing obstacles this would have entailed;
2. DHHL guaranty of loans at that time would be subject to the statutory \$21 million ceiling and any further authorizations would impact the State's debt ceiling and require legislative action to raise it; and,
3. DHHL had no collateral to provide as "other security."

It was noted that FHA insured financing requires the payment of an insurance premium by the borrowers. HUD consented to an agreement between HUD and DHHL in which FHA insured loans would be made available for DHHL homestead lessees.

Enabling legislation was needed to allow DHHL to participate in the program. Act 284, SLH 1985, accomplished this by amending section 208 of the Hawaiian Homes Commission Act. The amendment, in part, is cited below.

- "(6) Notwithstanding the provisions of paragraph (5), the lessee, with the consent and approval of the commission, may mortgage or pledge the lessee's interest in the tract or improvements thereon to a recognized lending institution authorized to do business as a lending institution in either the State or elsewhere in the United States; provided the loan secured by a mortgage on the lessee's leasehold interest is insured or guaranteed by the Federal Housing Administration, Veterans Administration, or any other federal agency and their respective successors and assigns, which are authorized to insure or guarantee such loans. The mortgagee's interest in any such mortgage shall be freely assignable. Such mortgages, to be effective, must be consented to and approved by the commission and recorded with the department.

Further, notwithstanding the authorized purposes of loan limitations imposed under section 214 of this Act and the authorized loan amount limitations imposed under section 215 of this Act, loans made by lending institutions as provided in this paragraph, insured or guaranteed by the Federal Housing Administration, Veterans Administration, or any other federal agency and their respective successors and assigns, may be for such purposes and in such amounts, not to exceed the maximum insurable limits, together with such assistance payments and other fees, as established under section 421 of the Housing and Urban Rural Recovery Act of 1983 which amended Title II of the National Housing Act of 1934 by adding section 247, and its implementing regulations, to permit the Secretary of Housing and Urban Development to insure loans secured by a mortgage executed by the homestead lessee covering a homestead lease issued under section 207(a) of

this Act and upon which there is located a one to four family single family residence.”

Section 213 of the Act was also amended by Act 284 to authorize DHHL to set up an account in the Hawaiian Home Trust Fund as a reserve for loans insured by FHA, VA, or any other federal agency.

Under the FHA insured loan program, mortgage insurance premiums collected from the lessee-borrowers, after deducting minor administrative costs, would be set aside in a reserve to cover losses, if any. The potential losses would be primarily from non-payment of loans and ultimate foreclosure proceedings in which the recovered amounts would not fully satisfy the loans outstanding.

What are the potential for such losses? In discussions with HUD’s Housing Administrator regarding FHA insured loans in Hawaii the current default rate (i.e., loans delinquent over 90 days) in Hawaii is less than one per cent (.873%) and the foreclosure rate is .189%. The reserve set aside in the DHHL/FHA program would more than adequately cover probable losses. What are the potential losses from Hurricane Iniki-type catastrophes? No lender sets up reserves for such extraordinary circumstances. HUD does report that when such events occur they implement a forbearance program to assist borrowers until they get back on their feet. They also indicated there were no appreciable rise in default rates in either Florida or Kauai in the aftermath of Hurricanes Andrew and Iniki.

HUD estimates insurance premium collections would average \$3,000 per loan. After deducting administrative expenses of \$250 per loan, the remainder is deposited into the reserve account. To implement the program DHHL established an initial fund of \$150,000 with HUD for the reserve account and a standby fund in DHHL of \$850,000. We understand total, but not all earned, premiums are in excess of \$300,000; estimated earned premiums are about \$30,000.

Before execution of the memorandum of agreement with HUD/FHA, an attorney general’s opinion was required that the agreement was in conformance with State laws. This was obtained.

We believe the auditors are in error in finding that the \$21 million limitation of section 214(b)(5) has been exceeded and that DHHL is not in compliance with that provision of the Act. The auditors are also mistaken in stating that the “estimated loan guarantees under the VA agreement could exceed \$160 million.” (Page 21) Under the new VA mortgage loan program only \$58 million is being made available on a nation-wide basis initially.

**10. *Auditors have taken the accounting treatment of a single item to reach the erroneous conclusion that “DHHL does not fully and accurately report its assets.” (Page 21)***

At the exit conference the accounting treatment of an item on deposit with the U. S. Department of Housing and Urban Development, Federal Housing Administration (FHA) was discussed. The auditors felt that the proper accounting of the item was to show it as an asset on our balance sheet. DHHL’s position is that until such time as it is returned by FHA to DHHL it is not an asset, but is properly reported as a note to our financial statement.

One of the stated objectives of the audit was to “Determine whether expenditures, transfers, and other disbursements are in accordance with the proper use of DHHL funds as prescribed by statute, appropriations act, or other authority.” (Page 2) At page 3 the auditors state: “To assess DHHL’s controls over assets, we reviewed financial and compliance audits, management letters, agreements, funding sources, and budget documents. We interviewed DHHL’s fiscal officer and staff and examined its accounting system and recordkeeping processes.”

Despite the stated objective of the audit, there is no finding as to the adequacy of the department's financial statements, internal controls, and compliance with applicable laws and regulations. At the very least, having reviewed previous financial and compliance audits, the auditors could have reported that independent certified public accounting firms have made annual audits for which DHHL has received "unqualified" opinions.

The disagreement over how the \$150,000 item is to be treated has led the auditors to make statements that mislead the reader in believing that the entire accounting system is inadequate when the problem perceived by the auditors deals only with how a single item is to be reported. These statements are not substantiated: "DHHL does not fully and accurately report its assets. . . The proper recording of assets is a fundamental requirement to safeguard assets from loss or misuse. It is also necessary for the preparation of financial statements in accordance with generally accepted accounting principles." (Page 21) "DHHL's practice of placing cash with an outside party and eliminating it from its records undermines internal accounting controls designed to safeguard assets against loss from unauthorized use or disposition." (Page 22)

These statements lead the reader to infer that DHHL's accounting practices and records are inadequate and that DHHL has eliminated reporting of a \$150,000 item from its records. Neither inference would be correct.

The item is accounted for and fully disclosed in notes to our financial statements, which have been audited by independent CPA's and for which we have received "unqualified" opinions. Notes are an integral part of our financial statements and there is no attempt to "eliminate it (the \$150,000) from records."

The \$150,000 item is not shown as cash in our balance sheet because to do so would overstate cash assets and would not be an accurate reporting of assets, since it would indicate that cash in the amount of \$150,000 is available when in fact, it is not.

Under DHHL's agreement with FHA, \$150,000 was to be the initial deposit to an HHL mortgage insurance account. This account is credited (increased) by mortgage insurance premiums, reimbursement of Temporary Mortgage Assistance Payments (TMAP) by mortgagors, payments by mortgagors under the assignment forbearance relief program, and other collections. Debits (decreases) include mortgage insurance claims, payments made under TMAP, service charges, mortgage insurance premium refunds, costs of servicing mortgages, and other disbursements.

The FHA retains the right to determine the actuarial soundness and the amount to be held in the HHL mortgage insurance account and, at its discretion, return excess funds to DHHL. If debits to the HHL mortgage insurance account exceed credits, we will instead have a liability and additional monies will need to be paid from DHHL's standby reserve.

The issue is simply a difference of opinion in accounting for an item, but the auditors unfairly and erroneously accuse DHHL of "eliminating it from (DHHL's) records," and characterize the accounting treatment of this single item as "DHHL's practice."

