Follow-Up Report on a Management and Financial Audit of the Department of Hawaiian Home Lands

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

THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

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

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

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

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

3. *Sunset evaluations* 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.

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Submitted by

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Introduction

The Office of the Auditor issues a wide variety of reports and studies recommending improvements in government operations. In response to growing interest in the impact of our audits, we have expanded our follow-up program to include a systematic review of selected findings and recommendations of previous audit reports. We revisit the subject agencies to verify and assess any progress made in addressing prior audit findings and recommendations. Government auditing standards require an audit follow-up process to determine whether an auditee has taken timely and appropriate corrective actions on findings and recommendations from previous reports.

The purpose of this report is to describe actions taken by the Department of Hawaiian Home Lands (DHHL) with respect to certain recommendations in our December 1993 report, *Management and Financial Audit of the Department of Hawaiian Home Lands*, Report No. 93-22. We hope that the information provided in this report will assist policy makers in ensuring effective, efficient, and accountable programs.

Background

DHHL is responsible for carrying out the Hawaiian Homes Commission Act of 1920, which was enacted by Congress to 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 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.

DHHL is headed by an executive board, the Hawaiian Homes Commission. The chair of the commission is also the director of the department.

DHHL's mission is to administer Hawaiian home lands for the benefit of native Hawaiians, primarily through homestead awards to persons who have at least 50 percent Hawaiian blood. The awards are in the form of leases up to 199 years for an annual rental fee of one dollar. Other DHHL activities include making mortgage loans directly to home lands beneficiaries and guaranteeing loans made by other institutions to beneficiaries.

In our 1993 audit, the Legislature requested that we determine DHHL's progress in meeting its mission to manage the Hawaiian home lands effectively and develop and deliver land to native Hawaiians. Our 1993 report found that DHHL was far from achieving its mission since the majority of beneficiaries were still waiting to receive their homestead. We found that the commission had not asserted its authority and policy-making responsibilities, and that DHHL lacked written policies and a strategic plan to direct and lead its programs. In addition, we found inadequacies in DHHL's administration of its records management and loan activities. We made recommendations for improvement.

Approach to Follow-Up

As a follow-up of our 1993 report, we reviewed DHHL's letter to the Auditor of November 3, 1994, which provided information concerning actions taken by the department. We then conducted fieldwork at DHHL to gather additional information necessary for this report. Our work was performed from December 1994 through March 1995.

The following is our overall assessment of progress by DHHL, followed by a description of each of our previous recommendations, actions reported by DHHL in its 1994 letter to us, and the results of our recent fieldwork.

Summary of Follow-Up

Our overall assessment is that little action has been taken on our 1993 recommendations because the prior DHHL administration disagreed with most of them. However, the new DHHL administration recently indicated its support for most of our recommendations. But, although DHHL reported actively working to reduce its loan delinquency ratio, the number of delinquent accounts has actually increased since our 1993 audit.

DHHL has made some progress in implementing our recommendation to develop a recordkeeping system to ensure that records are properly stored and secured.

Recommendations Made to Hawaiian Homes Commission in 1993 Report

In our 1993 report, we recommended that the Hawaiian Homes Commission assume its appropriate responsibilities by:

- Clarifying the administrative rules relating to the oversight authority of the commission and that delegated to the chair of the commission.

- Establishing a committee structure to address important policy issues facing the department.

- 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.

- Creating an executive committee to work with the chair in improving commission operations and approving agenda for commission meetings.

- Requiring the director of DHHL to regularly submit management information to the commission on the programs of the department.

- Rigorously supporting the department's loan collection procedures.

- Refraining from guaranteeing any additional loans until the outstanding balance of guaranteed loans falls within statutory limits.

Implementation as reported in DHHL's letter

In its November 1994 letter to the Auditor, DHHL concurred only with the recommendation to rigorously support the department's loan collection procedures. The letter reported that DHHL loan staff were actively working to reduce DHHL's loan delinquency ratio. An analysis of all delinquent accounts was underway to determine options to cure each delinquency such as establishing a repayment schedule, refinancing or restructuring the loan, or transferring, surrendering, or cancelling the lease.

DHHL's letter also said that contested case hearings had been scheduled throughout the state to address the most serious delinquency problems. Nine such cases had already been heard by the commission, and twelve others were pending. As a result, DHHL reported, loan delinquencies had decreased by 26 during the first nine months of 1994. In addition, DHHL planned to recruit for two additional support staff for the Loan Services Branch to assist in the loan collection effort.

DHHL's letter also indicated that an opinion from the attorney general supported DHHL's disagreement with our recommendation to refrain from guaranteeing additional loans until the outstanding balance of guaranteed loans falls within statutory limits.

Results of our fieldwork

Our follow-up fieldwork confirmed that the prior DHHL administration continued to disagree with all of the recommendations directed to the commission except the loan collection recommendation. DHHL therefore initiated action on loan collections only. However, we found that the results of these initiatives are not apparent. We also see no reason to change our recommendation with respect to refraining from guaranteeing additional loans.

Loan collections

Our follow-up found that DHHL in June 1994 adopted a *Loan Delinquency Action Plan 1995* to address the delinquent loan problem. The plan was designed to reduce the department's direct loan delinquency ratio to 30 percent by June 30, 1995. However, despite this plan and the department's statement that it has actively worked to reduce the loan delinquency ratio, we found that the ratio as well as number of delinquencies has increased.

Our previous audit reported that 644, or 36 percent, of DHHL's direct loans were delinquent for a total of $14,666,000 as of June 30, 1993. Of these delinquent accounts, 85 percent were over 90 days past due. In our follow-up, we found that 683, or 42 percent, of DHHL's direct loans were delinquent for a total of $16,769,000 as of November 19, 1994. Of these delinquent accounts, 81 percent were over 90 days past due.

Loan guarantees

In our 1993 report, we had found that DHHL made loan guarantees on behalf of Hawaiian home lands beneficiaries that exceeded limits imposed by the Hawaiian Homes Commission Act. The Act allows DHHL to guarantee loans to lessees provided that the State's liability, contingent (or potential) or otherwise, at no time exceeds $21 million. However, as of June 30, 1993, DHHL's balance on outstanding loan guarantees totaled more than $26.8 million. This was made up of about $13 million in Federal Housing Administration (FHA) loans and $13.8 million in other loans.

The total of $26.8 million exceeded the legal limit for potential liability by more than $5.8 million, yet DHHL was continuing to guarantee loans. Furthermore, DHHL had also entered into agreements with the Veterans Administration (VA) and the Office of Hawaiian Affairs (OHA) under which loan guarantees with the VA could exceed $160 million and reach $20 million with OHA. Our report pointed out that DHHL acts as an agent of the State when making loan agreements. When DHHL exceeds statutory limits on its contingent liability, the State is ultimately responsible for defaults and subject to financial loss. We recommended that DHHL refrain from guaranteeing additional loans until the outstanding balance of guaranteed loans falls within statutory limits.

In its November 1994 letter to the Auditor, DHHL took the position—supported by a letter to DHHL from the state attorney general—that the $21 million limit does not apply to DHHL's agreement with FHA because these loans are not "guaranteed" by DHHL. If there is a default, the U.S. Department of Housing and Urban Development insures repayment of the balance to the private lender and obtains reimbursement from DHHL through a reserve fund, with DHHL then taking over the loan. The fact that FHA required DHHL to set aside moneys in a reserve fund to cover potential losses is evidence that the department has contingent liability for losses. We believe that the attorney general's letter reinforces rather than rebuts our position, for it identifies DHHL as the final responsible agency for resolving FHA loans. We still believe the FHA loans constitute a contingent liability and we stand by our recommendation.

DHHL's November 1994 letter also observed that the VA Direct Loan Program is similar to the FHA program, so the VA loans should not be counted against the $21 million ceiling. We reviewed the memorandum of understanding between DHHL and the VA. We agree that the programs are similar but we believe that loans under both programs must be counted against the $21 million cap.

Recommendations Made to Director of DHHL in 1993 Report

The seven recommendations listed above were directed to the Hawaiian Homes Commission. Our 1993 report directed four additional recommendations to the Director of DHHL (who is also the commission chair). We recommended that the director make the following improvements:

- 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.
- Give priority to developing a recordkeeping system and adopting written management control policies and procedures to ensure that records are properly stored and secured.
- Enforce the department's collection policy expeditiously.
- Accurately record the department's 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.

Implementation as reported in DHHL'S letter

In its 1994 letter to the Auditor, DHHL concurred only with the recommendations concerning recordkeeping and loan collections. Loan collections are discussed earlier in this report.

Concerning recordkeeping, DHHL reported taking a number of steps to address deficiencies in its records management system. The steps include the following: recalling and reissuing all keys; changing locks to storerooms for homestead leases, loans, applications, and accounting records; keeping the application storeroom locked at all times; and storing all DHHL recorded documents in a fire-safe vault.

DHHL also reported contracting with a vendor to microfilm vital documents, thus providing security to DHHL records by providing a working copy for daily operations and archiving a backup copy with the State Records Center in the Department of Accounting and General Services (DAGS).

DHHL said it has compiled an inventory of all department records and is working with DAGS to develop a Departmental Records Retention Schedule that will meet statutory, audit, and administrative requirements. In addition, DHHL reported taking a number of steps to improve its management information system.

Results of our fieldwork

Our follow-up fieldwork confirmed that DHHL disagreed with our 1993 recommendations concerning strategic planning and recording the Federal Housing Administration Deposit as an asset. As a result, DHHL has not acted to implement these recommendations. Also, despite DHHL's agreement with our recommendation to enforce the loan collection policy, we found loan delinquencies increasing, as explained previously in this report.

We did find progress by DHHL in implementing our recommendation to develop a recordkeeping system to ensure that records are properly stored and secured. Keys were recalled, reissued, and locks changed. DHHL is now storing original lease and loan documents in a fire-safe vault, microfilming them, and completing an inventory of all documents. Also, applications are now securely stored on a daily basis in file cabinets or a file room as appropriate. However, written policies and procedures for recordkeeping have not been implemented.

Conclusion

At the time of our fieldwork, the Department of Hawaiian Home Lands continued to take exception to many of the recommendations of our 1993 audit. This reflected the department's previously expressed view that carrying out most of the recommendations will not help to put more beneficiaries on the land. As a result, it was only in the areas of records management and loan collections that DHHL had acted to implement our recommendations.

Recordkeeping has improved substantially and key documents concerning beneficiaries are now safe and secure, but policies and procedures for recordkeeping are still needed. The department's *Loan Delinquency Action Plan 1995* shows a commitment to improve loan collections. However, at the time of our follow-up work, loan delinquencies continue to be high. It remains to be seen whether the department will achieve its goal of reducing its direct loan delinquency ratio to 30 percent by June 30, 1995.

Concerning our other recommendations, we share DHHL's view that it should focus on putting beneficiaries on the land. However, we do *not* share the view that most of our recommendations will not help this take place.

For example, our 1993 report called for establishing a committee structure in the Hawaiian Homes Commission to address important policy issues facing the department. DHHL did not agree with this recommendation. However, we continue to believe that an executive committee, for example, could work with the chair on agendas for commission meetings to make sure that important issues are discussed. A program committee could help to ensure a systematic review of the department's performance to ensure that its programs meet the needs of native Hawaiians and do so as cost-efficiently as possible.

In another example, our 1993 report called for a comprehensive strategic plan—including goals, milestones, and monitoring controls—as a guide for DHHL's programs. We pointed out that the department's 1976 *General Plan*—which established land management goals, objectives, policies, and priorities—was outdated.

At the time of our 1993 audit, DHHL questioned the need for a written strategic plan, commenting that it did have a strategic planning *process* leading to key actions and decisions. We responded 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. Subsequently, in its 1994 letter to the Auditor, DHHL continued to disagree with our recommendation but noted that the Hawaiian Homes Commission has approved funding to update the DHHL General Plan. We are encouraged that this update is in progress and urge DHHL to reconsider our recommendation.

In 1993, DHHL took the position that money—funds for developing and improving homestead lands—is what drives the accomplishment of DHHL's mission, not forming more committees and doing more planning. We acknowledge that funds are essential. But with limited resources, DHHL also needs to examine whether it is using its resources as effectively and efficiently as possible. Our 1993 audit and this follow-up were designed to help bring this about.

At the conclusion of our follow-up work, the new DHHL administration indicated support for most of our 1993 recommendations. The new director indicated that appropriate corrective actions are underway to respond to many of the audit findings. We view this as a positive sign.