Financial Audit of the Department of Land and Natural Resources

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

Report No. 00-11
April 2000

THE AUDITOR
STATE OF HAWAII

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Conducted by

The Auditor
State of Hawaii
and
PricewaterhouseCoopers LLP

Submitted by

THE AUDITOR
STATE OF HAWAII

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Foreword

This is a report of the financial audit of the Department of Land and Natural Resources for the fiscal year July 1, 1998 to June 30, 1999. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct postaudits 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 PricewaterhouseCoopers LLP.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Land and Natural Resources.

Marion M. Higa
State Auditor

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Chapter 1
Introduction

This is a report of our financial audit of the Department of Land and Natural Resources (DLNR). The audit was conducted by the Office of the Auditor and the certified public accounting firm of PricewaterhouseCoopers LLP.

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

Background

In 1959, by Act 1 (the Hawaii State Government Reorganization Act of 1959), Second Special Session, the State Legislature created a separate Department of Land and Natural Resources (DLNR) and charged it with the general duty "to manage and administer the public lands of the State and the water resources and minerals thereon." Originally, DLNR was intended to be a temporary department.

Under the provisions of Act 1, land and water management functions formerly exercised by various territorial commissions, boards and authorities were to be centralized within a transitional DLNR. The same act provided that on July 1, 1962, DLNR was to be abolished as an executive department and that its functions were to be transferred to a newly designated Department of Agriculture and Natural Resources. However, in 1961, the Legislature enacted Act 132 that retained DLNR as a separate permanent department.

Under Section 26-15, Hawaii Revised Statutes (HRS), DLNR is responsible for managing, administering and exercising control over public lands, water resources and minerals thereon, including soil conservation, forests and forest reserves, aquatic life and wildlife resources, aquaculture programs, state parks, and historical sites.

More than half of DLNR's FY1998-99 operating budget is funded by state general funds. The remaining budget is funded by special and federal funds.

DLNR's payroll budget accounted for half of the total FY1998-99 budget. DLNR's personnel count for this fiscal year was approximately 721 employees.

Organization of the Department

DLNR comprises four organizational parts:

- Board of Land and Natural Resources
- Commission on Water Resource Management
- Office of the Chairperson
- Operating Divisions

DLNR's organizational chart is reported in Exhibit 1.1.

Board of Land and Natural Resources

DLNR is headed by an executive board known as the Board of Land and Natural Resources. The board has the statutory responsibility for managing public lands under DLNR's control. The chairperson of the board is also the director of DLNR. The board consists of six members, one from each land district and two at large, who are appointed by the governor.

Commission on Water Resource Management

The Commission on Water Resource Management has exclusive jurisdiction and final authority over the state water code (Chapter 174C, Hawaii Revised Statutes). The commission is responsible for overseeing and developing state policies for the management of surface and ground water supplies. The commission consists of six members. Four members are appointed by the governor. The chairperson of the Board of Land and Natural Resources is the chairperson of the commission, and the director of health serves as an ex officio voting member.

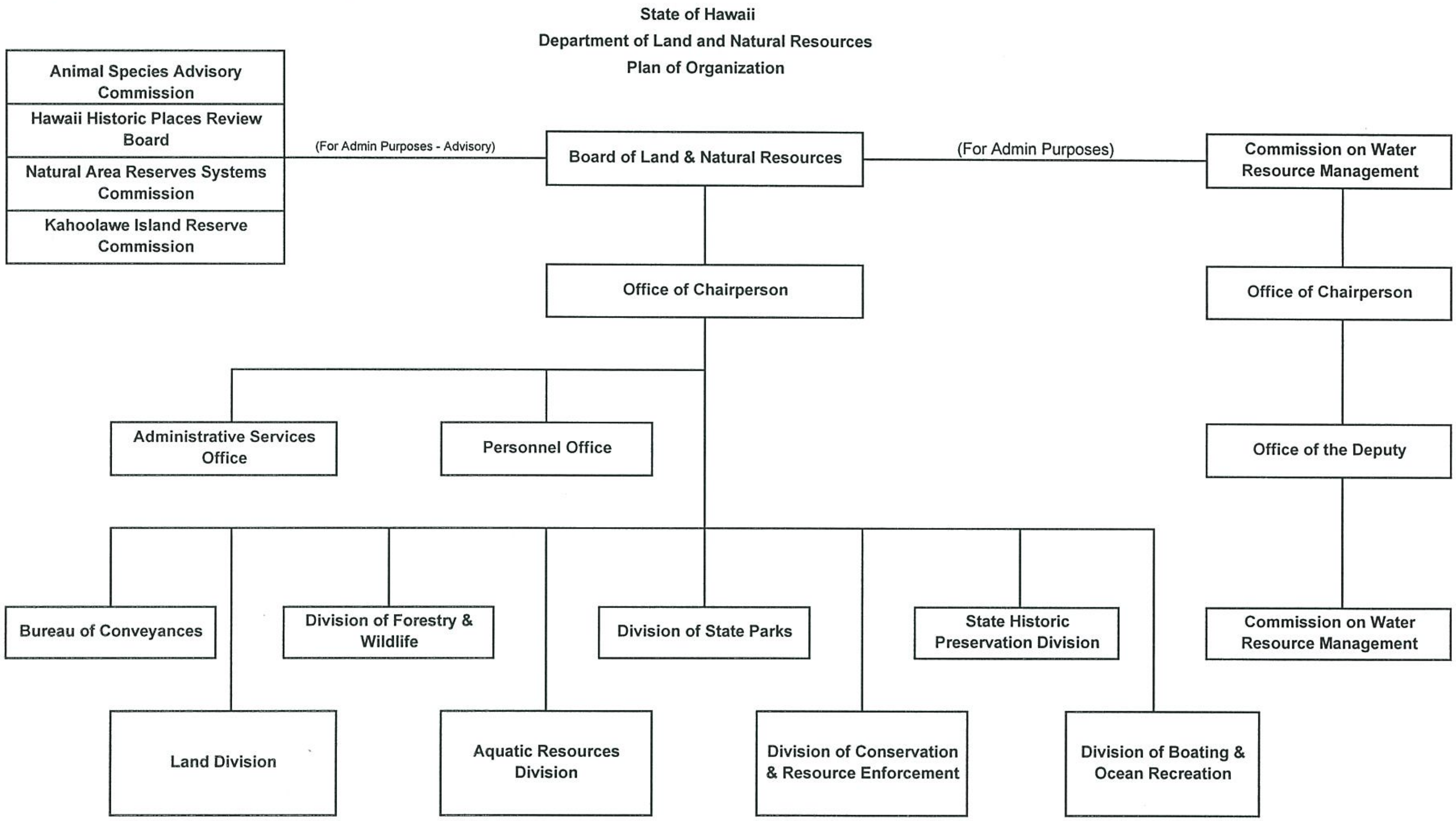
Office of the Chairperson

The Office of the Chairperson provides overall support services to the board and the operating divisions of DLNR. The Office of the Chairperson is divided into the following units:

Administrative Services Office. This office provides administrative support services, internal management assistance, auditing, budgeting, fiscal management and data processing services to the chairperson, members of the board and the operating divisions.

Personnel Office. This office maintains the personnel program for DLNR. Major services include guidance and technical assistance in position classification, employee relations, and employee training and development.

Exhibit 1.1
Organization Chart of the Department of Land and Natural Resources



Operating divisions

The operating divisions include those department units that carry out DLNR programs. These operating divisions and their activities are as follows:

Aquatic Resources. This division manages the state's marine and freshwater resources through programs in commercial fisheries and aquaculture, aquatic resources preservation, enhancement and education, and aquatic recreation. Major program areas include projects to maximize commercial fishery and aquaculture productivity, protect native and resident aquatic species and their habitat, and provide facilities and opportunities for recreational fishing consistent with the interests of the State.

Conservation and Resources Enforcement. This division is responsible for the enforcement of laws and rules regulating fish and wildlife, state parks, land management, forests and beaches. Major program areas include education of the public on conservation and preservation of Hawaii's land and natural resources, eradication of marijuana on state-owned lands, and administration of the Hunter Education Program.

Bureau of Conveyances. This division is responsible for the recordation of all legal documents related to real estate transactions. The division operates as two parallel units, the Land Court Recording Branch and the Regular System Recording Branch.

The Land Court Recording Branch processes and preserves documents and maps affecting title to lands registered in the court and issues a "Land Court Certificate of Title" showing the vested ownership, which is guaranteed by the State of Hawaii.

The Regular System Recording Branch processes and preserves legal and land title documents affecting unregistered lands.

Forestry and Wildlife. This division is responsible for the management of state-owned forests, natural areas, public hunting areas, and plant and wildlife sanctuaries. Program areas include watershed protection, native resources protection, outdoor recreation and commercial forestry.

State Parks. This division administers the state park system and the state recreation planning function. The two programs relating to this function include the Heritage and Recreation Parks and the General Administration for Culture and Recreation.

The Heritage and Recreation Parks Program provides opportunities and facilities for non-organized outdoor park recreation activities by preserving and making available for appreciation and study places of historical, scenic and natural significance.

The General Administration for Culture and Recreation Program provides general administration, planning and contract administration services.

Historic Preservation. This division operates a statewide inventory of properties of historic, architectural or cultural importance. It also runs the Burial Sites Program, the Hawaii Main Street Program and the Historic Preserves Program.

Land Division. This division is responsible for the planning, management and development of public lands and water resources. It makes land available for public and private use in accordance with established policies and plans, including negotiating the acquisition and disposition of public lands through sales, lease, rent or exchange, and maintaining a central depository of such official documents. It also provides for engineering development of water resources, flood control, safety of dams and reservoirs, soil and water conservation administration, disposition of mineral rights, geothermal development, and general engineering services to divisions and programs within DLNR and even statewide. It also coordinates the processing of conservation district-use applications for state and private lands.

Water Resource Management. Under the general direction of the Deputy of Water Resource Management, this division implements and administers the provisions of the state water code by planning, surveying, regulating, monitoring and conserving the state's water resources within established plans that have been adopted by the Commission on Water Resource Management.

Boating and Ocean Recreation. On July 1, 1992, the State Legislature transferred the operation of small boat harbors and boat launching ramps from the Harbors Division of the Department of Transportation to the Division of Boating and Ocean Recreation of DLNR. This division is responsible for the management and administration of statewide ocean recreation and coastal areas programs pertaining to the ocean waters and navigable streams of the State (exclusive of commercial harbors).

Objectives of the Audit

1. Report on the fair presentation of the financial statements of DLNR.

2. Assess the adequacy, effectiveness and efficiency of the systems and procedures for the financial accounting, internal control and financial reporting of DLNR; and recommend improvements to such systems, procedures and reports.

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

4. Ascertain the extent to which recommendations contained in Chapter 2 of the State Auditor's Report No. 92-2, "Financial Audit of the Department of Land and Natural Resources" for the fiscal year ended June 30, 1991, have been implemented.

Scope and Methodology

We examined the financial records and transactions and the related systems of accounting and internal controls of DLNR for the fiscal year July 1, 1998 to June 30, 1999. We also reviewed for compliance with applicable laws and regulations those transactions, systems and procedures tested.

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

In addition, the audit reviewed the extent to which the recommendations made in Chapter 2 of the State Auditor's Report No. 92-2, "Financial Audit of the Department of Land and Natural Resources" have been implemented.

The accountants' opinion as to the fairness of the financial statements presented is that of PricewaterhouseCoopers LLP. The audit was conducted from July 1999 through January 2000 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Practices

This chapter presents the general findings and recommendations on the financial accounting and internal control practices and procedures of the Department of Land and Natural Resources (DLNR). We also reviewed the progress of implementing the recommendations reported in Chapter 2 of the State Auditor's Report No. 92-2, "Financial Audit of the Department of Land and Natural Resources," for the fiscal year ended June 30, 1991. Although the department had implemented several of the recommendations made in Report No. 92-2, we found deficiencies in the management of federal grants, the administration of land leases, and internal procedures over cash receipts.

Summary of Findings

Our findings are as follows:

1. The department's financial operations failed to ensure the timely submission for approval of a federal grant for the Historic Preservation Fund Program. The department also credited subsequent year's general fund expenditures with federal grant funds received which enables the department to expend beyond its legislatively authorized ceiling. In addition, the department failed to meet federal requirements for submitting audited financial statements, which could jeopardize current or future federal funds. The department also lacks sufficient controls to track land lease renewals, bonds and insurance requirements. Failure to implement these controls places the State's assets at risk.

2. The Division of Boating and Ocean Recreation lacks internal control procedures, seriously jeopardizing its accountability over cash.

The Department's Financial Operations Need Improvement

The department received over $50 million in state, federal, special, and capital improvement project funds in FY1998-99. The department must ensure accountability over these funds given the significant amounts received. However, the department failed to follow federal and state law and accepted accounting practices in fulfilling its financial responsibilities.

Submission for a federal grant approval to defray the cost of the Historic Preservation Fund was not timely. In addition, the department incorrectly credited its federal grant funds received for various programs to the subsequent year's general fund expenditures. This enables the department to exceed its authorized appropriation ceiling. This practice also undermined the legislative authority that approved the appropriation ceiling.

Audited financial statements of the department were not completed in a timely manner and thus violated federal law. We also identified problems with untimely lease renewals of public land, and bonds and an insurance policy that expired while lease agreements remain in effect. Failure to monitor these agreements and policies places the State's resources at risk.

Untimely grant submission jeopardizes state resources

A federal grant for the Historic Preservation Fund Program was submitted to the awarding federal agency for approval in May 1999, eight months after the grant's commencement date of October 1998.

The program incurred $350,000 of general fund expenditures from December 1998 to April 1999 and did not claim for reimbursement until June 1999, shortly after receiving approval by the federal agency in May 1999. Late submission of grant applications to awarding/approving federal agencies jeopardizes the department's ability to maximize federal funds through appropriate reimbursements. If federal funds are not requested and approved (maximized), the department would expend general funds instead. These general funds could be used for other operating purposes rather than to defray federally allowable expenditures.

The department incorrectly credited federal grant funds received for subsequent year's general fund expenditures

The department recorded a receivable of $487,000 at June 30, 1999 for federal reimbursements for federal grant claims submitted for various programs in FY1998-99. However, this amount was received in FY1999-00 and was credited to the department's current general fund expenditures. We were informed by management that the general fund expenditures were credited because the FY1998-99 general fund appropriations were closed and there was insufficient time to compute the amount to transfer from the special fund. This crediting of a subsequent year's expenditure enables the department to spend its appropriation ceiling plus the additional $487,000 during FY1999-00. The department should instead seek legislative approval for the increased and actual appropriation amount that it actually intends to spend.

Authorized appropriation ceiling could be exceeded

The department's practice of crediting the subsequent year's general fund expenditures by $487,000 allows the department to exceed its authorized appropriation ceiling approved by the Legislature.

Although we were informed by management that the Department of Budget and Finance would not request the land and natural resources department to reimburse the state treasury, crediting a subsequent year's general fund expenditure raises serious operating concerns. This practice allows the department to exceed its authorized appropriation ceiling.

Article VIII, Section 8 of the State Constitution prohibits the executive branch from exceeding the general fund expenditure ceiling established by the Legislature. If the department expends its entire appropriation, as well as the $487,000 in credits, it exceeds its authorized appropriation ceiling.

Practice undermines legislative authority

The department's practice of crediting the subsequent year's general fund expenditures undermines legislative authority by keeping resources that could be appropriated to other programs. Even if the $487,000 lapsed at the end of FY1998-99, the department would have held these moneys longer than required.

The department did not meet the federal requirement for timely audited financial statements

The U.S. Office of Management and Budget's Circular A-133 requires the audited financial report be submitted to the cognizant or oversight agency within the earlier of 30 days after the state agency's receipt of the auditor's report or nine months after the end of the audit period. The department failed to meet this requirement, since it was untimely in resolving several outstanding audit issues.

For FY1997-98, the department's independent auditor issued its report on December 3, 1999. The department submitted its audited financial report to its cognizant agency on December 6, 1999, which was later than the required nine months after FY1997-98.

The department was unable to resolve the outstanding issues involving the reimbursement of federal operating and CIP moneys in a timely manner. The eventual resolution of these issues resulted in an adjustment to the financial statements. One adjustment changed the financial statements by more than $2 million. Another adjustment resulted in an elimination of more than $4 million.

The department is responsible for the timely and accurate reporting of its financial statements. Failure to ensure the timely issuance of the audit report could result in the department being assessed an unspecified amount, refunding its previous awards, or reducing future federal grant awards.

The department has not systematically maintained schedules to track State land lease renewals, and bond and insurance requirements

The department is responsible for the administration and management of public lands as described in Section 26-15, HRS. Under Section 40-2, HRS, the department is also responsible for maintaining and operating an adequate system of internal control.

The administration and management of public lands require that the department implement controls to ensure the protection of the State's interest in these lands. However, we found that the department failed to renew a lease, bonds, and an insurance policy on an existing lease in a timely manner. This failure jeopardized state resources through lost revenues from rent increases and an unprotected lease agreement.

Land lease renewals are not routinely tracked

Re-opening period provisions are part of most DLNR lease agreements. These provisions allow the department (lessor) to reassess the fair market value of leased properties every several years, to change the lease rents and to charge the lessees retroactive rents. New rent rates and retroactive rents are generally based on the newly determined fair market value of the properties.

In a sample of 20 leases, the department did not implement a new lease rent for one lease during the re-opening period. As a result, the lessee is currently billed at the old rent (the greater of either $10,800 per year or 6 percent of annual revenue) instead of a new higher rent. The department is currently negotiating a new lease with the tenant. According to department personnel, the new rent will be higher than the old rent but will not be applied retroactively. The department's failure to implement new lease rents in a timely manner will likely result in thousands of dollars lost to the State.

The department is aware of the problem and is currently implementing a new land management system to track lease re-opening periods to ensure new lease rents are being applied. DLNR uses a manual system for property management. Errors occur because the manual system does not have a tickler function to identify encumbrance requirements (i.e., rental re-openings and lease expirations). According to department personnel, the new land management system will provide automated tracking of encumbrance requirements. The new system will contain a database of information related to each property, including tenant, past defaults, insurance and bond requirements, rental re-openings, assignments and subleases. However the new system won't be implemented until November 2001; therefore, the department needs to implement an interim procedure to ensure the timeliness and accuracy of lease rent rates during re-opening periods.

Bonding and insurance compliance are not tracked

Most of the department's lease and permit agreements require that the lessee obtain an insurance policy and a bond (i.e., performance, fidelity, surety) to protect the State against breach or default of any of the terms, covenants, and conditions in the lease.

In our 1991 audit, we reported that DLNR had no follow-up procedures to ensure that bonds, once obtained by lessees, remained in effect. Our current audit found continued deficiencies in this area. In our sample of 20 leases and permits, we found that 1 performance bond, 1 fidelity bond, and 1 insurance policy had expired and were not renewed.

Management notified the respective lessees of the default after our audit identified these non-renewals, and the lessees recently obtained the required bond or insurance policy. However, the department's failure to ensure the timely renewal of bonds and insurance policy jeopardized the State's interest in these agreements. The newly executed performance and fidelity bonds cover amounts of $235,000 and $100,000, respectively. The newly executed insurance policy covers up to $4,000,000 for commercial general liability claims.

Although the department is aware of the problem and is currently implementing a new land management system to track bond and insurance policy expiration dates, this system is not expected to be implemented until November 2001. The department must establish interim procedures until the new system is operational and effective.

Recommendations

The department should establish and implement procedures to ensure federal grants are approved prior to the commencement date of the grant. In addition, the department should seek legislative authorization for any federal moneys credited to its general fund.

The department should also submit its financial report on or before the submission date as required by the U.S. Office of Management and Budget's Circular A-133. If the department expects that the financial report will not be submitted by the due date, it should notify the cognizant agency and obtain approval for the late submission.

The department should also review all lease agreements to ensure new lease rents are implemented during the re-opening periods as stated in the lease agreements. This review should be performed prior to the implementation of the new land management system so that the re-opening dates can be properly entered into the new land management system.

In addition, the department should review all leases and permits to ensure that all bonding and insurance requirements are being met. This review should be performed prior to the implementation of the new land management system so that current bonding and insurance policy expiration dates can be properly entered into the new land management system.

Internal Control Procedures in the Division of Boating and Ocean Recreation are Seriously Deficient

The Division of Boating and Ocean Recreation received approximately $10,578,000 in revenues for FY1998-99. We found certain deficiencies in cash receipts and with the management of agency fund accounts for the Division of Boating and Ocean Recreation. The deficiencies include the following:

- The division was unable to prepare accounts receivable aging reports.
- Treasury deposit receipts were not prepared in a timely manner.
- Reconciliations of the agency fund account were not performed.
- Payments for temporary mooring permits were received after the effective date of the permits.
- There are no procedures to ensure all amounts due from the issuance of temporary mooring permits are collected and recorded.

According to department personnel, the deficiencies occurred because the Division of Boating has been understaffed since July 1, 1992, when the division was transferred from the Department of Transportation to the Department of Land and Natural Resources.

New computer system cannot generate key control reports

We were informed that the Division of Boating and Ocean Recreation developed an in-house revenue and receivables computer system, that provides various management reports, including accounts receivable aging reports. These reports assist the division in managing revenue and accounts receivable balances.

The new computer system allows department personnel to access account holder information on an 'on-line real-time' basis. Therefore, the latest data inputted into the computer system is available to the system users, on a statewide basis, immediately after input. The computer system generates monthly billing statements, which are sent to account holders. We were informed that this computer system also generates aged receivable reports and related delinquent accounts as of a given date. However, the division was unable to deliver an aged accounts receivable report at June 30, 1999 after we requested it.

After several inquiries, we discovered that the in-house revenue and receivable computer system cannot prepare the June 30, 1999 aged accounts receivable report after June 30, 1999 (i.e., the June 30, 1999 aged accounts receivable report can only be prepared on that same day, June 30, 1999). In addition, the division did not prepare the June 30, 1999 aged accounts receivable report. We question the usefulness of a computer system that cannot produce key management and control reports such as an accounts receivable aging report.

Timely treasury deposit receipts are not prepared

Treasury deposit receipts (TDR) are the source documents for recording cash receipts in the department's accounting system. DLNR cannot access deposited cash receipts until the respective TDR has been processed and the cash receipt recorded. The Division of Boating and Ocean Recreation's fiscal office prepares its TDRs upon receipt of validated deposit slips and summaries of cash receipts submitted by the division's harbor agents.

During FY1998-99, harbor agents collected $6,615,000 in revenue for mooring fees, boating registration and miscellaneous fees. Customers receive pre-numbered receipts for all payments submitted to the harbor agents. On a daily basis, harbor agents input collections into the revenue system and prepare daily cash receipt journals. Harbor agents are responsible for depositing the collections. We were informed that harbor agents were instructed to submit validated deposit slips and summaries of cash receipts at least twice a week.

In a sample of 25 cash receipts, there were 14 instances in which the TDRs were prepared more than a week after the cash receipt date. In 2 of these instances, the TDRs were prepared more than 20 days after the cash receipt date. We discovered that the late TDRs were due to late submissions of validated deposit slips and summaries of cash receipts by the harbor agents.

According to department personnel, the late submissions were due to limited collection activity and limited personnel. For the smaller harbors, there is only one harbor agent managing a harbor. These harbor agents do not submit deposit slips and cash summaries to the fiscal office on a timely basis because there is little cash activity during the week, and the agents cannot leave their harbor unmanned. These agents usually accumulate the deposits over a period of time, then submit their collections to the fiscal office during the days when the harbors are not open for business. Nevertheless, the department should establish procedures to ensure the timely completion of TDRs.

Failure to reconcile agency fund accounts jeopardizes the department's fiduciary duty to customers

The department maintains several agency fund accounts for temporary deposits, one of which is for the Small Boat Harbors and Boat Ramps Program. These agency fund accounts contain security deposits held by the Division of Boating and Ocean Recreation for customers who maintain annual mooring permits. Upon expiration or cancellation of an annual mooring permit, the security deposit, less any outstanding balance due, is returned to the customer. As of June 30, 1999, the balance of the agency fund account was $698,892.

The division established an informal policy of reconciling quarterly the agency account balance from security deposits list to the accounting system. However, division personnel informed us that the agency account balance was not reconciled for the four quarters in FY1998-99. According to department officials, the reconciliation was not performed due to lack of resources (i.e., the boating division is understaffed). However, not performing these reconciliations increases the risk that differences between the security deposits list and the accounting system will not be identified and corrected.

Late collections for temporary permits issued jeopardize accountability over cash

Division officials informed us that harbor agents issue temporary mooring permits upon full payment for the permit. The Division of Boating and Ocean Recreation has a 72-hour grace period for harbor agents to collect temporary mooring permit payments from customers. The grace period is allowed because harbors are open five business days a week, and many temporary mooring permits have effective dates during non-business days.

In our sample of 25 cash receipts, we found 2 receipts in which harbor agents received payments for temporary mooring permits after the permits' effective dates. For these two instances, both the payment date and the effective date of the temporary mooring permit fell within the days the harbors were open for business so a grace period would not be applicable. The failure of harbor agents to issue permits after payments are received increases the risk of loss or misuse of moneys.

Harbor agents issue temporary mooring permits, collect payments, deposit the payments and prepare summaries of cash receipts. The division's fiscal office periodically reconciles bank deposit slips to the summaries of cash receipts. Through inquiries with division personnel, we were informed that no one compares the amount due from the issuance of temporary mooring permits against payments collected and recorded. Moneys could be lost or misused or permits unaccounted for because of the lack of reconciling procedures. The division's lax permit collections and reconciliation procedures must be corrected to ensure its safeguarding of cash.

Recommendations

1. The division should evaluate the usefulness and reliability of the in-house revenue and receivables computer system since it was not able to produce the June 30, 1999 accounts receivable aging report.

2. The department should monitor the division to ensure they comply with their policies to:

   - Submit validated deposit slips and summaries of cash receipts twice a week to the division's fiscal office from the harbor agents so that the TDRs can be prepared and recorded in the division's accounting system in a timely manner;

   - Reconcile quarterly the agency fund account balances from the security deposits list to the accounting system to ensure differences between the list and the system are identified and corrected; and

   - Collect payments for temporary mooring permits on or prior to the effective date of the temporary mooring permit to ensure such payments are collected in a timely manner.

3. The department should also establish policies and procedures to ensure that the division's fiscal office compares the amount due from the issuance of temporary permits against payments collected and recorded.

Chapter 3
Financial Audit

This chapter presents the results of the financial audit of the Department of Land and Natural Resources, State of Hawaii (DLNR) for the year ended June 30, 1999. This chapter displays financial statements of all fund types and account groups administered by DLNR, together with explanatory notes, and includes the report on compliance and internal control.

Summary of Findings

In the opinion of PricewaterhouseCoopers LLP, based on their audit, except for the general fixed asset account group, the financial statements present fairly, in all material respects, the combined financial position of DLNR as of June 30, 1999 and the combined results of its operations for the year then ended in conformity with generally accepted accounting principles.

Independent Auditors' Report

PricewaterhouseCoopers LLP's report filed with the auditor is as follows:

To the Auditor
State of Hawaii

We have audited the accompanying combined financial statements of the Department of Land and Natural Resources, State of Hawaii (DLNR), as of and for the year ended June 30, 1999, as listed in the foregoing table of contents. These combined financial statements are the responsibility of the management of DLNR. 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 auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 audit of the general fixed assets account group and, accordingly, we express no opinion on it.

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

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 general fixed assets account group, as explained in the third paragraph above, the combined financial statements referred to above present fairly, in all material respects, the financial position of DLNR, as of June 30, 1999, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards,* we have also issued our report dated January 7, 2000 on our consideration of DLNR's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

/s/ PricewaterhouseCoopers LLP

Honolulu, Hawaii
January 7, 2000

Descriptions and Definitions

This section provides descriptions of 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 audited by PricewaterhouseCoopers LLP. The financial statements are attached at the end of this chapter.

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

Combined statement of revenues, expenditures and changes in fund equity - all governmental fund types and expendable trust funds (Exhibit B). This statement presents revenues, expenditures, other financing sources (uses) and changes in fund equity for all governmental fund types and expendable trust funds used by DLNR on an aggregate basis. Revenues include state appropriations authorized by the State Legislature.

Combined statement of revenues and expenditures - budget and actual (budgetary basis), general and special revenue funds (Exhibit C). This statement presents a comparison of budgeted and actual revenues, expenditures and other financing sources for the general fund accounts and special revenue funds used by DLNR.

Definition of terms

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

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

Allotment. An authorization made 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, 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.

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

Notes to the Combined Financial Statements

Explanatory notes, which are pertinent to an understanding of the financial statements and financial condition of the funds administered by DLNR, are discussed in this section.

1. Significant accounting policies

DLNR is headed by the Board of Land and Natural Resources. DLNR manages, administers and exercises control over public lands, water resources, minerals and all other interests therein and exercises such powers of disposition thereof as authorized by law. DLNR also manages and administers the State of Hawaii's (the State) parks, historical sites, forests, forest reserves and other functions assigned to it by law. In connection with the above, DLNR leases certain lands and facilities under its jurisdiction to individuals and organizations under long-term and short-term agreements.

The following is a summary of significant accounting policies:

Reporting entity

DLNR is part of the executive branch of the State. DLNR's combined 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 is attributable to the transactions of DLNR. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually, which includes DLNR's financial activities.

Fund accounting

The accounts of DLNR are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The financial activities of each fund are accounted for with a separate set of self-balancing accounts, which represent the funds' assets, liabilities, fund equity, revenues and expenditures. Account groups are used to establish accounting control and accountability for DLNR's general fixed assets and general long-term obligations. Account groups are not funds as they do not reflect available resources.

Governmental fund types

The general fund is the general operating fund of DLNR. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget, as authorized by the State Legislature, provides the basic framework within which the resources and obligations of the general fund are accounted.

Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trust funds) that are restricted to expenditures for specified purposes.

Capital project funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary fund types

Trust and agency funds are used to account for assets held by DLNR in a trustee or agency capacity. These include expendable trust funds, which account for cash collected and expended by DLNR for designated purposes and agency funds, which account for the receipt and disbursement of various amounts collected by DLNR in a custodial capacity. Total agency fund cash receipts and disbursements during the fiscal year ended June 30, 1999 aggregated $1,477,222 and $1,636,118, respectively.

Account groups

General fixed assets acquired for use by DNLR in the conduct of its general governmental operations are accounted for in the general fixed assets account group at cost or estimated fair market value at the date of donation. Accumulated depreciation is not recorded in the general fixed assets account group.

Unmatured long-term general obligation bonds, loans and the obligation for the long-term portion of accrued vested vacation are recorded in the general long-term debt account group.

Basis of accounting

All governmental funds and the expendable trust funds are accounted for using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenue is recognized when it becomes measurable and available. Expenditures are generally recognized when the related fund liability is incurred. An exception to this general rule includes accumulated unpaid vacation, which is not payable from expendable available resources and is therefore included in the general long-term debt account group.

Appropriations

An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly and lapse if not expended by or encumbered at the end of the fiscal year. Allotted appropriations related to capital projects are exceptions.

Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances outstanding at fiscal year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

Cash in State Treasury

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." Those funds are pooled with funds from other State agencies and departments and deposited in approved financial institutions by the State Director of Finance.

Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State by third party custodians.

Accumulated vacation and sick leave

Eligible employees are credited with vacation at a rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year end. Liabilities of vacation pay are inventoried at the end of each accounting period and adjusted to current salary levels. The liability is included in the general long-term debt account group since substantially all of the liability is not expected to be liquidated using expendable available financial resources.

Eligible employees are credited with sick leave at a rate of one and three-quarter days per month of service. Unused sick leave may be accumulated without limit but can be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in DLNR's combined balance sheet. However, an employee who retires or leaves government service in good standing with sixty days or more in unused sick leave is entitle to additional service credit in the Employees' Retirement System of the State of Hawaii (ERS). Accumulated sick leave as of June 30, 1999 was approximately $16,710,000.

Intra-fund and inter-fund transactions

Significant transfers of financial resources between activities included within the same fund are offset within the fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

Inventory

Inventory of materials and supplies is recorded as expenditures when purchased.

Grants

Federal grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All federal reimbursement type grants are recorded as intergovernmental receivables and revenue when related expenditures are incurred.

Leases

DLNR generates revenues through leases, month-to-month permits, land and water licenses, easements, and other encumbrance activities. Revenues from these activities recorded in DLNR's special revenue funds are recognized on the modified accrual basis of accounting. DLNR also collects lease payments that are held in expendable trust funds managed by DLNR or deposited to the State treasury. Leases are generally issued for industrial, residential, pasture and agricultural use. Lease terms are generally 55 years for industrial, 65 years for residential, 20 years for pasture and 30 years for agricultural use. Lessees are responsible for insurance, taxes and maintenance costs for the leased property. DLNR's leases provide for minimum base rent and/or a percentage of the lessees' revenue and are generally due on a quarterly, semi-annual or annual basis.

Investments

Investments are carried at cost, which approximates market.

Unreserved fund balance

At June 30, 1999, the unreserved fund balance of the special revenue fund includes $13,320,000 of unexpended advances received by DLNR in connection with a federally funded program.

Fund balance reserves

Portions of fund balance are reserved for the following:

- Receivables to indicate that portion of the fund balance that is not available for funding current expenditures.

- Continuing appropriations, which include specific legislative appropriations, that do not lapse at the end of the year.
- Trust fund balances, which are restricted to the purpose of the accounts.

Memorandum only

The total columns are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in those columns do not present financial position, results of operations or changes in equity in conformity with generally accepted accounting principles. Neither is such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

Use of estimates

In preparing financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities; the disclosures of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

New accounting pronouncements

In June 1999, the Governmental Accounting Standards Board (GASB) issued GASB No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments" that will require that the basic financial statements and supplementary information for general purpose governments should consist of management's discussion and analysis; basic financial statements, including government-wide financial statements, fund financial statements, and notes to the financial statements; and supplementary information. Governments should report all capital assets, including infrastructure assets, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities. Governments with total annual revenues of $100 million or more are required to implement this Statement for periods beginning after June 15, 2001. Prospective reporting of general infrastructure assets is required at the effective date of this Statement. Retroactive reporting of all major general governmental infrastructure assets is encouraged at that date. Retroactive reporting is required four years after the effective date on the basic provisions for all major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980. Management has not yet determined the effect of the implementation of this Statement to the DLNR's financial statements.

2. Budgeting and budgetary control

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 - General and Special Revenue Funds (non-GAAP budgetary basis) are those estimates as compiled by the State Director of Finance. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the Hawaii Revised Statutes, and other specific appropriation acts in various Session Laws of Hawaii.

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 particular conditions relating to terminating the authorization for other appropriations.

Summarization of the budgets adopted by the State Legislature for the "budgetary" general and special revenue funds is presented in the Combined Statement of Revenues and Expenditures - Budget and Actual - General and Special Revenues Funds (non-GAAP budgetary basis). For purposes of budgeting, DLNR's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with generally accepted accounting principles (GAAP).

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with generally accepted accounting principles.

	General fund	Special revenue fund
Excess (deficiency) of revenues over (under) expenditures - actual on budgetary basis	$ 1,666,985	$ 318,516
Reserve for encumbrances at year end, net of encumbrances relating to prior years' appropriations	3,799,877	5,256,022
Fiscal 1999 salaries and wages funded by fiscal 2000 appropriation	(820,855)	(315,563)
Other fiscal 1999 expenditures funded by fiscal 2000 appropriations	(93,019)	(46,987)
Expenditures for liquidation of prior years' encumbrances and continuing appropriations	(2,521,099)	(3,317,632)
Accrual adjustments and other	(7,123)	(2,065)
Excess (deficiency) of revenues over (under) expenditures - GAAP basis	$ 2,024,766	$ 1,892,291

3. Investments

The State Department of Budget and Finance holds investments for DLNR. The following table presents DLNR's investments at June 30, 1999 and provides information about the credit and market risks associated with DLNR's investments. The three categories of credit risks are:

- Category 1: investments which are insured or registered, or securities held by the State or its agents in the State's name.
- Category 2: investments which are uninsured and unregistered, with securities held by the counterparty's trust department or agency in the State's name.
- Category 3: investments which are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

Repurchase agreements and certificates of deposit mature at various dates beginning July 1999 through May 2002.

	Carrying value	Market value	Category 1	Category 2	Category 3
Repurchase agreements	$21,550,000	$21,550,000	$21,550,000	$ -	$ -
Certificate of deposits	5,050,000	5,050,000	5,050,000	-	-
	$26,600,000	$26,600,000	$26,600,000	$ -	$ -

Repurchase agreements (securities purchased under agreements to resell) are generally treated as collateralized lending and are carried at the amounts at which the securities were initially acquired. The repurchase agreements are collateralized by U.S. Treasury and U.S. Government or agency securities, which are held by a third-party custodian.

4. Accounts receivable

At June 30, 1999, accounts receivable consisted of the following:

	Special revenue	Trust and agency
Rents, fees and licenses	$ 2,376,026	$ 2,862,449
Less allowance for doubtful accounts	289,487	249,762
	$ 2,086,539	$ 2,612,687

5. General fixed assets (unaudited)

The changes in the general fixed assets (unaudited) were as follows:

	Land	Building and improvements	Equipment	Total
Balance at July 1, 1998	$487,694,200	$ 46,433,997	$ 22,458,135	$556,586,332
Additions	7,310,600	1,014,691	2,306,920	10,632,211
Deductions	—	(2,960)	(857,512)	(860,472)
Balance at June 30, 1999	$495,004,800	$ 47,445,728	$ 23,907,543	$566,358,071

6. General long-term debt

The changes in general long-term debt were as follows:

	Accrued employee benefits	Due to other funds	General obligation bonds	Total
Balance at July 1, 1998	$ 5,243,966	$ 6,180,795	$13,088,798	$24,513,559
Principal payments	-	-	(911,689)	(911,689)
Net increase in accrued vacation	561,835	-	-	561,835
New issues	-	-	129,522	129,522
Balance at June 30, 1999	$ 5,805,801	$ 6,180,795	$12,306,631	$24,293,227

Due to other funds consists of a general obligation reimbursable bond funded loan from the State to the former Hawaii Water Authority, which is now part of DLNR.

The following are portions of the State of Hawaii general obligation bonds allocated to DLNR under Acts of various Session Laws of Hawaii. These bonds are backed by the full faith, credit, and taxing power of the State. Repayments of allocated bond debts are made to the State general fund. The details of these general obligation bonds at June 30, 1999 are as follows:

$3,666,553 series BT bonds dated February 1, 1991; due in annual installments of $203,714; final payment on February 1, 2001; interest at 5.7% to 8.0% payable semi-annually	$ 203,713
$1,191,079 series BU bonds dated November 1, 1991; due in annual installments of $44,890; final payment on November 1, 2001; interest at 5.6% to 7.25% payable semi-annually	89,799
$423,588 series BX bonds dated March 1, 1992; due in annual installments of $47,065; final payment on March 1, 2002; interest at 5.15% to 6% payable semi-annually	141,196

$1,867,548 series BW bonds dated March 1, 1992; due in annual installments of $103,742; final payment on March 1, 2012; interest at 5.15% to 6.4% payable semi-annually	1,348,650
$1,648,311 series BZ bonds dated October 1, 1992; due in annual installments of $103,019; final payment on October 1, 2012; interest at 5% to 6.125% payable semi-annually	1,339,253
$987,378 series CB refunding bonds dated January 1, 1993; due in annual installments of $75,945; final payment on January 1, 2008; interest at 4.3% to 5.75% payable semi-annually	683,506
$1,852,409 series CC refunding bonds dated February 1, 1993; due in annual installments of $132,323 through February 1, 2005 and $132,295 through February 1, 2009; interest at 3.85% to 7.75% payable semi-annually	1,323,117
$338,759 series CD refunding bonds dated February 1, 1993; due in annual installments of $42,340; final payment on February 1, 2003; interest at 3.85% to 5% payable semi-annually	169,361
$526,713 series CF refunding bonds dated July 1, 1993; due in annual installments of $58,520; final payment on July 1, 2002; interest at 3.25% to 5.5% payable semi-annually	234,080
$2,540,742 series CI refunding bonds dated November 1, 1993; due in annual installments of $158,674; final payment on November 1, 2010; interest at 4% to 5% payable semi-annually	1,903,820
$1,218,020 series CH bonds dated November 1, 1993; due in annual installments of $67,673 commencing November 1, 1999 through November 1, 2010 and $67,649 through November 1, 2013; interest at 4% to 6% payable semi-annually	996,048
$1,800,394 series CJ bonds dated January 1, 1995; due in annual installments of $100,029; final payment on January 1, 2005; interest at 5.625% to 5.8% payable semi-annually	400,117
$756,420 series CK bonds dated September 1, 1995; due in annual installments of $42,057 from September 1, 1998 through September 1, 2000 and $42,019 through September 1, 2006; interest at 5% to 6% payable semi-annually	294,134
$129,212 series CN bonds dated March 1, 1997; due in varying annual installments commencing March 1, 2002 though March 1, 2017; interest at 5.25% to 6.25% payable semi-annually	118,077

$1,543,702 series CO bonds dated March 1, 1997; due in varying semi-annual installments commencing March 1, 2000 through March 1, 2011; interest at 4.5% to 6% payable semi-annually	1,543,702
$19,478 series CQ bonds dated October 1, 1997; due in varying annual installments; final payment on October 1, 2004; interest at 4% to 5% payable semi-annually	17,069
$1,500,989 series CS bonds dated April 1, 1998; due in varying annual installments commencing April 1, 2003 through April 1, 2009; interest at 5% to 5.25% payable semi-annually	1,500,989
	$12,306,631

Interest paid by DLNR for the year ended June 30, 1999 approximated $695,000.

The approximate annual requirements to amortize the general obligation bond's debt and related interest are as follows:

Fiscal year ending June 30,	Principal	Interest	Total
2000	$ 781,482	$ 639,388	$ 1,420,870
2001	1,162,261	597,016	1,759,277
2002	1,087,966	534,419	1,622,385
2003	1,185,241	470,676	1,655,917
2004	1,100,154	383,283	1,483,437
2005	1,117,177	356,415	1,473,592
2006	1,032,377	297,981	1,330,358
2007	1,051,798	243,156	1,294,954
2008	1,029,790	190,407	1,220,197
2009	974,952	122,519	1,097,471
2010	604,701	85,958	690,659
2011	615,065	51,464	666,529
2012	283,463	23,275	306,738
2013	180,197	6,921	187,118
2014	77,678	1,723	79,401
2015	10,581	1,172	11,753
2016	-	617	617
2017	11,748	618	12,366
TOTAL	$12,306,631	$ 4,007,008	$16,313,639

7. Retirement benefits

Substantially all employees of DLNR are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost sharing multiple employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the ERS consisted only of a contributory plan. In 1984, legislation was enacted to create a new noncontributory plan for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are excluded from the noncontributory plan. The noncontributory plan 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 plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively. Contributions for employees of DLNR are paid from the State General Fund.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and non-vested benefits and other aspects of the ERS is also not available on a departmental or agency basis.

The State's policy is to fund its required contribution annually. DLNR's share of the retirement system expense for the year ended June 30, 1999 was included in Act 116 of the 1998 Regular Session as an item to be expended by the Department of Budget and Finance and is not reflected in DLNR's combined financial statements. The entire ERS' actuarial determination of the employer contribution requirements were met as of June 30, 1999.

The ERS issues a publicly available financial report that includes financial statements and required supplemental information. That report may be obtained from the ERS.

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all DLNR employees who retire from the State on or after attaining the age of 62 with at least 10 years of service, or age 55 with at least 30 years of service under the noncontributory option, and age 55 with at least 5 years of service under the contributory option. Retirants credited with at least 10 years of service, excluding sick leave credit, qualify for free medical insurance premiums; however, retirants with less than 10 years must assume a portion of the monthly premiums. All disability retirants who retired after June 30, 1984, with less than 10 years of service also qualify for free medical insurance premiums. Free life insurance coverage for retirants and free dental coverage for dependents under age 19 are also available. Retirants covered by the medical portion of Medicare are eligible to receive a reimbursement of the basic medical coverage premiums. Contributions are based upon negotiated collective bargaining agreements and are funded by the State as accrued. DLNR's general fund share of the expense for post-retirement healthcare and life insurance benefits for the year ended June 30, 1999 has not been separately computed and is not reflected in DLNR's general fund financial statements.

8. Commitments and contingencies

Litigation

DLNR is involved in several lawsuits and complaints arising in the normal course of operations. Based on discussion with counsel, management is of the opinion that the outcome of these lawsuits and complaints will not have a material adverse effect on the financial position of DLNR.

Insurance

Insurance is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. The State records 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, 1999, the State recorded an estimated loss for workers' compensation, automobile and general liability claims in the State's general long-term debt 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. Effective July 1, 1997, all benefits paid for workers' compensation are reflected in the respective department or agency's financial statements. Benefits paid by DLNR for the year ended June 30, 1999 approximated $87,000. At June 30, 1999, DLNR's liability was not significant to its general long-term debt account group. Expenditures for other insurance claims are made by the Department of Accounting and General Services, State of Hawaii, and are not reflected in DLNR's combined financial statements.

Deferred compensation plan

The State established a deferred compensation plan which enables State employees to defer a portion of their compensation. The Department of Human Resources Development, State of Hawaii, has the fiduciary responsibility of administering the plan. Plan assets are protected from claims of the State's creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. The deferred compensation is not available to employees until termination, retirement, death or an unforeseeable emergency. The assets and liabilities of the plan are not reflected in the State of Hawaii or DLNR financial statements.

Due to State of Hawaii

Included in the Special Revenue Fund is approximately $2,377,000 of federal fund reimbursements received by DLNR for expenditures incurred for various capital improvement projects. These amounts are required to be returned to the State Treasury under Act 328 of the 1997 Regular Session.

9. Small Boat Harbors and Boat Ramps Program

During the year ended June 30, 1999, DLNR paid the State Department of Transportation approximately $113,000 for services rendered during the year in connection with the Small Boat Harbors and Boat Ramps Program, which was transferred from the State Department of Transportation to DLNR effective July 1, 1992.

Report on Compliance and on Internal Control

To the Auditor
State of Hawaii

We have audited the combined financial statements, except for the general fixed assets account group, of the Department of Land and Natural Resources, State of Hawaii, as of and for the year ended June 30, 1999, and have issued our report thereon dated January 7, 2000. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States and the 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 Department of Land and Natural Resources, State of Hawaii's combined financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes), and procurement rules, directives and circulars, noncompliance with which could have a direct 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted an immaterial instance of noncompliance, which we have reported to the Auditor, State of Hawaii, which is further described in Chapter 2 (Finding #1).

Internal control over financial reporting
In planning and performing our audit, we considered the Department of Land and Natural Resources, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the

purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgement, could adversely affect the Department of Land and Natural Resources, State of Hawaii's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions have been reported to the Auditor, State of Hawaii, which are further described in Chapter 2 (Findings #1 and 2).

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 in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Finding #2 in Chapter 2 to be a material weakness.

This report is intended solely for the information and use of the Auditor, State of Hawaii and management of the Department of Land and Natural Resources, State of Hawaii and is not intended to be and should not be used by anyone other than these specified parties.

/s/ PricewaterhouseCoopers LLP

Honolulu, Hawaii
January 7, 2000

(Exhibit A)

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

Combined balance sheet - All fund types and account groups
June 30, 1999

	Governmental Fund Types			Fiduciary Fund Types	Account Groups		
ASSETS	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	TRUST & AGENCY	GENERAL FIXED ASSETS (Unaudited)	GENERAL LONG TERM DEBT	Total (Memorandum Only)
Cash in state treasury	$5,700,210	$17,997,284	$45,691,157	$3,748,852	$ -	$ -	$73,137,503
Investments	-	26,600,000	-	-	-	-	26,600,000
Receivables							
Due from Federal Government	-	953,401	-	-	-	-	953,401
Due from other funds	487,210	-	-	-	-	-	487,210
Accounts receivable, net	-	2,086,539	-	2,612,687	-	-	4,699,226
Accrued interest receivable	-	600,678	-	-	-	-	600,678
Fixed assets	-	-	-	-	566,358,071	-	566,358,071
Amount to be provided for the retirement of general long term debt	-	-	-	-	-	24,293,227	24,293,227
Total assets	$6,187,420	$48,237,902	$45,691,157	$6,361,539	$566,358,071	$24,293,227	$697,129,316
LIABILITIES AND FUND EQUITY							
Liabilities							
Vouchers and contracts payable	$1,001,468	$984,123	$887,716	$ -	$ -	$ -	$2,873,307
Accrued wages and employee benefits payable	2,610,445	695,848	56,996	-	-	5,805,801	9,169,090
Due to other agencies	-	2,306,235	-	3,213,095	-	-	5,519,330
Due to other funds	-	487,210	-	-	-	6,180,795	6,668,005
Due to State of Hawaii	-	2,376,707	-	1,684,016	-	-	4,060,723
General obligation bonds payable	-	-	-	-	-	12,306,631	12,306,631
Deferred revenue and other	-	2,467,931	-	1,443,456	-	-	3,911,387
Total liabilities	3,611,913	9,318,054	944,712	6,340,567	-	24,293,227	44,508,473
Fund equity							
Investment in general fixed assets	-	-	-	-	566,358,071	-	566,358,071
Fund balances							
Reserved for encumbrances	3,085,307	5,760,597	21,187,803	-	-	-	30,033,707
Reserved for receivables	-	3,640,617	-	-	-	-	3,640,617
Reserved for continuing appropriations	-	-	23,558,642	-	-	-	23,558,642
Reserved for amounts held in trust	-	-	-	20,972	-	-	20,972
Unreserved	(509,800)	29,518,634	-	-	-	-	29,008,834
Total fund equity	2,575,507	38,919,848	44,746,445	20,972	566,358,071	-	652,620,843
Total liabilities and fund equity	$6,187,420	$48,237,902	$45,691,157	$6,361,539	$566,358,071	$24,293,227	$697,129,316

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

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

(Exhibit B)

Combined statement of revenues, expenditures and changes in fund equity -
all governmental fund types and expendable trust funds
for the year ended June 30, 1999

	Governmental Fund Types			Fiduciary Fund Type	
	GENERAL	SPECIAL REVENUE	CAPITAL PROJECTS	EXPENDABLE TRUST	Total (Memorandum Only)
Revenues					
Appropriations	$29,071,031	$ -	$12,656,941	$ -	$41,727,972
Intergovernmental	-	9,622,077	-	-	9,622,077
Rents, fees and licenses	-	15,297,858	914,200	-	16,212,058
Fuel Taxes	-	1,511,290	-	-	1,511,290
Interest	-	1,237,051	-	-	1,237,051
Other	-	609,415	302	36,195	645,912
Total revenues	29,071,031	28,277,691	13,571,443	36,195	70,956,360
Expenditures					
Economic Development	1,795,432	1,748,770	-	-	3,544,202
Environmental protection	14,055,619	8,069,620	-	47,854	22,173,093
Culture & recreation	7,930,513	13,467,253	-	-	21,397,766
Public Safety	151,664	84,605	-	-	236,269
Individual rights	1,677,153	240,486	-	-	1,917,639
Government-wide support	1,435,884	2,774,666	-	-	4,210,550
Capital Outlays	-	-	11,609,926	-	11,609,926
Total expenditures	27,046,265	26,385,400	11,609,926	47,854	65,089,445
Excess (deficiency) of revenues over (under) expenditures	2,024,766	1,892,291	1,961,517	(11,659)	5,866,915
Other financing sources (uses)					
Operating transfers in	-	4,461,000	-	-	4,461,000
Operating transfers out	(245,541)	(7,730,000)	(1,000,000)	-	(8,975,541)
Total financing sources (uses)	(245,541)	(3,269,000)	(1,000,000)	-	(4,514,541)
Excess (deficiency) of revenue and other financing sources (uses) over (under) expenditures	1,779,225	(1,376,709)	961,517	(11,659)	1,352,374
Lapsed appropriations	(1,516,525)	-	(1,553,261)	-	(3,069,786)
Excess (deficiency) of revenue and other financing sources (uses) over (under) expenditures and lapsed appropriations	262,700	(1,376,709)	(591,744)	(11,659)	(1,717,412)
Fund balance at July 1, 1998	2,312,807	40,296,557	45,338,189	32,631	87,980,184
Fund balance at June 30, 1999	$2,575,507	$38,919,848	$44,746,445	$20,972	$86,262,772

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

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

(Exhibit C)

Comined statement of revenues and expenditures - budget and actual (budgetary basis) -
general and special funds
for the year ended June 30, 1999

	General Fund Accounts			Special Revenue Funds		
	BUDGET	ACTUAL ON BUDGETARY BASIS	VARIANCE FAVORABLE (UNFAVORABLE)	BUDGET	ACTUAL ON BUDGETARY BASIS	VARIANCE FAVORABLE (UNFAVORABLE)
Revenues						
Appropriations	$29,071,031	$29,071,031	$ -	$ -	$ -	$ -
Intergovernmental	-	-	-	10,105,118	9,622,077	(483,041)
Other	-	-	-	20,610,930	18,655,614	(1,955,316)
Total revenues	29,071,031	29,071,031	-	30,716,048	28,277,691	(2,438,357)
Expenditures						
Economic Development	2,266,313	1,831,879	434,434	1,874,545	1,748,206	126,339
Environmental protection	14,493,240	13,826,527	666,713	8,345,160	8,375,210	(30,050)
Culture & recreation	8,405,589	8,410,864	(5,275)	14,894,358	13,794,317	1,100,041
Public Safety	202,844	135,328	67,516	340,000	86,425	253,575
Individual rights	1,737,808	1,733,789	4,019	655,231	157,575	497,656
Government-wide support	1,965,237	1,465,659	499,578	4,606,754	3,797,442	809,312
Total expenditures	29,071,031	27,404,046	1,666,985	30,716,048	27,959,175	2,756,873
Excess of revenues over expenditure	$ -	$1,666,985	$1,666,985	$ -	$318,516	$318,516

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

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Land and Natural Resources on April 11, 2000. A copy of the transmittal letter to the department is included as Attachment 1. The response of the Department of Land and Natural Resources is included as Attachment 2.

The department generally disagrees with our findings that the State's assets were placed at risk or that accountability over cash or other fiduciary obligations were materially jeopardized by the matters discussed in the report.

In its response, the department provides an explanation as to the untimely submission of its Historic Preservation Grant. According to the department, delays in submitting the grant application were caused by the commencement of the federal fiscal year being three months after the State's fiscal year, the publication of a notice to the public, the distribution of a plan, and the receipt of public comment covering these grant moneys. However, we believe that the department can do a better job at expediting grant submissions than the current eight months it takes after the start of the federal fiscal year. This is an ongoing program, even though the specific amounts available may change from year to year and the department could prepare more efficiently for such recurrence.

The department provides an explanation for its practice of crediting federal funds for subsequent year's general fund expenditures. However, the department does not address the appropriateness of this practice that enables the department to exceed its legislatively authorized ceiling.

The department also states that the delay in completing the audit of its financial statements was out of its control, and its independent auditor was required to meet the contract provisions for the timely submission of the audit report. However, it is the department's responsibility to monitor and enforce the contract provisions. The seven-month delay beyond the federal deadline raises other questions about the effectiveness of the department's monitoring and enforcing of the audit contract provisions.

The department does not disagree with our finding on the untimely land lease renewal and compliance with lease agreements that require bonds and an insurance policy from leases. The department provided information on its procedures and details on its new State Land Information Management System that will help track land lease renewals and bonding and insurance requirements. The department now maintains that the land lease renewal rent increase *was* retroactively applied, resulting in no lost moneys to the State. But at the time of our audit, our contract auditor was informed that the new rent would not be retroactive. Moreover, documents reviewed by our contract auditor identify that staff recommended a percentage increase from 6 percent to 8 percent up to $1 million and 9 percent over $1 million in sales. The department did not accept the staff recommendation. The State was without the increased rent until the lessee paid at the new rental rate. The point remains, however, that the new lease rent was not in place in a timely fashion.

The department did not directly address our findings on the lack of internal control procedures at the Division of Boating and Ocean Recreation. The department instead provided information on its improvements or planned improvements to the fiscal operations of the division. It will use the department's year end close-out procedures to generate the aged receivable reports needed. In addition, to ensure that treasury deposit receipts are timely prepared, the department is considering modifying the revenue system to monitor the timeliness of collections and deposits.

The department reports that it has started to reconcile its agency fund accounts. The department disagrees with our statement that late collections for temporary permits jeopardize accountability over cash. Yet the department acknowledges the two errors but tries to minimize the finding by pointing out that the two late permits amounted to only $208. The issue here is the lack of controls that would ensure that collections are received on or prior to the effective date of the permits.

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

April 11, 2000

COPY

The Honorable Timothy E. Johns, Chair
Board of Land and Natural Resources
Department of Land and Natural Resources
Kalanimoku Building
1151 Punchbowl Street
Honolulu, Hawaii 96813

Dear Mr. Johns:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Department of Land and Natural Resources*. We ask that you telephone us by Thursday, April 13, 2000, 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 Monday, April 17, 2000.

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

BENJAMIN J. CAYETANO
GOVERNOR OF HAWAII

TIMOTHY E. JOHNS
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES

DEPUTY DIRECTOR
JANET E. KAWELO

REF:FIS-SA

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES

P.O. BOX 621
HONOLULU, HAWAII 96809

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
CONSERVATION AND RESOURCES ENFORCEMENT
CONVEYANCES
FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
LAND
STATE PARKS
WATER AND LAND DEVELOPMENT
WATER RESOURCE MANAGEMENT

April 18, 2000

RECEIVED
APR 18 4 04 PM '00
OFC. OF THE AUDITOR
STATE OF HAWAII

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

Dear Ms. Higa:

Thank you for forwarding to us draft copies of the Financial Audit of the Department of Land and Natural Resources. We are pleased that PricewaterhouseCoopers LLP, your contract auditor, stated that in their opinion, "the combined financial statements fairly presented, in all material respects, the financial position of the DLNR, as of June 30, 1999 and the results of its operation for the year then ended," excluding fixed assets that were not part of the audit scope.

However, we feel your report was remiss in providing none of the positive results about the Bureau of Conveyances, that was also an area of focus of the financial audit. The Bureau was not even mentioned in the report. We believe positive results should be acknowledged as well, in any audit.

Regarding your findings, we do not agree that the State's assets were placed at risk or that accountability over cash or other fiduciary obligations were materially jeopardized by the matters discussed in your report. Nonetheless, we thank you for the opportunity to provide additional information regarding these matters. Our comments are presented in the same order as they appear in your report.

Finding 1. *The department's financial operations failed to ensure the timely submission for approval of a federal grant for the Historic Preservation Fund Program. The department also credited subsequent year's general fund expenditures with federal grant funds, which enables the department to expend beyond its legislatively authorized ceiling. In addition, the department failed to meet federal requirements for submitting audited financial statements, which could jeopardize current or future federal funds. The department also lacks sufficient controls to track land lease renewals and bond insurance requirements. Failure to implement these controls places the State's assets at risk.*

Untimely grant submission jeopardizes state resources. (Page 8)

The timing of the application for the National Park Service Grant, which is beyond the Department's control, will continue to pose a problem. The federal fiscal year begins on October 1, three months after the commencement of the state fiscal year. The Department of Interior's Historic Preservation Grants are awarded according to a National Park Service formula based upon the amount of money Congress appropriates for state programs. The amount of funds available to the states is not made known until sometime in December. After this amount is known, National Park Service regulations require the state to notify the public as to how it intends to expend the moneys. The publication of such a notice, coupled with a reasonable time to distribute the plan and receive public comment, results in late January or early February being the earliest that a state grant application can be submitted for the federal grant moneys. Even in the best of circumstances, we will always be seven or eight months into the state fiscal year before we can even apply for these funds. Further, these funds must be expended in the same federal fiscal year in which they are received. The Department will use its best efforts to submit an application by February of each year.

The department incorrectly credited federal grant funds received for subsequent year's general fund expenditures. (Page 8)

Twelve of our 19 programs receive federal grant funds as an approved means of financing. The majority of these grants are annual, recurring grants, which are on a reimbursable, matching basis. We spend our money first and submit a monthly claim for the federal share. All claims to the federal agency must be based on actual expenditures and be properly documented. For June 30 expenses, it is not possible to prepare, submit, receive and deposit federal claims within the 15 to 20 days available before the State closes its books. If these funds which are received in the subsequent fiscal year are not available to us, we essentially would be asked to manage a full program year with less than a full year of federal funds.

At the request of your contract auditor, we and representatives of the Department of Budget and Finance met to explain our long-standing practice of depositing federal funds based on prior year expenses into the current year operating accounts. The contract auditor was given the opportunity to ask any questions concerning this issue. We believe the auditor's concerns were satisfactorily addressed, and are therefore surprised that this has been reported as a finding.

The department did not meet the federal requirement for timely audited financial statements. (Page 9)

In the 16 years since inception of the Single Audit Act, the Department missed only the 1998 audit deadline. The delay was not caused by the Department. We contract for audit services from independent accounting firms, and the contract provisions include the timely submittal of draft and final reports by our auditor. All audits since 1998, as well as before, have been submitted on time. Further, no negative responses were received from any of our federal grantor agencies concerning the report delay.

The department has not routinely tracked State land lease renewals and insurance and bond requirements. (Page 10)

With regard to the specific findings and recommendations, we do not dispute those occurrences, but suggest that the one deficiency in each of these areas be put into perspective of the 2,700 accounts that the Land Division has to monitor. We are also pleased that this audit notes the substantial improvements made in the Land Division since the last audit. Our implementation plan for the new State Land Information Management System (SLIMS) incorporates both recommendations you have presented. However, some incorrect statements were included in the draft, which we will address. Before addressing those findings, we are pleased that the number of findings for the Land Division has greatly decreased from prior audits. At the same time, we understand the urgency and importance of successful implementation of SLIMS to ensure that we perform a timely follow-up on all lease compliance issues which include renewals, insurance and bonding.

Because of the enormous amount of data we must manage, it is impossible to track these data efficiently or effectively without the aid of database technology. Upon execution of new leases, rental reopening dates (in addition to other critical lease data) will be entered into SLIMS. Standard reports showing the upcoming reopening, two years in advance, will regularly be printed for the appraisers' use to ensure they initiate the reopening in a timely manner. Furthermore, each step of the appraisal process will be tracked in SLIMS to ensure nothing "falls through the cracks" and each step is followed up on. Management oversight to ensure these tasks are being completed will be made possible by SLIMS.

The conversion of rental reopening information will be done manually, taking the reopening information directly from each lease file and then inputting it into SLIMS. We will use this opportunity to verify that the rental reopening on each and every lease has been conducted, once and for all cleaning the data ***before*** putting such data into the new system. We project that this verification will be completed by November 2000. We would like to note that the correct starting date for SLIMS is November 2000 and not November 2001 as stated in the draft.

The audit draft states, "According to departmental personnel, the new rent will be higher than the old rent but will not be applied retroactively. The department's failure to implement new lease rents in a timely manner will likely result in thousands of dollars lost to the State." These statements are incorrect. There is no statutory authority to waive retroactive rent for late reopenings, and the new rent ***has been*** applied retroactively. In this specific case, the lease rent is the higher of a base rent amount or a certain percentage of gross proceeds. Prior to the reopening, the base rent was $10,800/year or 6% of gross revenues. Based on standard appraisal methodology, the base rent increased to $36,192/year, but the percentage rent stayed the same at 6%. In applying this new rent retroactively, the Fiscal Office verified that, for the time period for which the reopening applied, the lessee had ***already*** paid at the 6% percent rate since these amounts had exceeded both base amounts of $10,800 and $36,192. Therefore, the State has already been ***paid in full*** and has lost no money whatsoever on this reopening.

Finding 2. *The Division of Boating and Ocean Recreation lacks internal control procedures, seriously jeopardizing its accountability over cash.*

Our comments on each of the findings follow.

New computer system cannot generate key control reports. (Page 12)

The Boating Division has adopted procedures that will allow it to generate aged receivable reports for the month and year end. The Division began using a new revenue system in fiscal year 1999 and believed that it could generate a 6/30/99 aged receivable report after 6/30/99. When the Boating Division attempted to generate a 6/30/99 aged receivable report on July 14, 1999 for June 30, 1999, it discovered that it could not. In seeking a solution to the problem, it discovered that the monthly and year end accounts receivable close-out procedures used by our departmental Fiscal Office could be applied to our division's independent system.

Timely treasury deposit receipts are not prepared. (Page 13)

Harbors collect money from their customers and deposit these funds into a statewide commercial bank account. They receive validated deposit slips from the bank to document the date and amount of these deposits. Validated deposit slips are then forwarded to the division's Fiscal Office in Honolulu for preparation of treasury deposit receipts (TDRs). TDRs are required to transfer collections in the statewide bank account into the Boating Special Fund. These steps typically take from two to ten calendar days.

Harbors in urban areas such as Ala Wai, Keehi, and Honokohau make deposits and submit validated deposit slips every day they are open for business. Other facilities in rural areas such as Haleiwa, Waianae, and Port Allen send validated deposit slips as funds are collected and deposited. Boating also has remote facilities such as Kaunakakai and Manele that have limited activity and staffing and in the case of Manele, no power or phone connections.

Neighbor island and rural Oahu harbors must mail or hand deliver their validated deposits to their district office or directly to the Honolulu Fiscal Office. This further increases the time period between the date of the deposit and the preparation of the TDR.

DBOR Fiscal Office has reminded district personnel of the importance of timely submission of deposit slips. The Fiscal Office will monitor the submission of validated deposit slips from its facilities. We will also investigate with Budget and Finance the possibility of processing TDRs using faxed or other electronically transmitted copies of the validated deposit slips for neighbor island offices or remote rural areas. In addition, we will assess the possibility of modifying our revenue system to provide exception reports identifying collection transactions that are not completed within their predetermined time periods.

Failure to reconcile accounts jeopardizes the Department's fiduciary duty to customers. (Page 14)

The problem of reconciling the account balance from security deposits for mooring permits has been corrected. The Boating Division most recently performed this reconciliation as of February 29, 2000 and will reconcile the accounts on a quarterly basis.

Late collections for temporary permits issued jeopardize accountability over cash. (Page 14)

Harbor agents have the responsibility of overseeing the activities in their harbors and they are also responsible for activities that occur in all navigable waterways and ocean areas in their jurisdiction. As a result, especially with facilities with minimal staffing, harbor agents may not always be present to process temporary mooring permits and payments as proscribed. Additionally, the boater may not always be present when the harbor agent returns. Harbor agents are trained to conduct inventories of their facilities to ensure that all vessels temporarily moored have the appropriate permits.

While the Boating Division realizes the importance of collecting payments prior to issuing temporary mooring payments for less than 30 days, we disagree with your finding that "late collections for temporary permits issued jeopardize accountability over cash." The two late mooring permits cited by your contract auditor totaled only $208, compared to total temporary mooring collections of $280,167 for the fiscal year.

As stated at the outset, we appreciate this opportunity to comment. While we are generally pleased with the relatively few number (2) of main findings, we recognize that there is always room for improvement in our performance and look forward to future audits as a valuable management tool.

Very truly yours,

TIMOTHY E. JOHNS
Chairperson