Financial Audit of the Department of Commerce and Consumer Affairs

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

Report No. 98-10
March 1998

THE AUDITOR
STATE OF HAWAII

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Conducted by

The Auditor
State of Hawaii
and
Coopers & Lybrand L.L.P.

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 98-10
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Foreword

This is a report of our financial audit of the Department of Commerce and Consumer Affairs for the fiscal year July 1, 1996 to June 30, 1997. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Coopers & Lybrand L.L.P.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Commerce and Consumer Affairs.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the State of Hawaii Department of Commerce and Consumer Affairs. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Coopers & Lybrand L.L.P.

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

Background

The Department of Commerce and Consumer Affairs is responsible for protecting the interests of consumers, depositors, and investors throughout the state. It sets standards and enforces all laws and rules governing the licensing, operation, registration and supervision of the conduct of trades, businesses, and professions including banks, insurance companies, brokerage firms and other financial institutions.

The department is also the consumer advocate for concerns relating to public utilities, which include public communications and transportation companies. The Hawaii Public Broadcasting Authority and the Hawaii Hurricane Relief Fund are assigned to the department for administrative purposes but are not within the scope of this audit.

Organization

The department is a centralized agency headed by a full-time director. Operations of the department are carried out by the following offices and divisions:

Divisions and offices

Administrative Services Office
This office provides the department with internal management, fiscal and office services, and performs personnel management functions.

Hawaiian Claims Office
This office provides administrative, technical and clerical support services to the Hawaiian Home Lands Trust Individual Claims Review Panel.

Information Systems/Communications Office
This office plans, directs, and coordinates the department's internal and external communications through sharing and transferring information using various mediums.

Office of Administrative Hearings
This office provides specialized staff to all divisions and boards that conduct hearings to resolve consumer complaints. The complaints include medical tort claims or professional negligence claims against engineers, architects or surveyors licensed under Chapter 464, Hawaii Revised Statutes.

Regulated Industries Complaints Office
This office provides specialized staff support to the department's director by resolving complaints and providing public information. It also analyzes and researches trends in consumer complaints and recommends to the director possible changes to regulations, laws, or policy.

Business Registration Division
This division administers various chapters of state laws relating to corporations; partnerships; registration of trademarks, trade names, prints and labels; sales of securities; miscellaneous business registrations; charitable organizations; franchises; and take-over bids.

Cable Television Division
This division insures that quality cable communication services are made available at reasonable rates to all potential subscribers and users in all locations within the state.

Division of Consumer Advocacy
This division assists the Consumer Advocate in performing his duties and obligations. It plans, organizes, directs and coordinates a program for the observance of laws regulating the conduct and management of all franchised or certificated public utility service companies operating in the state.

Office of Consumer Protection
This office provides protection to the public from businesses and individuals engaged in unfair or deceptive practices. It receives and investigates consumer complaints; files lawsuits; levies civil penalties; obtains restitution and determines unfair or deceptive practices; and recommends and drafts legislation.

Division of Financial Institutions
This division administers various chapters of the Hawaii Revised Statutes relating to the chartering, licensing, registration, examination,

supervision, and regulation of banks, trust companies, savings and loan associations, loan companies, credit unions, business development corporations, and escrow depositories.

Insurance Division
This division administers various chapters of the Hawaii Revised Statutes relating to the licensing, supervision, and regulation of all insurance transacted in the state by insurance companies, general agents, subagents and solicitors, and by nonprofit corporations and associations operating as fraternal and mutual benefit societies.

Professional and Vocational Licensing Division
This division provides administrative and support services to enable professional and vocational licensing boards and commissions to carry out their policies and regulatory missions. It reviews and processes applications for occupational licenses, and maintains records of licensees.

Units assigned for administrative purposes

Hawaii Public Broadcasting Authority
This agency is assigned to the department for administrative purposes. It is responsible for establishing, managing, controlling, and operating the State's public broadcasting facilities.

Hawaii Hurricane Relief Fund
This division administers the hurricane reserve trust fund and provides hurricane property insurance policies in Hawaii.

Objectives Of The Audit

1. Assess the adequacy, effectiveness, and efficiency of the department's systems and procedures for the financial accounting, internal control, and financial reporting; recommend improvements to such systems, procedures and reports; and to report on the financial statements of the department.

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

3. Make recommendations as appropriate.

Scope and Methodology

We audited the financial records and transactions and reviewed the related systems of accounting and internal controls of the department for the fiscal year July 1, 1996 to June 30, 1997. Included were all fund types and account groups, except the general fixed assets account group, Hawaii Hurricane Relief Fund, and the Hawaii Public Broadcasting Authority. We also reviewed the department's transactions and its systems and procedures for compliance with applicable laws and regulations.

The audit reviewed the department's accounting, reporting, and internal controls including the department's forms and records, management information system, accounting, and operational procedures.

The audit was conducted from June 1997 through September 1997 in accordance with generally accepted auditing standards as set forth by the American Institute of Certified Public Accountants and the standards for financial audits as set forth in the U.S. General Accounting Office's Government Auditing Standards (1994 Revision). The independent accountants' opinion as to the fairness of the financial statements presented in Chapter 3 is that of Coopers & Lybrand L.L.P.

Chapter 2
Financial Management Practices

Management controls are steps instituted by management to assure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial management control practices and procedures of the Department of Commerce and Consumer Affairs.

Summary of Findings

We found that the department could improve its operations by implementing or revising certain procedures. Specifically, our findings are:

1. The department's business registration and professional and vocational licensing divisions charge businesses and professions fees that are not in compliance with Section 26-9, Hawaii Revised Statutes. The fees do not bear a reasonable relationship to the cost or value of services rendered and unencumbered cash of $20 million is sitting in three special fund accounts as a result.

2. Fees assessed by the insurance division exceed the division's costs. The division's two revolving funds have unencumbered cash balances of $4 million at June 30, 1997.

3. Because receipts are not deposited in a timely manner, interest earnings are lost and checks can be lost or misplaced.

Fees Assessed Do Not Reasonably Relate to the Cost or Value of Services Rendered

The department has various special fund accounts and is authorized to assess fees on various businesses and professions to cover the cost of regulation. However, revenues from those regulatory fees and assessments have exceeded the cost of regulation. The department has accumulated more than $20 million of unencumbered cash balances in three of its special fund accounts. The growth of these accounts indicates that the assessed fees do not comply with Section 26-9(l)(1), Hawaii Revised Statutes, that allows the Director of the Department of Commerce and Consumer Affairs to:

> establish, increase, decrease or repeal fees relating to any aspect of the registration, certification, licensure, or any other administrative process for all laws within the jurisdiction of the

> department. *The fee assessed shall bear a reasonable relationship between the revenue derived from the fee and the cost or value of services rendered.* (emphasis supplied)

Fees collected from business registration and professional and vocational licensing have far exceeded the costs of services rendered. Fees collected from professional and vocational licensees to support the Regulated Industries Complaints Office have also exceeded the cost of operating that office. Further, there is no cost relationship between the number of complaints reviewed and the fees collected. Exhibit 2.1 summarizes unencumbered cash balances held in these accounts.

Exhibit 2.1
Unencumbered Cash Balances Held in Compliance Resolution Fund Accounts
June 30, 1997

Division/Office Account	Unencumbered Cash Balance
Business Registration Division	$12,727,000
Professional and Vocational Licensing Division	3,756,000
Regulated Industries Complaints Office	3,606,000
Total	$20,089,000

Business registration and professional and vocational licensing fees appear excessive

The department assesses business registration fees annually. Professional and vocational licensing fees are assessed biennially.

Prior to July 1, 1994, operations of the Business Registration Division and the Professional and Vocational Licensing Division were funded almost entirely by the State's general fund. Most of the fees assessed were deposited into the State's general fund and subject to public hearings and legislative approval. In 1993, the law was changed to require that fees collected be placed into the Compliance Resolution Fund and be used to defray the operating costs of the divisions and support offices. The department has established separate accounts within this fund to track revenues and expenditures for the Business Registration Division, the Professional and Vocational Licensing Division, and the Regulated Industries Complaints Office.

Fees assessed by the Business Registration Division and Professional and Vocational Licensing Division have far exceeded the costs of regulation. Financial information for the two divisions is presented in Exhibits 2.2 and 2.3.

Exhibit 2.2
Business Registration Division
Revenues, Expenditures, and Account Balance
Fiscal Years Ended June 30, 1995, 1996, and 1997

	FY1994-95	FY1995-96	FY1996-97
Beginning Balance	$4,528,000	$7,401,000	$8,158,000
Revenues	7,842,000	4,931,000	9,051,000
Expenditures	4,969,000	2,748,000	3,968,000
Transfer* (Out) In	0	(1,426,000)	14,000
Ending Balance	$7,401,000	$8,158,000	$13,255,000

* Transfers (out) and in are to and from the Regulated Industries Complaints Office account. The net transfer out of $1,412,000 represents the department's computation of the net amount due to the complaints office for moneys previously collected and deposited into this account.

Exhibit 2.3
Professional and Vocational Licensing Division
Revenues, Expenditures, and Account Balance
Fiscal Years Ended June 30, 1995, 1996, and 1997

	FY1994-95	FY1995-96	FY1996-97
Beginning Balance	$ 0	$1,913,000	$3,884,000
Revenues	3,088,000	4,921,000	3,090,000
Expenditures	1,175,000	2,950,000	3,197,000
Ending Balance	$1,913,000	$3,884,000	$3,777,000

The growth of these multi-million dollar account balances, particularly in the Business Registration Division, indicates that registration and licensing fees do not reasonably relate to the costs of registration and licensing services. Fees charged may not be warranted.

Some compliance resolution fees are excessive

The department assesses compliance resolution fees on all persons licensed by the Professional and Vocational Licensing Division. The compliance fees are assessed biennially with the licensing fees and are used to pay the operating costs of the Regulated Industries Complaints Office. Information on revenues and expenditures of the office is presented in Exhibit 2.4.

Exhibit 2.4
Regulated Industries Complaints Office
Revenues, Expenditures, and Account Balance
Fiscal Years Ended June 30, 1996 and 1997

	FY1995-96	FY1996-97
Beginning Balance	$0	$3,110,000
Revenues	4,780,000	3,803,000
Expenditures	3,096,000	3,271,000
Transfer** In (Out)	1,426,000	(14,000)
Ending Balance	$3,110,000	$3,628,000

** Prior to FY1995-96, these compliance resolution revenues and expenditures were combined with those of the Business Registration Division. Since 1995, the compliance resolution fees have been accounted for separately. The net transfer of $1,412,000 is from the Business Registration Division account and is based on the department's computation of net fees collected and deposited for the Regulated Industries Complaint Office.

In 1993, the Regulated Industries Complaints Office prepared an analysis of its cost of services for the various regulated professions and vocations. Its analysis concluded that an annual base cost of $33 for services for every licensee was warranted. Its analysis also showed that the annual service cost for various professions ranged from the minimum base of $33 to a high of $337. The office then developed fee schedules for each licensed profession or vocation; however, fees collected in accordance with this schedule have far exceeded the office's costs.

Compliance resolution fees do not relate to the number of complaints reviewed

Section 26-9(l)(1), HRS, applies not only to business and professional licensing and regulation, but also to the operations of the Regulation Industries Complaints Office. Compliance resolution fees charged of various professions should also reasonably relate to the office's cost of reviewing complaints made against regulated professions. The Regulated Industries Complaints Office should ensure that each regulated profession or vocation bears its proportionate share of complaint review costs. However, this is not the case.

The Regulated Industries Complaints Office keeps statistics on number of complaints reviewed for each profession or vocation. However, the office does not keep cost reports for the reviewing of those complaints. Therefore, we were unable to determine if compliance resolution fees actually covered the related costs of reviewing complaints. However, we were able to allocate operating costs to the various professions based on the office's statistics of the number of complaints reviewed.

For the calendar years 1994-1996, using the number of complaints reported in the department's 1996 annual report, we allocated total costs by number of complaints per profession. We then computed the applicable compliance fee assessed using the 1994 fee schedule set forth in administrative rules, multiplied by the number of licensees.

Our analysis showed dramatic differences between the department's collected fees based on the numbers of licensees, versus operating costs allocated based on the number of complaints reviewed. We noted that contractors received the highest annual average number of complaints and that the boxing commission had no complaints. Both groups were assessed fees at the 1994 rates ($55 annually for contracting and $35 annually for boxing). Our comparative analysis shows differences as follows:

Profession	No. of Licenses	Average Number of Complaints	Annual CRF Fees Assessed	Allocated Costs by Profession	Excess (Deficiency)
Contracting	6,898	601	$379,390	$1,028,727	$(649,337)
Motor Vehicle Industry	1,691	155	93,005	265,312	(172,307)
Boxing Commission	108	0	3,780	0	3,780
Cosmetology	5,813	13	203,455	22,252	181,203
Nursing	18,587	27	650,545	46,216	604,329

It is apparent that the fees paid by licensed nurses and cosmetologists subsidize the costs of resolving complaints against contractors and motor vehicle industry employees. Distortions in the cost analysis may occur due to insufficient information on costs for resolving complaints. However, the differences noted are significant enough to warrant a review of the current method of determining compliance resolution fees.

Insurance Division's Revolving Funds Have High Cash Balances

The insurance division has two revolving funds that had unencumbered cash balances of almost $4.1 million at June 30, 1997. The insurance division is authorized to assess fees to cover the costs of conducting required examinations of insurance companies and to cover costs of administering the State's no-fault automobile insurance law. Insurers are also assessed a statutory fee which is deposited into one of the funds. The excess of fees over costs for these two programs that averaged about $800,000 each year over the past three fiscal years, is held in the two revolving funds. Unencumbered cash balances in the two funds are presented here.

Revolving Fund	Unencumbered Cash Balance June 30, 1997
Insurance Examiners	$1,202,000
No-Fault Administration	2,874,000
Total	$4,076,000

Insurance Examiners Revolving Fund

This fund is authorized under Section 431:2-307, HRS, to fund the cost of examinations of insurance companies. The statute requires each authorized insurer to pay an annual $550 fee into the fund. Revenues of the fund also consist of reimbursements for examination costs from insurance entities for expenses when independent contract examiners perform work. The fund is scheduled for repeal on June 30, 2000. Any balance remaining in the fund at that time will revert to the general fund. Given the fund's large unencumbered cash balance and the fact that it is already scheduled for repeal, the Legislature should consider transferring the excess cash balance to the general fund before June 30, 2000.

No-Fault Administration Revolving Fund

This fund is authorized by Section 431:10C-115.5, HRS, to fund the cost of administering the State's no-fault automobile insurance law. The largest source of revenue to the fund is an annual assessment on regulated motor vehicle insurers and those self-insured under the no-fault law. By law, the assessment is to be "a fair and equitable amount." Since its inception in 1992, the fund's revenues have exceeded the costs of administering the no-fault law. For the fiscal year ended June 30, 1997, revenues exceeded expenditures by almost $500,000 and the unencumbered cash balance has grown to almost $2.9 million. The growing cash balance raises questions regarding the fairness of the annual assessments.

Receipts Are Not Deposited in a Timely Manner

The department receives applications daily with related payments (cash or check) for corporate filings, partnership filings, trademarks, trade names, service marks, and licenses. On a typical day, the checks alone total approximately $10,000. Once received, the checks are held up to 20 days while the accompanying applications are processed. As a result, on any given day, up to $200,000 in checks may be held pending the processing of those applications. The checks are not held in secured locations in the department before being deposited into the state treasury.

We were informed that the reason for this practice is to facilitate the division's return of checks with rejected applications, rather than issue refund checks with rejected applications. This reasoning is inconsistent with the division's practice of depositing cash immediately. Cash payments are deposited immediately into the state treasury through a daily armored car service. Only checks are held, pending the processing of the related paperwork. Because the department immediately deposits cash received with applications, it must then issue refund checks for those applications that are subsequently rejected.

Holding checks in unsecured locations prior to deposit exposes the department to the risk of theft or loss of the checks. Additionally, the department loses daily interest earnings on up to $200,000 of checks held. Checks received should be subject to the same controls as cash received—they should be deposited daily into the state treasury using the same armored car service used for cash deposits.

Recommendations

1. We recommend that the department make adjustments necessary to ensure that regulatory fees assessed on businesses and professions bear a reasonable relationship to the cost or value of services rendered.

2. We also recommend that the Legislature consider transferring excess cash from the Insurance Examiners Revolving Fund to the general fund before June 30, 2000.

3. We recommend that the insurance commissioner review annual no-fault insurance assessments with an eye toward bringing the annual assessments in line with annual no-fault administrative costs.

4. We recommend that the department ensure that all checks received are deposited daily into the state treasury.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Department of Commerce and Consumer Affairs as of and for the fiscal year ended June 30, 1997. This chapter includes the independent auditors' report and report on compliance and on internal control over financial reporting for the department.

Summary of Findings

In the opinion of Coopers & Lybrand L.L.P. based on their audit, except for the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and general fixed assets account group, which were excluded from the scope of work, the financial statements present fairly, in all material respects, the financial position of the department as of June 30, 1997, and the results of its operations for the fiscal year then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P. noted no matters involving the internal control structure and its operation that they considered to be reportable conditions. However, Coopers & Lybrand did note an instance of noncompliance with laws and regulations applicable to the department that is required to be reported under *Government Auditing Standards.*

Independent Auditors' Report

To the Auditor
State of Hawaii

We have audited the following financial statements of the State of Hawaii Department of Commerce and Consumer Affairs (department):

Combined Balance Sheet - All Fund Types and Account Groups, June 30, 1997 (Exhibit A);

Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types and Expendable Trust Funds, year ended June 30, 1997 (Exhibit B);

Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) - Governmental Fund Types, year ended June 30, 1997 (Exhibit C);

Component Unit - Enterprise Fund, Hawaii Hurricane Relief Fund Statement of Revenue, Expenses and Changes in Retained Earnings (Unaudited), year ended June 30, 1997 (Exhibit D);

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

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with the terms of our engagement, the scope of our audit did not include the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and general fixed assets account group. As a result, financial information pertaining to the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and general fixed assets account group are included in the accompanying combined financial statements of the department for information only. Financial information pertaining to the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and general fixed assets account group have been prepared from the department's records without audit and we express no opinion on them.

As discussed in Note 1, the combined financial statements of the department are intended to present the financial position and results of operations, except as described above, of only that portion of the financial reporting of the State of Hawaii that is attributable to the transactions of the department.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the scope of our audit included the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and general fixed assets account group as discussed in the third paragraph above, the combined financial statements referred to above present fairly, in all material respects, the financial position of the State of Hawaii Department of Commerce and Consumer Affairs as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 12, 1997 on our consideration of the department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Our audit was performed for the purpose of forming an opinion on the combined financial statements of the department taken as a whole. The following supplemental schedules, which are also the responsibility of the department's management, are presented for purposes of additional analysis and are not a required part of the combined financial statements:

Combining Balance Sheet - General Fund, June 30, 1997 (Schedule I);

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - General Fund, year ended June 30, 1997 (Schedule II);

Combining Balance Sheet - Special Revenue Funds, June 30, 1997 (Schedule III);

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Special Revenue Funds, year ended June 30, 1997 (Schedule IV);

Combining Balance Sheet - Trust and Agency Funds, June 30, 1997 (Schedule V);

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Expendable Trust Funds, year ended June 30, 1997 (Schedule VI);

Combining Statement of Changes in Net Assets and Liabilities - Agency Funds, year ended June 30, 1997 (Schedule VII)

The supplemental schedules described above, except for financial information pertaining to the Hawaii Public Broadcasting Authority, have been subjected to the auditing procedures applied in the audit of the combined financial statements and, in our opinion, are fairly stated in all material respects in relation to the combined financial statements taken as a whole.

/s/Coopers & Lybrand L.L.P.

Honolulu, Hawaii
September 12, 1997

Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Auditor
State of Hawaii

We have audited the combined financial statements of the State of Hawaii Department of Commerce and Consumer Affairs as of and for the year ended June 30, 1997, and have issued our report thereon dated September 12, 1997. We conducted our audit in accordance with generally accepted auditing standards and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the State of Hawaii Department of Commerce and Consumer Affairs' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*. As discussed more fully in Chapter 2, Compliance Resolution Fund fees assessed do not bear a reasonable relationship to the cost or value of services rendered as required by Section 26-9, Hawaii Revised Statutes.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Hawaii Department of Commerce and Consumer Affairs' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted a matter involving the internal control over financial reporting which concerns receipts not being deposited in a timely manner as more fully discussed in Chapter 2.

This report is intended for the information of the Auditor and the department's management. However, this report is a matter of public record, and its distribution is not limited.

/s/Coopers & Lybrand L.L.P.

Honolulu, Hawaii
September 12, 1997

Descriptions and Definitions

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

Descriptions of financial statements and schedules

The following is a brief description of the financial statements and schedules audited by Coopers & Lybrand L.L.P., except for financial information pertaining to the Hawaii Public Broadcasting Authority, Hawaii Hurricane Relief Fund, and the general fixed assets account group. Financial statements and schedules are attached at the end of this chapter.

Combined Balance Sheet—All Fund Types and Account Groups (Exhibit A). This statement presents assets, liabilities, and fund equity of all fund types and account groups used by the department on an aggregate basis.

Combined Statement of Revenues, Expenditures, and Changes in Fund Equity—All Governmental Fund Types and Expendable Trust Funds, Year ended June 30, 1997 (Exhibit B). This statement presents revenues, expenditures, and changes in fund equity for all governmental fund types and expendable trust funds used by the department on an aggregate basis. Revenues include state appropriations mandated by various appropriations acts of the Legislature.

Combined Statement of Revenues, Expenditures, and Other Financing Uses—Budget and Actual (Budgetary Basis) - General and Special Revenue Funds, Year ended June 30, 1997 (Exhibit C). This statement summarizes revenues and expenditures by source and type on the budgetary basis and compares such amounts to the budget as adopted by the Legislature.

Component Unit - Enterprise Fund, Hawaii Hurricane Relief Fund Statement of Revenue, Expenses and Changes in Retained Earnings, Year ended June 30, 1997 (Unaudited) (Exhibit D). This statement summarizes the revenues and expenses of the Hawaii Hurricane Relief Fund.

Combining Balance Sheet - General Fund, June 30, 1997 (Schedule I). This schedule presents assets, liabilities and fund equity of the general funds of the department.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - General Fund, Year ended June 30, 1997 (Schedule II). This schedule presents revenues, expenditures and changes in fund equity of the general funds of the department.

Combining Balance Sheet—Special Revenue Funds, June 30, 1997 (Schedule III). This schedule presents assets, liabilities and fund equity of the special revenue funds of the department.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances—Special Revenue Funds, Year ended June 30, 1997 (Schedule IV). This schedule presents revenues, expenditures and changes in fund equity of the special revenue funds of the department.

Combining Balance Sheet—Trust and Agency Funds, June 30, 1997 (Schedule V). This schedule presents assets, liabilities and fund equity of the trust and agency funds of the department.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances—Expendable Trust Funds, Year ended June 30, 1997 (Schedule VI). This schedule presents revenues, expenditures and changes in fund equity of the expendable trust funds of the department.

Combining Statement of Changes in Assets and Liabilities—Agency Funds, Year ended June 30, 1997 (Schedule VII). This schedule presents changes in assets and liabilities of the agency funds of the department.

Definition of terms

Technical terms are used in the combined financial statements and in the notes to the combined financial statements. The more common terms and their definitions are as follows:

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

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

Encumbrance. An obligation in the form of a purchase order or contract which is chargeable to an appropriation, the incurring of which sets aside the appropriation for the amount of the obligation.

Expenditure. The actual disbursement of funds for the payment of goods delivered or services rendered, the obligation to pay for such goods or services having been incurred against authorized funds.

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

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

Notes to Combined Financial Statements

Explanatory notes which are pertinent to an understanding of the combined financial statements and financial condition of the funds included in the scope of the engagement are discussed in this section.

(1)Financial reporting entity

The State of Hawaii Department of Commerce and Consumer Affairs (department) is responsible for protecting the interests of consumers, depositors, and investors throughout the State. It is responsible for setting standards and enforcing all laws, rules and regulations governing the licensing, registration, and supervision of trades, businesses, and professions including banks, insurance companies, brokerage firms and other financial institutions. The department serves as consumer advocate on matters relating to public utilities, communications and transportation. It ensures that subscribers are provided with cable communications services which meet acceptable standards of quality and monitor rates, charges and the operation and management of cable television operators. In addition, the Hawaii Public Broadcasting Authority and Hawaii Hurricane Relief Fund are assigned to the department for administrative purposes.

The accompanying combined financial statements reflect the financial position and results of operations of the following divisions of the department:

Cable Television Division

The Cable Television Division is charged with responsibility for ensuring that quality cable communication services are available to potential subscribers in all locations within the State at reasonable rates. The division's operations are reported in the Special Revenue Funds.

Division of Financial Institutions

The Division of Financial Institutions administers state laws relating to the chartering, licensing, registration, examination, supervision, and regulation of state-chartered banks, international-foreign banking corporations, foreign banks, trust companies, small loan companies, state-chartered credit unions, business development corporations and escrow depositories. The division's operations are reported in both the General and Special Revenue Funds.

Insurance Division

The Insurance Division administers state laws relating to licensing, supervision, and regulations of all insurance transacted in the State by insurance companies, general agents, subagents, and solicitors, and by nonprofit corporations and associations operating as fraternal and mutual benefit societies. The division's operations are reported in the General, Special Revenue and Trust Funds.

Business Registration Division

The Business Registration Division is responsible for administering state laws relating to corporations; partnerships; registration trademarks, trade names, prints and labels; miscellaneous business registrations; charitable organizations; franchises; takeover bids; and sales of securities. The division enforces all securities and investment related activities. The division's operations are reported in both the General and Special Revenue Funds.

Professional and Vocational Licensing Division

The Professional and Vocational Licensing Division provides administrative and technical assistance to approximately 40 regulatory boards and commissions. Specifically, the division is responsible for reviewing and processing applications for all occupational licenses and license renewals and for maintaining records of licensees. The division's operations are reported in the General, Special Revenue and Trust Funds.

Regulated Industries Complaints Office

The Regulated Industries Complaints Office provides specialized staff support to the director of commerce and consumer affairs in complaint resolution and public information. The office's operations are reported in both the General and Special Revenue Funds.

Division of Consumer Advocacy

The Division of Consumer Advocacy assists the Consumer Advocate in the performance of his duties and obligations. The Division plans, organizes, directs and coordinates a program for the observance of laws regulating the conduct and management of all franchised or certificated public service companies operating in the State. The division's operations are reported in both the General and Special Revenue Funds.

Office of Consumer Protection

The Office of Consumer Protection provides protection to the public from businesses and individuals engaged in unfair or deceptive practices. The unfair or deceptive practices investigated and subject to legal action by the office are generally those which have a potential impact on consumers. The office's operations are reported in both the General and Special Revenue Funds.

Hawaii Public Broadcasting Authority

The Hawaii Public Broadcasting Authority, assigned to the department for administrative purposes, is responsible for establishing, managing, controlling, and operating the State's public broadcasting facilities. It broadcasts television programs which are intended to enlighten the people of the State. The authority's operations are reported in the General, Special Revenue and Trust Funds.

Hawaii Hurricane Relief Fund

The Hawaii Hurricane Relief Fund, assigned to the department for administrative purposes, provides hurricane property insurance policies in Hawaii. It is reported as a component unit enterprise fund of the department.

(2)Summary of significant accounting policies

Financial statement presentation

The financial transactions of the department are recorded in individual funds and account groups which are reported by type in the combined financial statements. The department's financial statements are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State that are attributable to the transactions of the department. The State Comptroller maintains the central accounts for all State funds and account groups of the department and publishes financial statements for the State annually, which includes the department's activities.

Each fund and account group is considered a separate accounting entity. The operations of each are accounted with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, expenditures and expenses. Financial resources are allocated to and are accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

The total columns on the accompanying combined financial statements are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Information in these columns do not purport to present financial position or results of operations of the department in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation. Interfund balances and transactions have not been eliminated.

The department uses the following fund types, funds and account groups:

Governmental Fund Types:

General Fund. Accounts for all financial resources of the department except those required to be accounted for in another fund.

Special Revenue Funds. Account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes.

Fiduciary Fund Type:

Trust and Agency Funds. Account for assets held by the department in a trustee capacity or as agent for individuals, private organizations, other governments, and/or funds.

Account Groups:

General Fixed Assets Account Group. Accounts for all fixed assets of the department.

General Long-Term Obligations Account Group. Accounts for the long-term portion of accrued vested vacation and compensatory time.

Proprietary Fund Type:

Enterprise Fund. Accounts for operations that are financed and operated in a manner similar to a private business enterprise.

Basis of accounting

Governmental Fund Types, Expendable Trust and Agency Funds. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for by using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues) and decreases (i.e., expenditures and other financing uses) in net current assets.

The department uses the modified accrual basis of accounting for the General, Special Revenue, and Expendable Trust and Agency Funds. Under the modified accrual basis of accounting, revenues and related current assets are recognized in the accounting period when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year-end. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after year-end to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include funds appropriated by the State Legislature and allotted by the Governor.

Generally, proprietary fund types are accounted for on the accrual basis of accounting. Revenues are recognized in the period earned and expenses are recognized in the period incurred. However, the financial information pertaining to the Hawaii Hurricane Relief Fund, a proprietary fund type, was not audited.

Cash and cash equivalents

Cash and cash equivalents reported in the combined balance sheet includes cash in the state treasury and cash, time certificates of deposit and repurchase agreements with original maturities of three months or less in various banks in the State of Hawaii.

The State maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the combined balance sheet within "cash and cash equivalents." Those funds are pooled with funds from other State departments and deposited in approved financial institutions by the director of the Department of Budget and Finance. Hawaii Revised Statutes (HRS) require deposits not insured under any law of the United States to be fully collateralized with securities permitted under Section 38-3, HRS.

The statutes authorize the director of finance to invest any moneys of the State which in the director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

The department's agency fund and the Hawaii Hurricane Relief Fund maintain cash in banks that are held separately from cash in the state treasury. Those deposits of the department's agency fund which are not covered by federal deposit insurance are also fully collateralized by government securities held in the name of the State by third party custodians. Deposits of the Hawaii Hurricane Relief Fund were not audited.

Information relating to the bank balance, insurance, and collateral of cash deposits and investments are determined on a statewide basis and not for individual departments or divisions.

Fixed assets (Unaudited)

Fixed assets reported in the General Fixed Assets Account Group are recorded at cost. Those assets acquired or constructed for general governmental purposes were reported as expenditures in the funds that financed the assets at acquisition. No depreciation is provided on general fixed assets.

Reservation of fund balances

Portions of fund balances are reserved for the following:

- Encumbrances which are recorded obligations in the forms of purchase orders, contracts, or salary commitments. The department records commitments as encumbrances at the time purchase orders or contracts are awarded and executed.
- Expendable trust fund balances which are restricted to the purpose of the fund.

Encumbrances

Encumbrances represent commitments related to unperformed contacts for goods or services. Encumbrances accounting is utilized in the governmental fund types. Encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during a subsequent fiscal year.

Interfund transactions

Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the other financing uses section of the combined statement of revenues, expenditures and changes in fund balances - all governmental fund types and expendable trust funds. All such transfers require the governor's approval. Intrafund transfers have been eliminated.

Accrued vacation and sick leave

Vacation pay is accrued as earned by employees. Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end. The employees of the department are entitled to receive cash payments for accumulated vacation leave upon termination of their employment. In governmental fund types, the amounts expected to be liquidated with expendable available financial resources are accrued in the respective funds and the amounts payable from future resources are recorded in the General Long-Term Obligations Account Group.

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of an illness, is not convertible to pay upon termination of the employment and is recorded as an expenditure when taken. However, a public employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenditures and expenses during the reporting period. Actual results could differ from those estimates.

(3)Budgeting and budgetary control

The budget of the department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenue available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected as budgeted revenues in the Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) - Governmental Fund Types are those estimates as compiled by the department and reviewed by the Department of Budget and Finance. Budgeted expenditures are derived primarily from the General Appropriations Act of 1996 (Act 218, Sessions Laws of Hawaii of 1996), as amended, and from other authorizations contained in the Hawaii Constitution, the Hawaii Revised Statutes and other specific appropriation acts in various Session Laws of Hawaii.

All expenditures of these appropriated funds are made pursuant to the appropriations in the biennial budget as amended by subsequent supplemental appropriations. Budgetary control is maintained at the departmental level. Budget revisions and interdepartmental transfers may be effected with certain executives and legislative branch approvals.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other contingencies which may terminate the authorization for other appropriations.

Differences between revenues and expenditures reported on the budgetary basis and those reported in accordance with generally accepted accounting principles (GAAP) are mainly due to revenues and expenditures of unbudgeted funds, the treatment of lapses and transfers for budgeting purposes, and the different methods used to recognize resources used. For budgeting purposes, resource uses are recognized when cash disbursements are made or funds are encumbered. In financial statements presented in accordance with generally accepted accounting principles, expenditures are recognized as incurred and encumbrances are not reported as resources used.

A summarization of the differences between revenues and expenditures reported on the budgetary basis and those reported in accordance with GAAP for the year ended June 30, 1997 is as follows:

	General	Special Revenue
Excess (deficiency) of revenues over expenditures and other financing uses - actual (budgetary basis)	$152,949	$7,616,143
Reserved for encumbrances	327,635	2,155,936
Operating transfers out	—	(96,000)
Lapsed appropriations	(168,153)	—
Expenditures for liquidation of prior year encumbrances and reservations	(501,392)	(1,769,866)
Accrued expenditures, not recognized for budgetary purposes, net of prior year accruals	27,360	141,386
Excess (deficiency) of revenues over expenditures and other financing uses - GAAP basis	$(161,601)	$8,047,599

(4) Investments

At June 30, 1997, investments with original maturities greater than three months included the following:

Time certificates of deposit	$1,275,000
Repurchase agreements	1,300,000
U.S. Government Securities	350,000
	$2,925,000

(5) General fixed assets (Unaudited)

Changes in the Department's General Fixed Asset Account Group (unaudited) for the year ended June 30, 1997 are as follows:

	Balance 6/30/96	Additions	Disposals	Balance 6/30/97
Vehicles	$ 61,340	$ —	$ —	$ 61,340
Furniture and equipment	11,671,787	208,731	976,169	10,904,349
	$11,733,127	$208,731	$976,169	$10,965,689

(6) Premium taxes received under protest from insurers

Pursuant to Section 40-3, Hawaii Revised Statutes, any disputed portion of moneys representing a claim in favor of the State may be paid under protest to the agency of the State with which the claimant has the dispute. Premium taxes received under protest from insurers represents such payments made by insurance companies. The disputed premium taxes are held by the department pending final adjudication, at which time the moneys held will be distributed to the claimants and/or the State as designated by the court judgment.

In April, 1997, a court judgment dismissed an appeal by an insurance company for $2,997,452. The attorney general notified the department of this judgment in August, 1997. These funds are currently invested. The department plans to transfer these funds to the state general fund when the investments mature in September, 1997.

In August, 1997, a settlement agreement dated April 2, 1997, was amended. The revised refunds totaled $3,498,581. These funds are currently invested. The department plans to transfer these funds to a law firm for distribution when the investments mature in September, 1997.

(7) Pension information

Substantially all eligible employees of the department are members of the Employee's Retirement System of the State of Hawaii (System), a cost-sharing multiple employer public employee retirement plan. The

System provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option.

In 1984, legislation was enacted to create a new noncontributory option for members of the System who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five years and ten years of credited service under the contributory and noncontributory options, respectively.

Required contributions to the System are based on actuarially determined rates that should provide sufficient resources to pay member pension benefits when due. The funding method used to calculate the total employer contribution required is the frozen initial liability method, and includes amortization of the accrued unfunded liability of pension benefits and post retirement benefits fixed at $470 million over a period of twenty-eight years beginning July 1, 1987. The department's policy is to fund its required contribution annually. The department's general fund share of the retirement system expense for the year ended June 30, 1997, was to be expended by the Department of Budget and Finance and is not reflected in the department's general fund financial statements. Contributions expended from Special Revenue and Expendable Trust Funds in fiscal year 1997 were $3,181,413 and $124,415, respectively.

Measurement of assets and actuarial valuations are made for the entire System and are not separately computed for individual participating employers such as the department. The disclosures required by Governmental Accounting Standards Board Statement No. 5, "Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers" and are presented in the State of Hawaii Comprehensive Annual Financial Report (CAFR). The following data is provided as of June 30, 1996, the most recent information available, for the entire System from the disclosures contained in the CAFR for the year then ended:

Pension benefit obligation	$7,292,592,400
Net assets available for benefits, at cost (market value $6,657,378,000)	6,063,074,610
Unfunded pension benefit obligation	$1,229,517,790

The pension benefit obligation is a standardized measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

Ten-year historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due is presented in the System's CAFR.

The entire System's actuarially determined employer contribution requirements were met as of June 30, 1996.

Section 88-107, HRS, was amended so that 100 percent of the investment earnings from the System shall be deposited to the pension accumulation fund effective July 1, 1996. Prior to July 1, 1996, 80 percent of the investment earnings above 8 percent were used to reduce the department's actuarially determined employer contribution. Section 88-122, HRS, was also amended to change the valuation method used by the actuary to the "entry age normal cost" funding method. The impact of these changes on the department's contribution for fiscal year 1997-98 has not been determined.

Effective July 1, 1997, a reciprocal benefits package was enacted to provide spousal retirement benefits for reciprocal beneficiaries who are prohibited from marrying. Funding for the additional benefits to be paid by the department beginning in fiscal year 1998-99 has not been determined.

Effective July 1, 1997, the department will be required to adopt Statement No. 27 of the Government Accounting Standards Board entitled "Accounting for Pensions by State and Local Government Employers." This statement established standards for the measurement, recognition, and display of pension expenditures/expense and related liabilities, assets, not disclosures and, if applicable, required supplementary information in the financial reports of State and Government employers. This statement, when adopted, is not expected to have a material effect on the department's financial statements.

(8)Post retirement health care and life insurance benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits for retired State employees. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The department's general fund share of expense for post retirement benefits for the year ended June 30, 1997, has not been separately computed and is not reflected in the department's general fund financial statements.

(9) Changes in general long-term obligations account group

The following changes occurred in liabilities reported in the General Long-Term Obligations Account Group for the year ended June 30, 1997:

	Accrued vacation payable
Balance, June 30, 1996	$2,601,309
Net increase in accrued vacation payable	252,490
Balance, June 30, 1997	$2,853,799

(10) Operating leases

The department leases land and equipment under noncancelable operating leases. The commitments under such lease agreements provide the minimum annual rental payments as follows:

Year ending June 30:	
1998	$102,000
1999	60,000
2000	19,000
2001	19,000
2002	18,000
Thereafter	50,000
	$268,000

Rental expense for all operating leases aggregated $99,163 for the year ended June 30, 1997. The leases expire through the year 2012. The department subleases certain office space from the Department of Accounting and General Services (DAGS)at no cost.

(11) Commitments and contingencies

Litigation

The attorney general reports that there are pending claims against the department in connection with alleged damages resulting from various types of actions. Those claims are in various stages of litigation. The attorney general has advised that she is unaware of any other pending litigation or unasserted claims of such a unique character as to be a significant departure from the department's experience. Losses, if any, to be incurred as a result of such legal proceedings will be funded by the State Legislature through future years' appropriations. No amounts have been accrued by the department for such losses.

Accumulated sick pay

Sick leave for the department's full-time employees accumulates at the rate of 1-3/4 working days for each month of service. While it accumulates without limit, sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a department employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System. Accumulated sick leave as of June 30, 1997 approximates $7,797,000.

Deferred compensation plan

The State established a deferred compensation plan pursuant to Internal Revenue Code Section 457 which enables State employees to defer a portion of their compensation. The State of Hawaii Department of Human Resource Development has the fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforseeable emergency.

All amounts of compensation deferred under the plan, all property rights purchased with those amounts, and all income attributable to those amounts, property, or rights, are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to claims of the state's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant. The assets of the plan and the deferred compensation payable are recorded in the State of Hawaii's Employee Benefits Agency Fund.

Insurance coverage

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State follows Governmental Accounting Standards Board Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" and No. 30 "Risk Financing Omnibus" which establish accounting and financial reporting standards for risk financing and insurance related activities of state governmental entities and require the recordation of a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 1997, the State recorded an estimated loss for workers' compensation, automobile and general liability claims in the general long-term obligations account group as the losses will not be liquidated with currently expendable available financial resources.

The estimated losses will be paid from legislative appropriations of the State's general fund. At June 30, 1997, the department's liability was not significant to its general long-term obligations account group. The department's share of workers' compensation losses are appropriated annually in the general fund. Workers' compensation expenditures for the year ended June 30, 1997, was $20,239.

(12)Non-imposed employee fringe benefits

Non-imposed fringe benefits related to general fund salaries are assumed by the State and are not charged to the department. These costs, totaling $1,799,000 for the fiscal year ended June 30, 1997, have not been reported as revenues and expenditures of the department's General Fund.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the Special Revenue Funds.

Exhibit A

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combined Balance Sheet - All Fund Types and Account Groups
June 30, 1997

	Governmental Fund Types		Fiduciary Fund Type	Account Groups			Component Unit	
	General	Special Revenue	Trust and Agency	General Fixed Assets (Unaudited)	General Long-Term Obligations	Total Primary Government (Memorandum Only)	Hawaii Hurricane Relief Fund (Unaudited)	Total Reporting Entity (Memorandum Only)
Assets								
Cash and cash equivalents	$ 354,995	$ 32,506,003	$ 32,095,519	$ --	$ --	$ 64,956,517	$ 73,617,565	$ 138,574,082
General fixed assets	--	--	--	10,965,689	--	10,965,689	--	10,965,689
Investments	--	2,000,000	925,000	--	--	2,925,000	--	2,925,000
Amount to be provided for retirement of general long-term obligations	--	--	--	--	2,853,799	2,853,799	--	2,853,799
Total assets	$ 354,995	$ 34,506,003	$ 33,020,519	$ 10,965,689	$ 2,853,799	$ 81,701,005	73,617,565	$ 155,318,570
Liabilities and Fund Equity								
Vouchers and contracts payable	$ 27,360	$ 141,386	$ 29,264	$ --	$ --	$ 198,010	$ --	198,010
Premium taxes received under protest from insurers	--	--	28,200,926	--	--	28,200,926	--	28,200,926
Arbitration costs for lemon law claims	--	--	110,420	--	--	110,420	--	110,420
Accrued vacation payable	--	--	--	--	2,853,799	2,853,799	--	2,853,799
Total liabilities	27,360	141,386	28,340,610	--	2,853,799	31,363,155	--	31,363,155
Fund Equity:								
Investment in general fixed assets	--	--	--	10,965,689	--	10,965,689	--	10,965,689
Fund balances -								
Reserved for encumbrances	327,635	2,155,936	42,100	--	--	2,525,671	--	2,525,671
Reserved for amounts held in trust	--	--	4,637,809	--	--	4,637,809	--	4,637,809
Unreserved	--	32,208,681	--	--	--	32,208,681	--	32,208,681
Total fund balances	327,635	34,364,617	4,679,909	--	--	39,372,161	--	39,372,161
Retained earnings	--	--	--	--	--	--	73,617,565	73,617,565
Total fund equity	327,635	34,364,617	4,679,909	10,965,689	--	50,337,850	73,617,565	123,955,415
Total liabilities and fund equity	$ 354,995	$ 34,506,003	$ 33,020,516	$ 10,965,689	$ 2,853,799	$ 81,701,005	$ 73,617,565	$ 155,318,570

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

Exhibit B

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combined Statement of Revenues, Expenditures and Changes in Fund Balances -
All Governmental Fund Types and Expendable Trust Funds
Year ended June 30, 1997

	Governmental Fund Types		Fiduciary Fund Type	
	General	Special Revenue	Expendable Trust	(Total Memorandum Only)
Revenues:				
Allotted appropriations	$ 5,825,417	$ --	$ --	$ 5,825,417
Charges for current services	--	23,616,921	--	23,616,921
Licenses and permits	--	3,089,626	--	3,089,626
Donations, contributions and deposits	--	2,171,974	2,661,097	4,833,071
Total revenues	5,825,417	28,878,521	2,661,097	37,365,035
Expenditures	5,818,865	20,734,922	1,750,275	28,304,062
Excess of revenues over expenditures	6,552	8,143,599	910,822	9,060,973
Other Financing Uses:				
Operating transfers out	--	(96,000)	--	(96,000)
Unrequired balances of appropriations lapsed	(168,153)	--	--	(168,153)
Total other financing uses	(168,153)	(96,000)	--	(264,153)
Excess (deficiency) of revenues over expenditures and other financing uses	(161,601)	8,047,599	910,822	8,796,820
Fund balances at July 1, 1996	489,236	26,317,018	3,769,087	30,575,341
Fund balances at June 30, 1997	$ 327,635	$ 34,364,617	$ 4,679,909	$ 39,372,161

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

Exhibit C

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combined Statement of Revenues and Expenditures - Budget and Actual (Budgetary Basis) - Governmental Fund Types
Year ended June 30, 1997

	General Fund			Special Revenue Funds		
	Budget	Actual (Budgetary Basis)	Variance - Favorable (Unfavorable)	Budget	Actual (Budgetary Basis)	Variance - Favorable (Unfavorable)
Revenues:						
Allotted appropriations	$ 5,844,954	$ 5,825,417	$ (19,537)	$ --	$ --	$ --
Charges for current services	--	--	--	22,038,891	23,616,921	1,578,030
Licenses and permits	--	--	--	3,936,157	3,089,626	(846,531)
Donations, contributions and deposits	--	--	--	2,103,379	2,171,974	68,595
Total revenues	5,844,954	5,825,417	(19,537)	28,078,427	28,878,521	800,094
Expenditures	5,844,954	5,672,468	172,486	28,078,427	21,166,378	6,912,049
Excess of revenues over expenditures	--	152,949	152,949	--	7,712,143	7,712,143
Other financing uses:						
Operating transfers out	--	--	--	--	96,000	(96,000)
Excess of revenues over expenditures and other financing uses	$ --	$ 152,949	$ 152,949	$ --	$ 7,616,143	$ 7,616,143

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

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Component Unit - Enterprise Fund
Hawaii Hurricane Relief Fund
Statement of Revenue, Expenses and Changes in Retained Earnings
Year ended June 30, 1997
(Unaudited)

Revenues	$ 102,671,456
Expenses	79,751,024
Net income	22,920,432
Retained earnings at July 1, 1996	50,697,133
Retained earnings at June 30, 1997	$ 73,617,565

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

Schedule I

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Balance Sheet - General Fund
June 30, 1997

	Office of the Director	Division of Financial Institutions	Insurance Division	Business Registration Division	Professional and Vocational Licensing Division	Regulated Industries Complaints Office	Division of Consumer Advocacy	Office of Consumer Protection	Hawaii Public Broadcasting Authority (Unaudited)	Totals
Assets										
Cash and cash equivalents	$ 247,984	$ --	$ 22,549	$ 6,858	$ 541	$ --	$ 39,806	$ 21,187	$ 16,070	$ 354,995
Liabilities And Fund Balances										
Vouchers and contracts payable	27,360	--	--	--	--	--	--	--	--	27,360
Total liabilities	27,360	--	--	--	--	--	--	--	--	27,360
Fund balances:										
Reserved for encumbrances	220,624	--	22,549	6,858	541	--	39,806	21,187	16,070	327,635
Total fund balances	220,624	--	22,549	6,858	541	--	39,806	21,187	16,070	327,635
Total liabilities and fund balances	$ 247,984	$ --	$ 22,549	$ 6,858	$ 541	$ --	$ 39,806	$ 21,187	$ 16,070	$ 354,995

Schedule II

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - General Fund
Year ended June 30, 1997

	Office of the Director	Division of Financial Institutions	Insurance Division	Business Registration Division	Professional and Vocational Licensing Division	Regulated Industries Complaints Office	Division of Consumer Advocacy	Office of Consumer Protection	Hawaii Public Broadcasting Authority (Unaudited)	Totals
Revenues - allotted appropriations	$ 1,638,853	$ 865,452	$ 1,008,387	$ --	$ --	$ 339,159	$ --	$ 560,792	$ 1,412,774	$ 5,825,417
Expenditures	1,600,784	925,585	1,049,834	--	--	337,492	2,925	541,641	1,360,604	5,818,865
Excess (deficiency) of revenues over expenditures	38,069	(60,133)	(41,447)	--	--	1,667	(2,925)	19,151	52,170	6,552
Other financing uses:										
Unrequired balances of appropriations lapsed	(73,251)	(27,791)	(5,639)	--	--	(1,667)	(4,962)	(15,263)	(39,580)	(168,153)
Total other financing uses	(73,251)	(27,791)	(5,639)	--	--	(1,667)	(4,962)	(15,263)	(39,580)	(168,153)
Excess (deficiency) of revenues over expenditures and other financing uses	(35,182)	(87,924)	(47,086)	--	--	--	(7,887)	3,888	12,590	(161,601)
Fund balance at July 1, 1996	255,806	87,924	69,635	6,858	541	--	47,693	17,299	3,480	489,236
Fund balance at June 30, 1997	$ 220,624	$ --	$ 22,549	$ 6,858	$ 541	$ --	$ 39,806	$ 21,187	$ 16,070	$ 327,635

Schedule III

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Balance Sheet - Special Revenue Funds
June 30, 1997

	Cable Television Division	Division of Financial Institutions	Insurance Division	Business Registration Division	Professional and Vocational Licensing Division	Regulated Industries Complaints Office	Division of Consumer Advocacy	Hawaii Public Broadcasting Authority (Unaudited)	Total
Assets									
Cash and cash equivalents	$ 1,059,249	$ 1,146,180	$ 3,959,599	$ 13,099,346	$ 3,779,240	$ 3,629,185	$ 1,097,837	$ 4,735,367	$ 32,506,003
Investments	--	--	1,300,000	200,000	--	--	--	500,000	2,000,000
Total assets	$ 1,059,249	$ 1,146,180	$ 5,259,599	$ 13,299,346	$ 3,779,240	$ 3,629,185	$ 1,097,837	$ 5,235,367	$ 34,506,003
Liabilities And Fund Balances									
Vouchers and contracts payable	$ 2,309	$ --	$ 32,832	$ 57,952	$ 2,198	$ 1,059	$ 32,718	$ 12,318	$ 141,386
Total liabilities	2,309	--	32,832	57,952	2,198	1,059	32,718	12,318	141,386
Fund balances:									
Reserved for encumbrances	144,963	10,288	162,312	513,492	20,400	21,393	526,357	756,731	2,155,936
Unreserved	911,977	1,135,892	5,064,455	12,727,902	3,756,642	3,606,733	538,762	4,466,318	32,208,681
Total fund balances	1,056,940	1,146,180	5,226,767	13,241,394	3,777,042	3,628,126	1,065,119	5,223,049	34,364,617
Total liabilities and fund balances	$ 1,059,249	$ 1,146,180	$ 5,259,599	$ 13,299,346	$ 3,779,240	$ 3,629,185	$ 1,097,837	$ 5,235,367	$ 34,506,003

Schedule IV

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Statement of Revenues, Expenditures and Changes in Fund Balances -
Special Revenue Funds
Year ended June 30, 1997

	Cable Television Division	Division of Financial Institutions	Insurance Division	Business Registration Division	Professional and Vocational Licensing Division	Regulated Industries Complaints Office	Division of Consumer Advocacy	Hawaii Public Broadcasting Authority (Unaudited)	Total
Revenues:									
Charges for current services	$ 829,212	$ 652,119	$ 5,248,655	$ 9,051,024	$ --	$ 3,802,860	$ --	$ 4,033,051	$ 23,616,921
Donations, contributions and deposits	--	--	--	--	--	--	2,171,974	--	2,171,974
Licenses and permits	--	--	--	--	3,089,626	--	--	--	3,089,626
Total revenues	829,212	652,119	5,248,655	9,051,024	3,089,626	3,802,860	2,171,974	4,033,051	28,878,521
Expenditures	577,587	139,039	4,284,481	3,982,132	3,196,376	3,271,044	2,324,513	2,959,750	20,734,922
Excess (deficiency) of revenues over expenditures	251,625	513,080	964,174	5,068,892	(106,750)	531,816	(152,539)	1,073,301	8,143,599
Other Financing Uses:									
Operating transfers out	--	--	--	--	--	--	--	(96,000)	(96,000)
Total other financing uses	--	--	--	--	--	--	--	(96,000)	(96,000)
Excess (deficiency) of revenues over expenditures and other financing uses	251,625	513,080	964,174	5,068,892	(106,750)	531,816	(152,539)	977,301	8,047,599
Fund balances at July 1, 1996	805,315	633,100	4,262,593	8,172,502	3,883,792	3,096,310	1,217,658	4,245,748	26,317,018
Fund balances at June 30, 1997	$ 1,056,940	$ 1,146,180	$ 5,226,767	$ 13,241,394	$ 3,777,042	$ 3,628,126	$ 1,065,119	$ 5,223,049	$ 34,364,617

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Balance Sheet - Trust and Agency Funds
June 30, 1997

	Expendable Trust Funds					
	Insurance Division	Professional and Vocational Licensing Division	Office of Consumer Protection	Hawaii Public Broadcasting Authority (Unaudited)	Agency Fund	Total
Assets						
Cash and cash equivalents	$ 879,550	$ 2,835,730	$ 54,523	$ 14,370	$ 28,311,346	$ 32,095,519
Investments	500,000	425,000	--	--	--	925,000
Total assets	$ 1,379,550	$ 3,260,730	$ 54,523	$ 14,370	$ 28,311,346	$ 33,020,519
Liabilities and Fund Balances						
Vouchers and contracts payable	$ --	$ 29,264	$ --	$ --	$ --	$ 29,264
Premium taxes received under protest from insurers	--	--	--	--	28,200,926	28,200,926
Arbitration costs for lemon law claims	--	--	--	--	110,420	110,420
Total liabilities	--	29,264	--	--	28,311,346	28,340,610
Fund balances:						
Reserved for encumbrances	6,339	35,761	--	--	--	42,100
Reserved for amounts held in trust	1,373,211	3,195,705	54,523	14,370	--	4,637,809
Total fund balances	1,379,550	3,231,466	54,523	14,370	--	4,679,909
Total liabilities and fund balances	$ 1,379,550	$ 3,260,730	$ 54,523	$ 14,370	$ 28,311,346	$ 33,020,519

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Expendable Trust Funds
Year ended June 30, 1997

	Insurance Division	Professional and Vocational Licensing Division	Office of Consumer Protection	Hawaii Public Broadcasting Authority (Unaudited)	Total
Revenues:					
Donations, contributions and deposits	$ 241,761	$ 2,407,090	$ 12,246	$ --	$ 2,661,097
Total revenues	241,761	2,407,090	12,246	--	2,661,097
Expenditures	58,606	1,680,962	10,668	39	1,750,275
Excess (deficiency) of revenues over expenditures	183,155	726,128	1,578	(39)	910,822
Fund balances at July 1, 1996	1,196,395	2,505,338	52,945	14,409	3,769,087
Fund balances at June 30, 1997	$ 1,379,550	$ 3,231,466	$ 54,523	$ 14,370	$ 4,679,909

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Combining Statement of Changes in Assets and Liabilities - Agency Funds
Year ended June 30, 1997

	Balance, July 1, 1996	Additions	Deductions	Balance, June 30, 1997
Assets				
Cash and cash equivalents	$ 35,988,660	$ 12,099,389	$ 19,776,704	$ 28,311,346
Liabilities				
Premium taxes received under protest from insurers	35,988,660	11,985,970	19,773,704	28,200,926
Arbitration costs for lemon law claims	--	113,420	3,000	110,420
Total liabilities	$ 35,988,660	$ 12,099,390	$ 19,776,704	$ 28,311,346

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs on January 14, 1998. A copy of the transmittal to the department is included as Attachment 1. The department's response is included as Attachment 2.

The department generally disagrees with our findings. It claims that the fees charged by the Business Registration Division and the Professional and Vocational Licensing Division are not in violation of Section 26-9, HRS, which requires that fees assessed by the department bear a reasonable relationship between the revenue derived and the cost or value of services rendered.

The department disagrees with our premise that the aggregate cash balance of $20 million at the end of the year resulted from fees collected in excess of the reasonable cost or value of the services rendered. It believes that the reasonable relationship test is "not between total fees collected and total expenditures, but rather the relationship between the (individual) fee assessed and the cost or value of services rendered for the process that the fee is based upon." The department also contends that much of the $20 million accumulated cash balance was the result of the department's prudent fiscal spending. It responds that "with limited experience in this area and a projected need to conserve spending in order to accumulate adequate reserves and maintain mandatory services, conservative spending was and is, we believe, a wise course to follow." It believes that our analysis of the fund balances should have included planned or budgeted expenditures rather than actual expenditures.

The department also disagrees with our finding that the compliance resolution fees assessed on all persons licensed by the Professional and Vocational Licensing Division are excessive. It believes that our interpretation of the standard for determining fees to be incorrect, the standard for determining whether the Regulated Industries Complaints Office fees were reasonably related was incomplete or inaccurate, and that the accumulated fund balance does not in and of itself, justify our conclusion that the fees are excessive. We generally disagree. Since the department failed to keep detailed cost information on the cost or value of the services rendered, our methodology of comparing annual revenues to expenditures is reasonable in determining excessive fees. In addition, annual revenues for these special funds have exceeded expenditures in almost all of the past three fiscal years. The department's comment that it could have spent more is irrelevant since the fees should be based on the value of services delivered and not on services that could have been delivered.

The department also disagrees with our finding that the insurance division's revolving funds have high cash balances. It believes that some reserve balances in the two revolving funds are necessary because of timing differences between the revenues collected and the expenditures of the division. The department also noted that a large reserve is necessary to support two new programs created by the 1997 Legislature. While we agree that some reserves are necessary because of timing differences in revenues and expenditures, a fund balance in excess of $4 million, along with an average excess of revenues over expenditures of about $800,000 each year over the past three fiscal years, is excessive.

Finally, the department generally agrees with our recommendation that checks received be deposited daily into the state treasury. It stated "that the decision to hold checks until the accompanying documents have been processed was made to reduce the time required to make refund and to address the assumption that receipt and deposit of a filing fee equated to acceptance of a document or filing." It will reexamine its procedures and seek alternatives that will address our concerns.

We made some technical and editorial changes to our draft report for accuracy, clarity, and consistency.

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

January 14, 1998

COPY

The Honorable Kathryn S. Matayoshi
Director
Department of Commerce and Consumer Affairs
Kamamalu Building
1010 Richards Street
Honolulu, Hawaii 96813

Dear Ms. Matayoshi:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Department of Commerce and Consumer Affairs*. We ask that you telephone us by Friday, January 16, 1998, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Friday, January 23, 1998.

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

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

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

BENJAMIN J. CAYETANO
GOVERNOR

KATHRYN S. MATAYOSHI
DIRECTOR

BENJAMIN I. FUKUMOTO
DEPUTY DIRECTOR

STATE OF HAWAI'I
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE & CONSUMER AFFAIRS
1010 RICHARDS STREET
P. O. BOX 541
HONOLULU, HAWAI'I 96809

January 26, 1998

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

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

Dear Ms. Higa:

Thank you for the opportunity to respond to the Financial Audit of the Department of Commerce and Consumer Affairs.

Chapter 2, Financial Management Practices contains your findings and recommendations. We would initially like to raise several general issues of importance, after which more division-specific information will be covered. We then will address the recommendations as outlined on page 11 of the report.

GENERAL ISSUES

1. We disagree with your finding that the Business Registration Division (hereafter "BREG"), Professional and Vocational Licensing Division (hereafter "PVL") and the Regulated Industries Complaints Office (hereafter "RICO") are in violation of section 26-9, Hawai'i Revised Statutes (hereafter "HRS"). We believe the premise relied upon in concluding a violation of section 26-9, HRS (that the existence of an aggregate cash balance of $20 million at the end of the year establish that the fees collected do not bear a reasonable relationship to the cost or value of the services rendered) is not in keeping with what section 26-9, HRS provides.

   Section 26-9(l)(1), HRS states:

   "(l) Any law to the contrary withstanding, the director of commerce and consumer affairs may:
   (1) Establish, increase, decrease, or repeal fees relating to any aspect of the registration, certification, licensure, or any other *administrative*

> *process* for all laws within the jurisdiction of the department. *The fee* assessed shall bear a reasonable relationship between the revenue derived *from the fee* and the cost or value of services rendered." (Emphasis added)

Section 26-9 (l)(1), HRS clearly describes the relationship between *a fee* and the cost or value of the *administrative processing*. Thus, the reasonable relationship test is **not between total fees collected and total expenditures**, but rather *the relationship between the (individual) fee assessed and the cost or value of services rendered for the process that the fee is based upon.* Lumping all fees collected in these six different funds, spread over three different divisions with widely varying costs, services and processes, distorts the relationship between a fee and the process or service provided.

For example, PVL has a separate "application fee", "original license fee", "renewal fee", BREG has an "application fee" and "registration fee", all of which as individually assessed, is to have a reasonable relationship to the application, license, registration processing per applicant, licensee or registrant. RICO has the "compliance resolution fund fee" which is based on the value of services available to the regulated industries, and the individual licensees. The fee also incorporates the costs related to the actual process of complaints in each category.

We note also that the fees were originally statutorily provided (and in BREG's case continues to be statutorily provided). Most of the statutory fees have been retained by the divisions, and over the three years of these funds' existence, infrequently increased, and in some instances decreased.

We believe our fees are in keeping with section 26-9(l)(1), HRS, and that the interpretation of section 26-9(l)(1), HRS, as provided in the report is not the proper reading of what is required.

The report fails to recognize the other statutory provision which governs the establishment of fees for regulated professions and vocations (PVL and RICO). Section 26H-2(7), HRS states that:

> "Fees for regulation and licensure shall be imposed for all vocations and professions subject to regulation; provided that the aggregate of the fees for any given regulatory program *shall*

not be less than the full cost of administering that program." (Emphasis added)

The general rule of statutory construction is that, in cases of conflicting statutory provisions, the more recent and more specific will prevail. Thus, section 26H-2(7), HRS should apply to PVL's fees. There is very little if any basis any violation of section 26H-2(7), HRS, since revenues are not less than the cost of the programs, except perhaps (as noted below) PVL's total FY 1997 revenues did not cover the full cost of administering all of its programs.

2. Turning to the major thrust of the report, that the department has $20 million dollars of unencumbered cash balance in its special and revolving funds, we take exception with the report's failure to also state that such cash balances are required to fund the coming year's operations. BREG, PVL and RICO are completely self-sufficient from the general fund, and the functions funded by the Insurance Division's revolving fund are similarly bereft of general fund support. Cash balances are crucial to the on-going operations of these divisions. Because deficit spending is not allowed, funding resources must be accumulated prior to expenditures. New revenues received continue the cycle of a year end balance to start the next fiscal year on a self-sufficient basis. If we were to end a fiscal year with no cash reserves, we would not have funds to sustain our operations in the new year until calendar year-end, when the bulk of our revenue is generated. In addition, major expenditures, (such as updated computer systems) cannot be undertaken until adequate funds are accrued to pay for them.

Perhaps because the GAAP methodology limits recognition to incurred expenditures only, this relevant point could not be made. The report however, gives a false impression of "unencumbered cash...sitting in special fund accounts" with no intended use or purpose. On the contrary, to fulfill our responsibility of self sufficiency so we are not, and do not become a liability to the general fund, it is imperative there be year-end balances to sustain much of the costs of the divisions for the upcoming year. Were one to use the Exhibits in the report to compare the revenues and expenditures on a per year basis *absent the beginning balance*, FY 1996-97 reflects PVL is not self sufficient because it spent more than revenues received, RICO was barely self sufficient with a nominal revenue balance of $532,000 remaining. Thus, carryover or beginning balances are critical to ensuring self-sufficiency.

3. The report states the department has accumulated more than $20 million of unencumbered cash balances in three of its special fund accounts. In

actuality, BREG's year-end balance of $13.2 million reflects the activities of 5 funds listed in Exhibit 2.2b attached hereto, PVL's is $3.7 million, and RICO's is $3.6 million. The report's only conclusion for the large accumulated balances are that our revenues exceed our cost. It, however, fails to recognize our explanations for the accumulated fund balances which are the curtailment of our expenditures (because of hiring freezes, spending limitations, planned expenses failing to occur in targeted fiscal years) and further, very conservative spending by these three divisions to accrue and ensure a carryover balance to continue self sufficiency for the next fiscal year. If a different methodology were incorporated, comparing the planned budget each division had per fiscal year, to the revenues received, it would show the numbers very closely aligned, and a contrary picture of less than (self) sufficient balances. These divisions are the department's first foray into self-sufficiency. With limited experience in this area and a projected need to conserve spending in order to accumulate adequate reserves and maintain mandatory services, conservative spending was and is, we believe, a wise course to follow.

We do not believe that we have erred in prudent fiscal spending, especially given the tight economy, the relative inexperience with self-sufficiency, and significant fluctuations in revenues (which also is not mentioned in the report but can be gleaned by looking at the respective Exhibits).

It seems paradoxical that while people decry the State's lack of foresight in failing to establish a "rainy day" fund, our divisions, who are not dependent on the tax revenues of the general fund, are now criticized for the foresight to establish adequate reserves.

4. With regard to the Insurance Division's revolving funds, the need for a reserve balance necessitates a high cash balance. The rationale for the reserve balance is detailed in the Insurance Division's section of this response.

5. In the body of the report, page 6, it states:

> "The department estimates the biennial operating costs for the Business Registration Division and the Professional and Vocational Licensing Division. It then compares total estimated fee revenues to total estimated operating costs of the appropriate division. *If a deficit is projected, all fees of the applicable division are raised across the board using a single*

percentage rate. If a surplus is projected, fees are left unchanged." (Emphasis added)

Neither BREG or PVL had indicated, established, nor implemented this practice. We were asked the hypothetical question, "What would we do if revenues were insufficient?" One of our responses included "possibly adjusting fees cross the board". "Surplus" was never discussed. Since none of our divisions have used such a practice stated in the report, we are puzzled as to the basis for such a conclusion in the report.

DIVISION SPECIFIC INFORMATION

Business Registration Division

The Division's response to the reported balances in its three special funds will explain how the current situation came about. First, the balances in the accounts do not reflect the amounts which have been appropriated for major projects for the Division. These include $250,000 for the Local Area Network installation, $250,000 for consumer/investor educational programming, $50,000 for a new phone system, $200,000 for a computer consultant contract, and $700,000 for positions which were authorized or requested.

Second, no comparisons were made for the budgeted items which were not fully expended during the prior years of the funds. The unexpended amounts include items such as personnel costs (while positions were frozen or reduction in force (RIFs) were in effect), restriction on travel, delays in acquiring physical space for new employees, and delays of processing positions for hiring. These amounts would total nearly $5 million if expended during the last 4 years. See Exhibit 2.2a, attached hereto.

Third, balances were also distorted by following factors. FY 1997 include a one time revenue spike from initial mutual fund registrations which amounted to an over $1.1 million increase in revenue. That revenue is expected to drop by 75% as mutual funds pay renewal fees of $50 rather than initial registration fees of $200. In addition, expected registrations for securities salespersons were much higher than anticipated. The Division estimated a stable population of 22,000 to 24,000 salespersons. During this period the population grew to over 31,000 licensees and now over 33,000 licensees are registered. This amounted to over $400,000 more revenue than expected during this period in one fund alone and $160,000 in another.

Further distorting the fund balances was the fact the major collections for the Division has occurred within the last few months before June 30, 1997. The bulk of the Division's collections are taken in just prior to the June 30, the fiscal year end. Balances were significantly lower, for example on November 30, 1997.

The balances for BREG also include $500,000 which properly belongs to the Office of Consumer Protection and not BREG.

Finally, the provisions of HRS 26-9 (l) only apply to those fees which can be administratively adjusted. All the fees for the Division are subscribed by statute. The ability of the Department to adjust these fees administratively has been rejected by the legislature.

The figures shown in Exhibit 2.2 of the report are attributed to the Business Registration Division. Our review indicates that, while the figures are correct, they reflect the revenues and expenditures of the Business Registration Self-Sufficiency Fund, the Expedited Review Fund, the Office of Consumer Protection's Compliance Resolution Fund and, for FY 95, the Regulated Industries Complaints Office's Compliance Resolution Fund. A more accurate display of the figures are shown in Exhibit 2.2b, attached hereto.

Professional and Vocational Licensing Division

The revenue for this special fund is derived from application, original license, and biennial renewal fees. We have seen a slight decrease in the number of application for new licenses, but total renewals appear to remain constant. Revenues fluctuate, with higher revenues received in even-numbered years as compared to odd-numbered years. This is due to (biennial) renewals being greater in number during even-numbered years. Also, more than 50% of yearly revenues come from renewals, but these revenues are realized only in the 2nd quarter and 4th quarter of each year. The fact that revenues do not come in a steady monthly stream makes it even more challenging for PVL to attain self sufficiency for a current year and on a long term basis.

PVL has also restricted expenditures in or to ensure maintenance of mandated services. For example, PVL has set aside replacing its WANG database system and replacing its phone system, both of which are problem areas, generating numerous client complaints. The limited capabilities and lack of accessibility caused by our antiquated systems have made us less efficient and service friendly to our clients. But in weighing priorities, establishing a firm basis for maintaining our operations on a self-sufficient basis rises to first position, because it will in the long run allow us to better service our clients.

The following is supplemental financial information on PVL based on a comparison of the planned and appropriated budget to revenues for each of the same three fiscal years to emphasize the point made earlier that the numbers do align very closely with one another. Also, it presents a different picture for ending balances, less prone to allegations of "accumulated millions", "growth of these accounts", and "fees collected....far exceed the costs of services rendered". As follows:

Planned Budget vs. Expenditures

	FY 95	FY 96	FY 97
Beginning Balances	0	1,294,000	2,841,000
Revenues	3,088,000	4,921,000	3,090,000
Transfer In	1,527,000		
	4,615,000		
Budget	3,321,000	3,374,000	3,892,000
Ending Balance	1,294,000	2,841,000	2,039,000

On the subject of expenditures, Exhibit 2.3 in the report (PVL's financial information) does not reflect a "transfer in" of $1.5 million in general funds and the expenditures related to those funds. When PVL was allowed to become independent from the general fund in FY 1995, it was recognized that the revenues were not collected on a regular basis. Thus, the Legislature saw fit to provide start-up funds for the program from the general fund. We feel that the following information more accurately reflects the expenditure level of PVL:

	FY 95	FY 96	FY 97
Beginning Balances	0	1,913,000	3,884,000
Revenues	3,088,000	4,921,000	3,090,000
Transfer In	1,527,000		
	4,615,000	4,921,000	3,090,000
Expenditures	2,702,000	2,950,000	3,197,000
Ending Balance	$1,913,000	$3,884,000	$3,777,000

Regulated Industries Complaints Office

We believe there is a reasonable relationship between the revenue derived from the RICO CRF fee and the cost or value of services rendered, and that the fees are not excessive. We disagree with the Auditor's findings as: 1) the Auditor interpreted the standard for determining the fees incorrectly; 2) the Auditor's analysis in implementing the standard for determining whether RICO fees were reasonably related was incomplete or inaccurate; and 2) RICO's accumulating balance does not, in and of itself, justify the Auditor's conclusion that the fees are excessive.

1. We disagree with the Auditor's interpretation of the standard articulated in Section 26-9 to determine the compliance resolution fees.

a. Reasonable relationship. HRS Section 26-9(l)(1) states that the "fee assessed shall bear a reasonable relationship between the revenue derived from the fee and the cost or value of services rendered." "Reasonable" means "within the bounds of common sense". (See, The American Heritage Dictionary, New College Edition) However, the Auditor limited its analysis to whether the fee charged actually covers the related costs of reviewing complaints (See, page nine of the Auditor's report). "Actual" means "in existence, real or factual" (See, The American Heritage Dictionary, New College Edition) and is a much narrower standard than that which is statutorily required to determine whether an appropriate relationship exists between fees and the cost or value of services rendered.

b. Cost or value of services rendered. RICO has a compliance resolution fund fee which is based on the value of services available to the regulated industries and the individual licensees. Unfortunately, the Auditor appears to define the "cost or value of services" as only those costs directly related to complaints processing (See, the Auditor's comparative analysis between fee payments by those with no complaints and those areas with complaints in the chart on page nine). In fact, the range of services provided to support licensees and the public are much broader.

All of these expenses which the fee must address are statutorily recognized and allowed. (See, section 26-9(o), HRS, which states in part that the moneys in the fund "shall defray all other administrative costs, including personnel costs of operating the regulated industries complaints office and costs incurred by supporting offices and divisions.") Clearly, the Auditor's approach is an oversimplification of what the statute allows as a cost or value of service rendered.

2. We disagree with the Auditor's methodology in concluding that the RICO CRF fees are not reasonably related to the cost or value of services rendered.

a. Timesheets. The Auditor states on page nine that RICO "does not keep timesheets or cost reports for the reviewing of those complaints" and thus, "(d)istortions in the cost analysis may occur due to insufficient information on time and costs for resolving complaints."

This statement is incorrect. Since 1989, RICO has maintained and continues to maintain data on the time spent by its staff on cases specifically for fee study purposes. This data is a prominent feature in RICO's fee study to determine the setting of fees for each license category. A copy of RICO's fee study report was provided to the Auditor's independent contractor and is in fact, referenced on page eight of the Auditor's report. The study defined "staff cost" as "a pro rata salary of investigators and attorneys calculated by the amount of time spent on complaints for each board and divided among the number of licensees for that category of license or board." The fee study actually took its articulated formula, and produced specific dollar amounts per licensee for each category. That specific dollar amount was one of three main numerical factors used in determining the current fees.

b. Fees based solely upon operating costs and the number of complaints reviewed. The auditor attempted to allocate operating costs to the various professions based solely on the office's statistics of the number of complaints reviewed. Such an attempt appears to assume that every case takes the same amount of time, staff cost and expense to process. In reality, it is rare for any two cases to take the same amount of time, staff cost and expense to process. As such, the auditor's comparative analysis demonstrating dramatic differences between the department's collected fees and its operating costs is flawed.

Further, there are certain operating expenses the auditor appears to feel a license category should not have to pay if there are no complaints processed in their area (see, chart on page nine of the Auditor's report). However, those operating expenses are necessary in order to make RICO services available. Such expenses, defined in RICO's fee study as "base costs", are in addition to the actual costs of investigation and prosecution of complaints and include the Consumer Resource Center, which intakes complaints and complaint inquiries, provides initial screening and investigative functions, dissemination of complaints history information and consumer education, legislative work and other duties relating to the overall complaints enforcement system.

The fee structure also takes into consideration the long standing belief that there is a public interest in maintaining fees within a reasonable range to assure the availability of licensed services. The floor and ceiling amounts for CRF fees address, among other things, the situation where there are only a few licensees over which to spread the costs of enforcement. Without the ceiling, the CRF fees alone would be in the hundreds of dollars to some license categories, placing licensure in conceivably an unaffordable range.

c. Although the current RICO CRF fees were implemented in 1994, the Auditor states that it used 1993 fees in its analysis.

The Auditor states that it used 1993 CRF fee rates in its analysis as to whether they are reasonably related to the cost or value of services rendered. (See, page nine of the Auditor's report). However, it appears the figures the Auditor used were the current fees which were imposed in 1994. This conflict makes it unclear as to what fees the Auditor actually used its analysis, and thus raises questions as to its results.

3. We disagree with the Auditor that the RICO CRF fees are excessive.

Exhibit 2.4 of the Auditor's report shows a balance in RICO's account of $3,628,000 as of June 30, 1997. The Auditor feels that such a balance is excessive and indicative of unjustified fees. We disagree.

a. As a "self sufficient division", a reserve representing approximately one year of RICO operating expenses is not unreasonable. The ending balance of $3,628,000 is RICO's operating expenses actually represents the beginning balance for RICO's following fiscal year. Over the past three years, RICO has moved towards self-sufficiency. This fiscal year (1997-1998) is the first year that RICO will be entirely self-supporting, receiving no general funds at all. In order to reach this financial independence from tax dollars, RICO shifted all of its remaining general funded personnel to its special fund, with corresponding increase in its budget of $574,735. The report does not include the impact of this increase on the financial resources of RICO.

Thus, as an agency reliant on its self-sufficient funds as of 1997, RICO's balance must be capable of sustaining the division for part of or the entire fiscal year. If it cannot, the division would run the risk of becoming a liability to the general fund, or cutting off needed and mandated services. In fiscal year 1996-97, expenditures were approximately $3,271,000, less than $550,000 short of the revenues taken in during that time period.

Fees are subject to fluctuations that are neither predictable or controlled by RICO. These fluctuations include the number of license applications and renewals, legislative changes as to fee collections, and additions or deletions of programs, commissions and boards. Given our experience with the last fee study, should fees need to be changed, the process from initiation to implementation could be as long as three years. Should numbers reflect a marked decrease in revenues collected, RICO would have to utilize its reserve while fees are reviewed.

Additionally, fees are collected only at certain times during a biennial cycle and not on a continuous, day-to-day basis. Thus, the CRF must have adequate cash balances at any given time during the fiscal year to carry the agency through until the next set of fees are collected. This timing factor was critically reviewed, considered and calculated into RICO's 1993 fee study. On the other hand, the Auditor's report makes no mention of such consideration.

b. General restraint on spending. Since 1995, Hawaii has experienced serious economic issues which have resulted in restrictions, general restraint on spending, and cutbacks by various government agencies. Such measures have not surprisingly resulted in an accumulation of unexpended costs, which in part is reflected in RICO's balance. This accumulation of unexpended costs does not logically lead to the Auditor's conclusion that the fees are therefore excessive. In fact, if restraints were not placed on spending and RICO had fully implemented its program to the budgeted ceiling, the RICO CRF fund would likely be running in a deficit status.

	FY 95	**FY 96**	**FY 97**
BEGINNING BALANCES	0	0	1,205,379
REVENUES	0	4,780,000	3,803,000
TRANSFER IN	0	6,206,000	
	0	1,426,000	6,206,000
BUDGET	$3,820,222	5,000,621	5,151,178
ENDING BALANCE	0	1,205,379	-142,799

Since 1995, administrative and self imposed restrictions on spending have been administered. Travel was restricted, positions were cut and requests for purchases scrutinized. This conservatism in spending and fiscal frugality has continued. Space considerations, infrastructural limitations and administrative issues have contributed to the cessation of any expansive movement. All of these factors resulted in its desired result - to save money. It is unfair to now hold the fact that RICO saved money, against the agency.

This fiscal prudence has not been without impact on program effectiveness. RICO has struggled to provide adequate service in spite of staff and resource reductions.

1) <u>Staff Reductions</u>: Due to the 1995 statewide reduction in force, RICO lost three field investigation positions. This loss, coupled with the attrition of personnel, has negatively impacted RICO's field investigation staff statewide. The four RICO neighbor island offices have experienced field investigation staff reductions. For instance, each of the Hilo and Kona offices have only one field investigator to cover their respective territories. To handle aging cases, field investigation support has necessarily had to come from the Oahu staff. Additionally, the Kauai investigative staff is being supervised from Oahu. However, the Oahu field investigation staff has shrunk from 24 to 19 persons in the past three years.

2) <u>Case Backlogs</u>: Where staffing has decreased, the amount of time to handle cases has increased. The result is an increase in the average case processing time for the field investigation section from 136 days (for FY 94) to 171 days (for FY 97).

Insurance Division

A. Insurance Examiners' Revolving Fund

The unencumbered cash balance at December 31,1997 was $542,162.

There are two sources of revenues for this fund. The annual assessment of $550 per insurer (approximately 900 insurers assessed in 1997) and reimbursements from insurance entities for the cost of examinations when independent contract examiners perform the work.

A reserve balance in the fund is necessary because of the timing difference between revenues and expenditures. A large sum of cash must be available at the start of each fiscal year to encumber the contracts with the independent insurance examiners. This fiscal year, contracts were executed with five CPA firms totaling $800,000 for examination services.

The contracts were encumbered, up front, in the first quarter of the fiscal year, but the matching revenues from the examined insurance entities to pay off the contracts will be received through out the fiscal year. As a result, for any given fiscal year the unencumbered cash balance will be at its highest at the end of the year and at its lowest balance in the first quarter of the year.

Allowing for a 6 months' reserve to cover personnel costs (approximately $230,000) and for the up front contract encumbrances (approximately $800,000), a reserve of at least $1,000,000 appears to be appropriate at the current level of budget.

This fund allows the Commissioner to appoint examiners to perform the triennial examinations of companies and on-going financial surveillance of all insurers. In 1993, the law was amended to assess annually all companies and also allow the Commissioner to appoint staff examiners, independent contractor examiners, and administrative support personnel to examine the affairs of authorized insurance companies.

This change in the law was vital to provide financial surveillance of all insurers, detect early warning signs of financial distress and allow early intervention to prevent insolvencies. The financial surveillance staffing is also a requirement for the Division to meet the National Association of Insurance Commissioners' accreditation standards.

Chapter 432D, HRS, "Health Maintenance Organization Act" became effective January 1, 1996. This new program has significantly increased the workload of the financial examiners. By June 30, 1996, all existing HMOs were required to submit an application for a Certificate of Authority to the Division. No additional staff was provided to the Division.

The examiners are responsible for reviewing the applications, providing financial surveillance and monitoring of their financial condition and compliance with Hawaii statutes on an ongoing basis, as well as examining the financial affairs of the HMOs at least once every three years.

Another program adding workload to the examination section is the captive insurance enabling law which became effective in 1987. In December 1987, the first captive insurance company was licensed, and since then the number of licensed captives has increased each year. As of December 31, 1997, a total of 52 captives were licensed in the State of Hawaii. Continued growth is expected beyond the year 2000.

The captives by statute must be examined annually and may be extended to once every three years. The utilization of the examiners' revolving fund is vital to meet the ever increasing examination requirements of captive insurance companies.

B. Motor Vehicle Insurance Administration Revolving Fund (MVRF)

The unencumbered cash balance at December 31, 1997 was $2,894,604.

a. There are two sources of revenues for this fund: an annual assessment on all licensed motor vehicle insurers and self-insurers, and fees paid by insurers participating in the no-fault peer review program.

1993 was the last year assessments were made on the insurers and self-insurers. For calendar years 1994-1997, no assessments were made because the other revenue source generated sufficient funds.

The other source comes from fees paid by insurers for submitting no-fault challenges pursuant to §431:10C-308.6, HRS. The insurer submits with each challenge a $200 filing fee and a $304 peer review fee. The $304 peer review fee is a "wash" because it pays the $304/challenge cost of the PRO services rendered. The current unencumbered cash balance results solely from the $200 filing fees.

The revenue from the $200 filing fee will be ending because Act 251, SLH 1997 repealed the peer review program, effective January 1, 1998. Peer review benefits however remain available to claimants and insurers for policies in effect, and accidents which occurred, up to December 31, 1997.

With the time lag from date of accident to date of peer review challenge, the Insurance Division anticipates that the number of challenges filed in the next year will only decrease slightly from the levels previously experienced. The Division currently receives 380-400 peer review challenges per month.

It appears just a matter of time before the assessments on the insurers and self-insurers will become necessary again. The peer review program will eventually wind down and the revenues from the filing fees will decrease correspondingly.

b. A large reserve is necessary to support the Division's new programs, the timing differences in the revenues and expenditures in the peer review program, and funding for temporary staff to support the Office of Administrative Hearings.

Act 251, SLH 1997, created two new programs: the Fraud Investigation Unit and the Motor Vehicle Task Force, the costs for which are paid for from the MVRF.

The Fraud Investigations Unit added two permanent positions and re-described four PRO positions into the Fraud Unit. The annual personnel cost for these positions is estimated at $301,000.

Three new temporary positions were established to support the Motor Vehicle Task Force, with projected personnel costs of approximately $153,000 per year. (which includes fringe benefit costs estimated at 42.22%.)

The fund ceilings were not adjusted by the Legislature to accommodate these two new programs.

Some reserve is also needed in the MVRF due to the fact that expenditures occur from a couple of months to two years or more after the receipt of peer review revenues. It usually takes about two to three months from the date a challenge is received to the date payment is made to a PRO for services rendered.

The other expenditure made even later is the cost to process the no-fault hearing cases. The parties involved in a peer review challenge may file for a hearing if they do not agree with the PRO decision on a challenge. The MVRF currently pays for one hearings officer to process all cases. However, as of December 31, 1997, there was a backlog of approximately 2,000 cases awaiting hearing. The Division anticipates that the backlog will increase even more due to the inadequate number of hearings officers presently available to hear motor vehicle cases.

The Division, together with the Office of Administrative Hearings, has requested additional staffing in the FY 1999 Supplemental Budget for two more hearings officers and a legal clerk. The anticipated personnel costs for the new positions is $176,000 per year.

The number of motor vehicle insurance hearings filed with the Office of Administrative Hearings since 1992 are as follows:

Year	**Motor Vehicle Insurance Cases Filed**
1992	237
1993	288
1994	741
1995	967
1996	1,422
1997	1,720

As of September 15, 1997, the following were the categories of pending cases:

Cases pending hearings and final dispositions	921
Cases awaiting scheduling of hearings	1,027

§431:10C-211 and §431:10C-308.6(f), HRS, are the provisions which provide for administrative hearings in motor vehicle insurance cases. Most cases are for motor vehicle accident dates two years prior. A sample size of 209 of the pending cases in September 1997 resulted in the following distribution by accident year:

Accident Year	# Cases	% Cases
1993	2	0.96%
1994	24	11.5%
1995	75	35.9%
1996	103	49.3%
1997	5	2.4%

HRS §431:10C-308.6 was repealed effective January 1, 1998. However, no-fault accidents occurring on or before December 31, 1997 may still go to hearing after January 1, 1998, as provided in §431:10C-308.6, HRS. With a two year time lag for most cases going to hearing (as shown above), the Insurance Division anticipates that the level of activity for hearing cases filed in 1997 will continue at the same level through calendar years 1998 and 1999.

Some reserve is also necessary because the statute requires that assessments be made on April 1st of each year. This means that when the revenue source reverts entirely to assessments, the revenues will be deposited in the 4th Quarter of each fiscal year. The reserves should cover at least a minimum of nine months before revenues will be received. A larger than nine months' reserve would be more appropriate to accommodate late/delinquent assessment payments from the insurers and self insurers and the time lag necessary to pay off expenses. Nevertheless, some reserve is necessary in anticipation of the assessments.

In conclusion, while the unencumbered balances may initially appear to be large, there are many circumstances and reasons why this has been the case. As a result of the repeal of peer review, the trend in the MVRF is expected to decline significantly. The staffing for this function will not decline, however, due to the time lag for payment of expenses and the time lag from date of challenge which is based legally on the date of accident.

There are also additional functions and responsibilities the Division is carrying out for which the fund ceilings were not adjusted. Some reserves are necessary due to the change in revenue source solely to assessments in the near future.

RECOMMENDATIONS:

1. In response to the recommendation that the department make adjustments necessary to ensure regulatory fees assessed on business and professions bear a reasonable relationship to the cost or value of services rendered, you have brought a potentially serious problem to our attention. Our focus during the past three years (the first years of self sufficiency for BREG, PVL, and RICO) has been on individual programs and their stability in maintaining their on-going operations. Aggregating these funds provides us with a new fiscal perspective, which we appreciate. We will seriously review the recommendations and hope to arrive at a fair solution which addresses the expectations of the consuming public and our licensees.

2. In response to the recommendation that the Legislature consider transferring excess cash from the Insurance Examiners Revolving Fund to the general fund before June 30, 2000, we feel that the current balance of unencumbered cash is close to the appropriate amount required to maintain a prudent reserve as explained above in the Insurance Division's specific section.

3. In response to the recommendation that the insurance commissioner review annual no-fault insurance assessments with an eye toward bringing the annual assessments in line with annual no-fault administrative costs, we have provided additional information that the auditor overlooked that would have changed the recommendation. That is, no assessments have been made on the insurers and self-insurers since calendar year 1993. The source of revenue that generated the current balance came from the $200 filing fee for the no-fault peer review program. However, the revenues from the $200 fee will be declining with the end of the no-fault peer review program. Again, as explained above in the Insurance Division's specific section, we feel that some reserve balance is necessary and that assessments will have to begin again in the future to fund all of the motor vehicle insurance programs.

4. In response to the recommendation that the department ensure all checks received are deposited daily into the State Treasury, we agree that this is an area where we may need to revise our procedures. The decision to hold checks until the accompanying documents have been processed was made to reduce the time required to make refunds and to address the assumption that receipt and deposit of a filing fee equated to acceptance of a document or filing. However, we will reexamine

that decision, and believe that are alternatives which may address both the Auditor's recommendation and the administrative processing concern.

Once again, we thank you for the opportunity to review and respond to your report. If you or your staff have any questions or concerns, please feel free to contact me.

Very truly yours,

KATHRYN S. MATAYOSHI
Director

EXHIBIT 2.2a

Business Registration Division

Self-Sufficiency Fund
Planned Budget vs. Expenditures

	FY 95	FY 96	FY 97
Beginning Balance	0	680,000	1,305,000
Revenues	2,861,000	3,071,000	7,164,000
Transfer in	0		
	2,861,000		
Budget	2,181,000	2,446,000	3,926,000
Ending Balance	680,000	1,305,000	4,543,000
Actual Expenditures	738,000	1,628,000	2,720,000

Expedited Review Fund
Planned Budget vs. Expenditures

	FY 95	FY 96	FY 97
Beginning Balance	592,000	294,436	-286,906
Revenues	564,000	574,000	470,000
Transfer in	0		
	564,000		
Budget	861,564	1,155,342	1,185,356
Ending Balance	294,436	-286,906	-1,002,262

BREG Compliance Resolution
Planned Budget vs. Expenditures

	FY 95	FY 96	FY 97
Beginning Balance	2,340,000	2,752,023	3,068,521
Revenues	764,000	908,000	973,000
Transfer in	0		
	764,000		
Budget	351,977	591,502	718,000
Ending Balance	2,752,023	3,068,521	3,323,521

EXHIBIT 2.2b

Compliance Resolution Fund

		FY 95	FY 96	FY 97
Beginning Balances				
BREG		0	2,123,000	3,566,000
BREG Exp. Review		592,000	506,000	557,000
BREG CRF		2,340,000	2,675,000	3,187,000
OCP CRF		744,000	620,000	852,000
RICO CRF		852,000	1,477,000	-4,000
	Total	4,528,000	7,401,000	8,158,000
Revenues				
BREG		2,861,000	3,071,000	7,164,000
BREG Exp. Review		564,000	574,000	470,000
BREG CRF		764,000	908,000	973,000
OCP CRF		66,000	378,000	444,000
RICO CRF		3,588,000		
	Total	7,843,000	4,931,000	9,051,000
Expenditures				
BREG		738,000	1,628,000	2,720,000
BREG Exp. Review		650,000	523,000	519,000
BREG CRF		429,000	396,000	568,000
OCP CRF		190,000	146,000	161,000
RICO CRF		2,963,000	55,000	0
TRANSFERS			1,426,000	-14,000
	Total	4,970,000	4,174,000	3,954,000
Ending Balances				
BREG		2,123,000	3,566,000	8,010,000
BREG Exp. Review		506,000	557,000	508,000
BREG CRF		2,675,000	3,187,000	3,592,000
OCP CRF		620,000	852,000	1,135,000
RICO CRF		1,477,000	-4,000	10,000
	Total	7,401,000	8,158,000	13,269,000 *

* These figures are based on DCCA files. It appears that the $-14,000 may have been double counted in Exhibit 2.2 of the Report