
Financial Audit of the Judiciary

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

Report No. 00-12
April 2000

THE AUDITOR
STATE OF HAWAII

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Conducted by

The Auditor
State of Hawaii
and
Grant Thornton LLP

Submitted by

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STATE OF HAWAII

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Foreword

This is a report of the financial audit of the Judiciary 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 Grant Thornton LLP.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Judiciary.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the Judiciary for the fiscal year ended June 30, 1999. The audit was conducted by the Office of the Auditor (Auditor) and the independent certified public accounting firm of Grant Thornton LLP. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

Background

The Judiciary of the State of Hawaii is an independent branch of government whose mission is to administer justice in an impartial, efficient, and accessible manner in accordance with the law.

Appropriations for the Hawaii State Judiciary are made by the Legislature on a statewide basis, with each fiscal year beginning July 1 and ending June 30. Both the operating and capital improvements budgets of the Judiciary are legislatively determined every biennium with operating moneys allocated from the state general and special funds and capital improvement moneys from the State Capital Projects Fund.

State general and capital project funds represent over 95 percent of the funding source for all Judiciary expenditures. The Legislature appropriated approximately \$93,800,000 from the state general fund for operations during the fiscal year ended June 30, 1999, and \$1,980,000 was appropriated to the Judiciary from the State Capital Projects Fund. Other operating moneys come from federal funds, trust funds, and special revenue funds such as the Driver Education and Training Fund.

Organization

The Judiciary has court operations as well as support service functions. The Chief Justice is the overall administrative head of the Judiciary with direct responsibility and authority for the operations of the courts. The Administrative Director of the Courts has authority and responsibility for support services to the courts.

All courts are part of the state government. There are four integrated levels of appellate and trial courts: the Supreme Court, the Intermediate Court of Appeals, Circuit Courts, and District Courts. The Judiciary also includes two specialized courts, the Land and Tax Appeal Court and Family Courts.

Each county is served by a separate judicial circuit: Honolulu (First Circuit), Maui (Second Circuit), Hawaii (Third Circuit), and Kauai (Fifth Circuit). There is no fourth circuit. Each circuit is served by at least one circuit court, a system of district courts, and a family court. The Land and Tax Appeal Court is a statewide court of record based in Honolulu.

The following is a description of the operations of the Judiciary.

Courts of Appeal. The Judiciary's appellate level is comprised of the Supreme Court and the Intermediate Court of Appeals. Courts of Appeal hear appeals from all trial courts and specific state boards and agencies.

The Supreme Court of Hawaii is the State's highest court. Its decisions are binding on all other Hawaii courts. The primary mission of the Supreme Court is to review the decisions of the lower courts in which appeals have been allowed. Cases reviewed on appeal have been initiated in either trial court or in an agency.

The second highest court in the state, the Intermediate Court of Appeals shares concurrent jurisdiction with the Supreme Court in reviewing legal matters brought before the Court of Appeals. This court generally handles cases involving trial court error or the application of settled law rather than the formulation and development of law.

Circuit Court. Circuit courts are trial courts of general jurisdiction. They have exclusive jurisdiction in all criminal felony cases, in probate and guardianship proceedings, and in civil cases where the contested amount exceeds \$20,000. Circuit courts share concurrent jurisdiction with District Courts in civil non-jury cases that specify amounts between \$10,000 - \$20,000.

Family Courts. Family courts were created in 1965 as divisions of circuit courts to deal with children and families. The Family Court hears all legal matters regarding children, such as delinquency, waivers, status of offenses, abuse and neglect, termination of parental rights, adoption, guardianships, and detention.

District Courts. District Courts have exclusive jurisdiction over traffic infractions, summary of possession or ejectment proceedings (landlord-tenant) regardless of the amount of the claim, and non-jury trial civil cases where the relief sought is under \$10,000. District Courts also have jurisdiction over civil cases where the debt, amount, damages, or value of the property claimed does not exceed \$20,000, or where the remedy sought is specific performance valued under \$20,000.

Land Court. The Land Court has jurisdiction over applications for the registration of title to land and easement or rights in land held and possessed in fee simple within the state.

Tax Appeal Court. The Tax Appeal Court has jurisdiction over disputes concerning property, excise, liquor, income and insurance taxes.

Objectives of the Audit

1. To assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the Judiciary; to recommend improvements to such systems, procedures, and reports; and to report on the financial statements of the Judiciary.
 2. To 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.
 3. To make recommendations as appropriate.
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Scope and Methodology

The contract with Grant Thornton LLP required an audit of the financial records and transactions, and review of the related system of accounting and internal controls of the Judiciary for the fiscal year July 1, 1998 through June 30, 1999. The contract provided for the review of the Judiciary's transactions, systems, and procedures for compliance with applicable laws and regulations.

To the extent possible, we examined the Judiciary's existing accounting, reporting, and internal control structure. We identified deficiencies and weaknesses in the internal control structure and made recommendations for improvements.

The independent auditors' report on the combined financial statements presented in Chapter 3 is that of Grant Thornton LLP. The work was conducted from July 1999 through December 1999 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Practices

Internal controls are measures established by an organization to meet its goals and achieve its mission. Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to promote efficiency, reduce the risk of asset loss, and help to ensure the reliability of financial information and compliance with laws and regulations. Internal control consists of five interrelated components: the control environment, risk assessment, control activities, information and communication, and monitoring.

Reportable conditions are significant deficiencies in the design or operation of the internal controls, that in our judgment, could adversely affect the Judiciary's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Several reportable conditions were found in our review of the Judiciary's system and procedures for internal controls. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the Judiciary.

Summary of Findings

We found the following reportable conditions:

1. Internal controls over cash and the collection of cash need improvement. Weaknesses in the Judiciary's safeguarding of cash existed because of the Judiciary's inadequate segregation of duties, untimely depositing of cash, and unauthorized access to documents and data files.
2. The Judiciary did not implement adequate controls and procedures to ensure the accountability over and accurate reporting of all restitutions due. It did not appropriately monitor and evaluate these restitutions due for collectibility, undermining the intent of the restitution orders.
3. The Judiciary's computer systems used for accountability and tracking of fines remain inadequate and severely limit the court's ability to effectively monitor and enforce unpaid balances.
4. The Judiciary's decentralized operations result in inefficiencies among the court systems.

5. The Judiciary did not adhere to the State Procurement Code and failed to ensure that a contract extension was executed before services were started. Also, several courts failed to escheat unclaimed property. In addition, government realizations were not transferred in a timely manner as required by the Judiciary's Financial Administration Manual.
6. The Judiciary's financial reporting system is deficient and resulted in several departures from generally accepted accounting principles. This results in a qualified opinion to the Judiciary's financial statements—a serious deficiency in meeting proper accounting standards. Deficiencies include an unrecorded workers' compensation liability and salaries and wages appropriation, and a failure to properly disclose the outstanding restitution receivables.

Accountability Over Cash and Other Receipts is Weak

During the fiscal year ended June 30, 1999, the Judiciary collected over \$55 million in fines, restitutions, and other trust receipts such as bails. Cash represents the Judiciary's largest and most active asset. Given the substantial amount of cash collected by the Judiciary, it is essential that appropriate control procedures be established to ensure that all cash receipts due are collected, accounted for properly, and safeguarded.

We examined controls in 11 courts that collect over 80 percent of the fines, restitutions, and other trust receipts such as bails received by the Judiciary. We found that the Judiciary failed to separate key cash handling and reporting functions, limit access to bail receipts, and secure access to data files. Failure to implement these key internal controls puts the Judiciary's resources and assets at risk.

Duties and functions are not adequately segregated

Inadequate segregation of duties and functions regarding the collection of cash receipts increases the opportunity for someone to commit fraud or abuse. Good business practices require that cash handling and reporting functions be separated to ensure the safekeeping and accountability of all receipts. However, for the five district courts visited, we found that certain bail receipts were processed by individuals who had custody of these cash receipts, the bail receipts, the transmittal log, and access to the cash register. In addition, permitting cashiers to count, print the daily cash register tapes, and record and balance their own cash registers raise concerns over the reporting and safeguarding of any cash overages.

Section 40-2, Hawaii Revised Statutes (HRS), requires the Judiciary to be responsible for the establishment and maintenance of an adequate system of internal control. Fundamental to good controls is the adequate

segregation of duties and functions. Different employees should be assigned the responsibilities of recording transactions, maintaining custody of or access to assets, and reconciling.

In its Financial Administration Manual, the Judiciary requires that the functions of preparing deposit slips, depositing collections, and recording the amounts in the accounting records be separated and performed by different individuals. However, the manual does not require reconciliation functions to be separated from maintaining custody of or access to assets. Thus, critical duties over the cash handling functions are not adequately separated.

One position (either the cashier or court clerk) is responsible for collecting cash receipts, counting and recording cash in the registers, printing of the cash register tapes and reconciling the cash to the register tapes. This enhances the opportunity for theft. For example, if an employee had collected more cash than reported, the employee could keep the excess cash without affecting the cash register total.

In addition, bail collections are not adequately segregated. Bail is the collateral given by the defendant and the defendant's surety or sureties to ensure that the defendant appears for trial and complies with the court's judgment. Bail collections during normal working hours are presented at the fiscal office of the respective courts. Bail collections after normal working hours (during holidays and weekends) are collected and posted at the police station or the Cellblock Division, Office of the Sheriff.

Each collection of cash bail from the police or sheriff's department is accompanied with a copy of an official receipt (transmittal log) and a bail receipt. These receipts are sent daily to the court clerk. The clerk counts the cash in the presence of the officer and compares the amounts to the transmittal log and the bail receipts. The clerk acknowledges receipt of the collections by signing the transmittal log and providing a copy to the officer. Any discrepancies are investigated and resolved. If no discrepancies are found, either the clerk or cashier enters the amounts in the cash register and the moneys are secured in a safe.

The Judiciary's lack of adequate procedures and controls creates opportunities to discard (or alter) the transmittal log and the bail receipts which makes it difficult to detect the misuse of funds. Only if a defendant submits a request for his or her bail moneys could an impropriety be detected.

A district court needed reimbursement of \$4,036 to cover missing bail moneys. Upon request for reimbursement by the defendant, the court realized that the bail moneys were missing. The court could not locate bail receipts, deposit slips, and the transmittal log. The Judiciary cannot determine whether it had received these bail moneys or whether the amounts were lost, taken, or stolen.

Receipts are not deposited on a timely basis

The Judiciary failed to follow its own requirement to deposit cash on a daily basis. A common control procedure is to deposit cash received in a timely manner. By depositing cash receipts daily, unauthorized access to cash is substantially reduced. We found that the Judiciary did not deposit cash daily as required by its manual.

The Financial Administration Manual requires cash to be deposited daily. According to the manual, cash received prior to an established time of the day shall be deposited on that same day. Cash received after the court's established time shall be deposited on the following business day. Collections are delivered by armored car for depositing with the financial institutions. Given that \$55 million in cash was received in FY1998-99, timeliness and accountability over cash is extremely critical.

We found that collections are held overnight and normally delivered to the bank by armored car service in the afternoon of the next business day. Our review of 96 cash receipts from 3 court systems found 95 instances in which the cash collected was deposited between 2 to 18 business days from the date of receipt. Thus, these courts violated their cash deposit policy. The fiscal and support services director indicated that some of the delays were due to the armored car not meeting the banks' drop-off times, consequently, the armored car held the collections and delivered them to the banks for deposit on the following business day. However, approximately 21 of the 95 instances of cash was deposited more than 2 business days after receipt.

The Judiciary fails to secure bail receipts

Mishandling or misusing moneys often involves an individual having access to either (1) the asset or (2) the related asset record in order to conceal the improper activity. We found that most courts did not secure copies of their bail receipts, affording the possibility of unauthorized refunds.

Bail receipts serve as the primary document supporting bail refunds. The Financial Administration Manual requires that upon a defendant's appearance in court or abidance with the judgment of the court, any cash or property deposited as bail shall be returned to the person who posted bail.

District courts are tasked with following the manual's requirements. Bail refunds are normally processed if accompanied by a disposition slip or by order of the judge, and either a bail receipt or identification of the person who posted bail. The district court's copy of the bail receipt is retrieved by the cashier and compared to the disposition slip. The defendant, acknowledging receipt of refund, signs the back of the court's copy of the bail receipt. The cashier then proceeds to generate the check, obtain the supervisor's or clerk's approval, and enter the refund into the bail information system.

The fiscal and support services director and internal auditor both informed us that the court's copy of the bail receipt was not required to refund the bail. The courts' failure to comply with the directive jeopardizes control over the bail money. For example, individuals accessing bail receipts can forge a defendant's signature and process the entry into the bail information system as refunded. Defendants at the Honolulu and Waianae District Courts requested bail refunds amounting to \$250 and \$100, but the bail moneys were missing.

***Easy access to files
compromises data
integrity***

Unauthorized access to critical data files compromises the integrity of information being processed and increases the opportunity for input tampering, which involves the entry of false or fraudulent data into the computer. Our visits to the first, second, and third circuit courts found that these courts did not have security measures to ensure restricted access to data files containing restitution balances. Cashiers were able to modify critical restitution data including names, addresses, and amounts.

The Judiciary should implement control procedures performed by a computer called electronic controls to enhance the reliability or integrity of data. Electronic data controls provide evidence that data is correctly processed and that the accounting system is not accidentally or deliberately modified or corrupted.

However, the three circuit courts we visited did not implement electronic data controls. These courts use an automated trust accounting system to track fines and restitutions. Fines are usually imposed as a condition of probation for circuit court criminal cases. Restitution is a court-ordered monetary obligation and payment by an offender to the victim to compensate for the injury. The courts usually determine and order the amount of fines or restitutions owed to the State.

Upon receiving a "Notice to Open Account," court cashiers establish the case number, amount of restitution payments to be received, and the victim who should receive these payments. The cashier, through the mail or at the court desk, receives payments and enters the payments into the trust accounting system. Once payments are approved, cashiers will generate a check to the victim.

In three circuit courts, disbursements exceeding a certain dollar limit must be approved by the supervisor or fiscal officer. Although the dollar limit varies from court to court, the trust accounting system automatically places the victim's name as payee on the check. However, the system does not prohibit or limit access to the data master files. Cashiers have the ability to change account information on the on-line data master files including the victim's name and address.

Allowing a cashier to issue checks without authorization (for those checks under a court's dollar threshold) increases the possibility of loss or misused cash. Restitution payments for a deceased victim or an out-of-state victim can be changed and issued to another individual by simply changing the account information. Once the check is issued, the account information can be changed back to the victim. Any unauthorized payments are difficult to detect and undermine the objective of restitution and the Judiciary's responsibility to victims.

Recommendations

1. The Judiciary should appropriately segregate cash receipt duties so that no one individual has custody of cash, access to supporting documents or records, and the function of depositing the cash. In addition, to prevent mishandling of cash overages, a separate cashier should print the final cash register tape and balance the register.
2. The Judiciary should adhere to its policy of depositing cash daily. In addition, the Judiciary should review its current contract with the armored car service and determine whether adequate contract provisions ensure that cash is deposited daily. Appropriate action should be taken against the armored car service for noncompliance with contract provisions.
3. Fiscal officers should comply with the Judiciary's policy of refunding bail moneys. If such policy has been rescinded, access to the court's copy of the bail receipts should be restricted to appropriate personnel.
4. The Judiciary should restrict access to documents or records, including data master files, to appropriate personnel.

The Judiciary Needs to Improve on its Responsibility to Victims

As of June 30, 1999, the Judiciary reported approximately \$30 million in restitution due. Individuals who owe restitution include offenders who are on probation, as well as offenders in the custody of the director of the Department of Public Safety and are not on probation. The Judiciary failed to implement adequate controls and procedures to ensure that all restitution amounts due (receivables) have been properly accounted for, monitored, and evaluated for collectibility.

The Judiciary imposes restitution to compensate victims for their losses and confront the offender with direct personal consequences of the crime. Restitution orders may be imposed as a condition of probation or as a separate order. A court probation officer is assigned to each case to monitor and enforce restitution orders that are issued as a condition of

probation. Family and circuit courts use the statewide automated trust accounting system to account for outstanding restitution receivables. The Judiciary's failure to implement controls over the reporting, monitoring, and enforcement of these restitution undermines the intent of the courts and jeopardizes the Judiciary's responsibility to victims.

Inadequate controls over recording of restitution due

The Judiciary failed to implement adequate controls and procedures over the recording of restitutions resulting in more than \$500,000 of errors in restitution balances.

The fiscal office in the first circuit court is responsible for accounting, reporting, and maintaining records of all restitution owed. Transmittal forms are sent to the fiscal office to initiate a separate account. The transmittal form, detailing case information, is used by the fiscal office to enter the restitution information in the trust accounting system. However, if the fiscal office does not receive a copy of the court order from the Department of Public Safety, the fiscal office is unable to determine whether the Department of Public Safety has properly transmitted all restitution orders.

Without adequate control over the accounting of these court orders, the Judiciary is unable to assure that restitution orders are properly accounted for. In addition, without the court order copy, the fiscal office is unable to ensure the accuracy and completeness of information submitted to the fiscal office.

In our review of recorded restitution balances, we noted an instance where a \$375,000 additional restitution (ordered to be paid) was not included in the list of outstanding restitution receivables. We also noted an account balance with \$176,971 more than the restitution order issued by the court.

Monitoring and enforcement of restitution is weak

The Judiciary is responsible for the monitoring and enforcement of restitution payments. Probation officers are required to monitor and enforce payments on restitution receivables under their jurisdiction. When an offender makes no attempt to pay or refuses to pay, the offender is in violation of the restitution order.

The probation officer is required to document the reasons for non-payment, provide timely notification to the offender that payment has not been received and the consequences of non-payment, and if warranted, initiate revocation proceedings for noncompliance. These procedures are designed to ensure that appropriate monitoring and enforcement efforts are made to collect these amounts.

The deputy administrative director of the courts noted that restitution orders issued as a condition of probation and not a separate order are no longer in effect once the probation expires. Unless the restitution order was an independent order combined with the condition of probation, the order for restitution ends once the required probation terms are met and the Judiciary does not have any legal jurisdiction to enforce collection. However, if the restitution order was issued separately from probation, the Judiciary could impose a civil judgment under Section 706-647, Hawaii Revised Statutes. This section allows the State or the victim to collect restitution as a judgment in a civil action.

We found over 65 percent of the restitution orders reported in the First Circuit Court were issued as a condition of probation and were more than five years outstanding. Thus, the Judiciary's existing policies are not being followed. The Judiciary's failure to appropriately monitor and enforce collection prior to the expiration of the probation period will result in closure of these accounts from the restitution receivable records.

Although the Judiciary is currently revising its policies and procedures to incorporate the impact of Section 706-647, HRS and other changes, it is imperative that probation officers collect outstanding restitution prior to the expiration of the probation period. To allow restitution receivables to remain uncollected after the completion of the probation period increases the risk of noncollection.

Recommendations

1. The Judiciary should develop and implement control procedures over the recording of the restitution. The objectives of the procedures are to ensure that all restitution orders that have been issued by the court have been received and recorded properly. The Judiciary should consider the feasibility of developing a log that identifies restitution orders issued by the courts. From this log, the fiscal office would be able to compare amounts received from the Adult Probation Division or the Department of Public Safety.
2. The Judiciary should ensure that probation officers enforce collection of the restitution prior to the expiration of the probation period. Once the offender is deemed to be in default, appropriate efforts must be expended to address this delinquency. Current policies and procedures provide for the probation officer to initiate the revocation proceedings for noncompliance by the offender.
3. The Judiciary should evaluate the feasibility of replacing the current trust accounting system. If replacement is not deemed to be cost beneficial, the Judiciary should determine whether the current system can be modified to provide adequate information to the probation officers to assist their monitoring of outstanding balances.

4. Fiscal officers should perform an analysis of the current restitution balances due and determine which accounts should be closed and deleted from the receivable records. The analysis should also identify accounts that are under the jurisdiction of the Department of Public Safety and procedures should be developed and implemented to delete closed cases and uncollectible accounts.

Computer Systems Used for Collection and Monitoring of Fines Need Improvement

The collection of court fines, fees and costs is a considerable matter. These moneys vary from document filing fees and traffic fines, to fines imposed on convicted felons as part of their sentence. In addition to being a significant source of revenues for the State, the collection of these moneys reinforces the effectiveness of the courts and the justice system.

The State Auditor's January 1998 *Audit of the Collection of Fines, Forfeitures, and Restitutions in the Judiciary*, Report No. 98-2, found that the Judiciary should strengthen its collection of fines and restitutions. The Judiciary had not established management controls sufficient to ensure the maximum collection of fines and restitutions. The report noted that the Judiciary needed stronger commitment, centralized accountability, and strategies. Collection was inconsistent and fragmented among the courts; there was a lack of uniform policies and procedures for collections; computer systems were inadequate; and monitoring and enforcement was weak.

In a December 1997 letter to the State Auditor, the Judiciary outlined a "four point plan to improve collections." The plan summarized the additional controls and steps to improve collections. However, much of the plan was not implemented because during the FY1997-98 the Judiciary worked with the attorney general to clarify the Judiciary's authority to collect moneys of the State.

During the current year, the Judiciary has worked with the Department of the Attorney General to clarify the Judiciary's authority to collect moneys owed the State. It is a collective opinion of the two agencies that the Judiciary is the administrator and collector of fines/restitution in "the first instance" (collecting court ordered fines and judgments immediately after the imposition of sentence), and the Department of the Attorney General is the entity authorized by statute to pursue accounts when they become delinquent.

The Judiciary has developed procedures in the district court of the First Circuit for transferring certain cases to the attorney general's office and is currently implementing these procedures in other district courts. However, we found that problems with collections have persisted. Specifically, computer systems used for accountability and tracking of

traffic fines remain inadequate and severely limit the court's ability to effectively monitor and enforce unpaid balances, and although the Judiciary has strengthened controls over the collection and enforcement of unpaid fines and fees, we found that traffic and district courts are not adequately monitoring or enforcing unpaid balances. The Judiciary determined that \$6 million in outstanding traffic fines were uncollectible and written-off from the accounting records. The inability of the current information system to generate adequate information on outstanding balances has severely limited the Judiciary's ability to effectively monitor unpaid balances.

Traffic violations account for at least 80 percent of the total outstanding fines and fees. The TRAVIS computer system is used to monitor such fines and fees and produce a default judgment letter for accounts delinquent more than 30 days. A follow up demand letter on the attorney general's letterhead is issued if accounts are delinquent more than 60 days. If payment is not received within 90 days, the case is forwarded to the Department of the Attorney General for collection. With the exception of these letters, there appears to be no other significant efforts to monitor or effectively enforce payments prior to the account being transferred to the attorney general.

Recommendation

The Judiciary should improve its computer systems to provide such reports as needed to effectively monitor unpaid balances.

Decentralized Operations Result in Inefficiencies

The Financial Administration Manual contains policies and procedures governing fiscal transactions. However, the Judiciary's highly decentralized structure hinders implementation and enforcement of uniform policies and procedures among the courts and contributes to inefficient and ineffective operations. Tasks are duplicated, functions are omitted, and internal accounting control procedures are inconsistent.

System wide monitoring and enforcing of fiscal policy is lacking

An entity's organizational structure provides the framework for achieving its objectives and performing activities such as planning, executing, controlling, and monitoring. Presently, each court operates independently of other courts and is responsible for accounting and reporting its own fiscal transactions. Each county is served by a separate judicial circuit: Honolulu (First Circuit), Maui (Second Circuit), Hawaii (Third Circuit), and Kauai (Fifth Circuit). Each circuit comprises at least one circuit court, a system of district courts, and a family court. The Land Court and the Tax Appeal Court are statewide courts of records based in Honolulu.

Chief court administrators manage the administrative functions of their respective circuit and district courts. The administrators of each court are supervised by an administrative judge and staffed by a court fiscal officer. A statewide administrative office, the Judiciary's Office of the Administrative Director of the Courts, provides advisory services to the fiscal offices of each court but does not monitor and enforce fiscal policy. The Judiciary's failure to provide system-wide monitoring and enforcement of fiscal policies and controls creates confusion and problems among the courts.

Practices and procedures are inconsistent

During our visit to selected courts we noted the following inconsistencies. Practices and procedures for the transfer of government realizations (fines, fees, and other revenue) vary among courts. One court transferred moneys to the State Treasury on a daily basis, whereas other courts transferred moneys beyond a week of collection. Moreover, one court prepared treasury deposit receipts (TDR) about once a month, while other courts prepared TDR's on a weekly basis. This inconsistency makes it difficult to monitor the activities of the courts and maintain accountability over collections.

The handling of bail receipts and refunds also lack consistency. The fiscal and support services director and internal auditor verbally instructed fiscal officers to refrain from using a court's bail receipt copy to refund bail. However, fiscal officers in the district courts were not complying with this requirement. In addition, bail refunds are mailed in one court, whereas other courts do not mail bail refunds. Failure to comply with procedures to refund bails undermines the authority of the Judiciary's administration and delays the refunding of bails.

Also, not all courts adhere to the practice of requiring a separate cashier to print the final cash register tape and balance the cash register. In addition, restitution orders were not being issued uniformly. Some judges issue separate restitution orders, whereas others issue a consolidated restitution and conditions of probation order. In addition, procedures for notifying cashiers to open and close a restitution account vary. Procedures to verify cash receipt input and various thresholds for approving checks also varied among the courts.

In July 1999, the chief justice approved several recommendations to improve the Judiciary's structure, procedures and processes. Two recommendations addressed the consolidation of court administrative offices into one office. They also included having one court administrator per circuit and standardizing procedures and practices within and among the courts. However, the recommendations did not require a specific department, office or person to have system-wide responsibility and authority to monitor and enforce compliance with fiscal policies. Without this function, the Judiciary may continue to experience fiscal operational inefficiencies.

Recommendation

The Judiciary should evaluate the feasibility of having the fiscal office of each court under the authority and responsibility of the Administrative Director of the Courts.

The Judiciary Did Not Comply with State Law, Policies and Procedures

Policies and procedures can ensure that management directives are carried out efficiently and support an organization's objectives. We found that the Judiciary failed to comply with state law and administrative procedures when it failed to: 1) comply with Chapter 42D, Hawaii Revised Statutes (HRS), 2) execute a contract before services began, 3) escheat unclaimed property, and 4) transfer government realizations on a timely basis.

Noncompliance with Chapter 42D, HRS

Section 42D-12, HRS, "Interim measure for successive contracts," permitted purchase of service contracts to be extended for a specified period not to exceed 90 days, if specific conditions were satisfied at the time of extension. One of these conditions required the Judiciary to provide a letter offering to extend the contract at least 60 days prior to the end of the contract year. However, we found that a purchase of service contract extension letter out of the 58 contracts reviewed did not comply with the 60-day requirement. Although the contract extension occurred after Chapter 42D, HRS, was repealed, provisions under the State Procurement Code required compliance with Chapter 42D based on a contract's original date of execution.

The request to extend the contract for services up to 90 days beyond the June 30, 1999 expiration date was dated May 18, 1999 (17 days after the deadline). The Judiciary's failure to comply with the procurement requirement jeopardizes the validity of the contract extension.

Contract executed subsequent to commencement of contract period

In our review of six multi-year contracts we found a contract that was originally procured for a period of eight months, from November 1, 1996 through June 30, 1997. Subsequently, the contract was amended to allow for the term to be extended for two additional 12-month periods, through June 30, 1998 and 1999, respectively. Special provisions of the contract allowed for the two 12-month extensions without bidding. We found that the first amendment to the agreement dated October 24, 1996 extended the duration of the contract from July 1, 1997 to June 30, 1998. However, this extension was executed on July 21, 1997, 20 days after the start of the first extension period.

Without an executed contract stipulating the conditions, covenants and terms, the Judiciary is exposed to unnecessary risk for events or occurrences during the period of services that is not covered by a legal

agreement. Good business practice requires that contracts be executed prior to the start of the contracting period to avoid any possible dispute to compensation, covenants, conditions, or terms during the period of performance.

Failure to escheat unclaimed property

Certain courts did not escheat unclaimed property and bail refunds in accordance with State laws and the Judiciary's Financial Administration Manual.

Escheating is a process where unclaimed property is presumed abandoned and custody passes to the State. Section 523A-13, HRS, provides that property held for the owner by the courts and unclaimed for more than one year shall be presumed abandoned. Such property includes deposits, restitutions, overpayments, and outstanding checks from Judiciary bank accounts.

Section 804-2, HRS, further provides that all deposited bail or bond moneys that have not been declared forfeited and claimed within two years after final disposition shall, after due notice to the payer, be deposited in the State Treasury. Part 6, Section 4.4 of the Judiciary's financial manual, "Unclaimed bails and bonds," requires an attempt to locate the payer by telephone, letter, or single advertisement in a paper of general circulation for the disposition of unclaimed bails. After notice to the payer and if not claimed within two years after final disposition, bails and bonds shall be deposited in the State Treasury. We were informed by various fiscal officers that the delays in processing these unclaimed bail refunds are primarily due to its low priority.

At June 30, 1999, 44 checking accounts with approximately \$15,000 of outstanding checks since December 1993 and approximately \$2,910 (Kaneohe Division of the District Court of the First Circuit) of unclaimed bail refunds were not escheated as required by state law and the Judiciary's policies and procedures.

Government realization not transferred in a timely manner

Government realizations are collections of fines and other revenues of the State. The Judiciary's financial manual requires government realizations to be transferred from the Judiciary's bank accounts to the State Treasury at least weekly and at the end of the month. However, the Judiciary did not transfer government realizations to the State Treasury in accordance with its manual. In reviewing a sample of 70 transfers at certain courts, we noted 54 instances in which moneys were not being transferred on a weekly basis.

Recommendation

We recommend that the Judiciary ensure that contracts and extensions are executed prior to the rendering of services and comply with state law. The Judiciary must also comply with state law and policies regarding escheatment of unclaimed property and transfer of government realizations.

Financial Reporting is Deficient

The financial statements as of and for the fiscal year ended June 30, 1999, were audited by Grant Thornton LLP, who issued a qualified opinion. A qualified opinion modifies the auditor's opinion on the financial statements for deviations from accepted accounting practices or generally accepted accounting principles.

Generally accepted accounting principles (GAAP) are uniform minimum standards of and guidelines to financial accounting and reporting. Adherence to GAAP assures that financial statements of all state and local governmental agencies contain the same type of financial statements and disclosures based on the same measurement and classifications criteria. The purpose of the qualification is to indicate that the auditors are satisfied with the financial statements taken as a whole, except for those items that do not comply with the accounting or reporting standards.

The auditor's opinion on the Judiciary's financial statements as of and for the fiscal year ended June 30, 1999 was qualified because of departures from generally accepted accounting principles. These departures included an unrecorded workers' compensation liability and salaries and wages appropriation, and the failure to disclose the outstanding restitution receivable. The Judiciary also incorrectly recorded operating and other transfers which does not impact the qualified opinion on the financial statements.

All of these deficiencies result in the inaccurate reporting of the Judiciary's financial statements. Failure to follow the standards raises questions about the Judiciary's knowledge and review of accounting and reporting issues. In addition, inaccurate reporting may jeopardize the Judiciary's current and future federal funds.

Failure to record liability for unpaid workers' compensation claims

Statement No. 10 of the Governmental Accounting Standards Board, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues," states that a liability for unpaid claims costs, including estimates of costs relating to incurred but not reported claims, should be accrued when insured events occur. That liability should be based on the estimated ultimate cost of settling the claims, using past

experience adjusted for current trends, and any other factors that would modify past experience. As of June 30, 1999, the Judiciary has excluded from the general long-term obligation account group approximately \$992,000 of certain reserves for workers' compensation claims that, in our opinion, should be recorded to conform to generally accepted accounting principles.

As a result, the financial statements were not presented in conformity with generally accepted accounting principles and the auditor's report was issued with a qualified opinion.

Failure to record appropriation of salaries and benefits distorts operation

The annual budget and appropriations process of most governmental units is based on planning and controlling the financial operations of the governmental funds. The expenditure estimates in the annual budget, as modified by the legislative body, are enacted into law through the passage of an appropriation act(s) or ordinance(s). The appropriations constitute maximum expenditure authorizations during the subsequent fiscal year.

Under Act 355, 1997 SLH as amended by Act 109, 1998 SLH, the Judiciary's staff salaries and wages amounting to \$2,253,262 and \$34,135 in the general and special revenue funds respectively, for the period from June 16, 1999 through June 30, 1999 are funded with moneys appropriated for FY1999-00.

As of June 30, 1999, these amounts were accrued and recorded as a current liability. However, the Judiciary did not record the receivable and related revenue for these salaries and wages to be funded by the FY1999-00 appropriations.

The Judiciary utilizes the modified accrual basis of accounting in measuring its financial position and operating results. Under this basis of accounting, revenues should be recognized in the accounting period in which they become susceptible to accrual—that is, when they become both measurable and available to finance expenditures of the fiscal period. "Available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. This is consistent with Statement 11 of the Governmental Accounting Standards Board, "Measurement Focus and Basis of Accounting – Governmental Fund Operation Statements," which indicates that although transactions and events may not result in current-period inflow or outflow of cash, recognition of their effect on the financial resources in the period they take place is necessary for measuring interperiod equity.

As a result, the financial statements were not presented in conformity with generally accepted accounting principles and the auditor's report was issued with a qualified opinion.

Statement of Financial Accounting Concepts No. 4, "Objectives of Financial Reporting by Nonbusiness Organizations," state that one of the objectives of financial reporting should be to provide useful information to present and future resource providers and other users in assessing how managers of a nonbusiness organization have discharged their stewardship responsibilities and other performance aspects. Users of the financial statements need assurances that managers have exercised their special responsibilities in using resources as specifically designated by resource providers.

Nondisclosure of restitution owed deviates from reporting standards

As of June 30, 1999, the Judiciary reported restitution receivables of approximately \$30 million. Although the Judiciary holds agency assets received solely in a custodial capacity, the Judiciary has administrative responsibilities that go beyond the receipting and remitting of assets to victims. In accordance with policies and procedures, the courts determine the total amount of restitution, set payment schedules, and are responsible for the monitoring and enforcement of restitution payments. To properly assess the Judiciary's stewardship and accountability over the monitoring and enforcement of these outstanding restitution receivables, adequate disclosure should be made.

In accordance with Statement of Auditing Standard No. 32, the presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosures of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes. An independent auditor considers whether a particular matter should be disclosed in light of the circumstances and facts of which he is aware at the time. If management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles, the auditor should express a qualified or an adverse opinion and should provide the information in his report. The Judiciary's omission of the disclosure of restitution receivables resulted in a qualified opinion to the auditor's report.

Operating transfers not properly reported

We found that operating transfers were not properly reported in the financial statements. According to the Judiciary's accounting policies, significant transfers of financial resources between activities included within the same fund should be eliminated and only transfers between funds should be recorded as operating transfers in the financial statements. This policy is consistent with governmental accounting and financial reporting principles. However, for the fiscal year ended June

30, 1999, the Judiciary did not eliminate operating transfers within the same fund and reported \$2,543,878 and \$1,894,127 as operating transfers in the general and capital projects funds, respectively.

Fund transfer recorded improperly

Act 121, Session Laws of Hawaii 1998, which amended Act 305 (1996), provides for the Judiciary to administer the indigent legal assistance fund effective June 22, 1998. As a result of Act 121, the Judiciary received from the Office of Community Services, approximately \$614,000 of funds representing past net surcharges for indigent legal services. The Judiciary recorded the amounts as other revenues for FY1998-99.

In accordance with National Council on Governmental Accounting Statement 1, Governmental Accounting and Financial Reporting Principles, residual equity transfers such as the \$614,000 should be reported as an addition to or deduction from the beginning fund balance of governmental funds and not as fund revenues. Again, the Judiciary failed to follow proper accounting standards.

Recommendation

The Judiciary should comply with proper accounting and reporting standards to ensure consistency and accuracy in reporting its operational results to users of its financial statements.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Judiciary as of and for the fiscal year ended June 30, 1999. This chapter includes the independent auditors' report and the report on compliance and internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards* as they relate to the Judiciary. It also displays the Judiciary's financial statements together with explanatory notes and supplementary information.

Summary of Findings

In the opinion of Grant Thornton LLP, based on their audit, the combined financial statements present fairly, in all material respects, except for the effects of not recording revenues and receivables, the effects of not recording liabilities for unpaid workers' compensation claims, and except for the omission of the disclosure of restitution receivables, the financial position of the Judiciary as of June 30, 1999 and the results of its operations for the year then ended in conformity with generally accepted accounting principles. Grant Thornton LLP noted certain matters involving the Judiciary's internal control over financial reporting and its operations that they considered to be reportable conditions. Grant Thornton LLP also noted that the results of their tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Independent Auditors' Report

To the Auditor
State of Hawaii

We have audited the accompanying combined financial statements of the Judiciary, State of Hawaii (the Judiciary), as of and for the year ended June 30, 1999, as listed in the accompanying table of contents. These combined financial statements are the responsibility of the management of the Judiciary. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 financial

statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note A, the combined financial statements of the Judiciary are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State of Hawaii that is attributable to the transactions of the Judiciary.

As described in note B to the financial statements, portions of the 1999 and 1998 salaries and wages were funded with moneys appropriated for fiscal year 2000 and 1999, respectively. The Judiciary has not recorded the revenues and receivables related to these salaries and wages liabilities of \$2,253,262 as of June 30, 1999 and \$2,409,430 as of June 30, 1998. In our opinion, generally accepted accounting principles require that revenues and related assets are recognized in the period when they both become measurable and available to finance operations or liquidate liabilities existing at year end. If the financial statements were corrected for that departure from generally accepted accounting principles, the general fund unreserved fund balance as of June 30, 1999 would increase by \$2,253,262, due from State General Fund would increase by \$2,253,262, and fiscal year June 30, 1999 revenues would decrease by \$156,168.

The Judiciary has excluded from the general long-term obligation account group certain reserves for workers' compensation claims that, in our opinion, should be recorded to conform with generally accepted accounting principles. If these liabilities for unpaid workers' compensation claims were recorded, other long-term liabilities and amounts to be provided for the retirement of general long-term obligation as of June 30, 1999 would increase by \$992,030.

The Judiciary's financial statements do not disclose information pertinent to approximately \$30 million of restitution receivables as of June 30, 1999. Also, no analysis was performed by the Judiciary to determine the collectibility of these restitution receivables. In our opinion, disclosure of this information is required to conform with generally accepted accounting principles.

In our opinion, except for the effects of not recording revenues and receivables as discussed in the fourth paragraph, the effects of not recording liabilities for unpaid workers' compensation claims as discussed in the fifth paragraph, and except for the omission of the

information discussed in the preceding paragraph, the combined financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Judiciary as of June 30, 1999 and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 3, 1999 on our consideration of the Judiciary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Honolulu, Hawaii
November 3, 1999

Notes to Combined Financial Statements

Note A – Summary of significant accounting policies

The Judiciary, State of Hawaii (Judiciary), is a statewide system of courts consisting of four integrated court levels of appellate and trial courts as follows: the Supreme Court, the highest court in the State with appellate jurisdiction; the Intermediate Court of Appeals, the second highest court in the State with concurrent and limited appellate jurisdiction; the Circuit Courts, trial courts of general jurisdiction; and the District Courts, trial courts of limited jurisdiction (nonjury). In addition, there are three specialized courts of limited jurisdiction: the Land Court, the Tax Appeal Court, and the Family Courts.

Each of Hawaii's four counties constitutes a separate judicial circuit with each circuit served by a Circuit Court, at least one District Court, and a Family Court. The Land Court and Tax Appeal Court are statewide courts of record based in Honolulu.

The financial statements of the Judiciary have been prepared in conformity with generally accepted accounting principles as applied to government units. The following is a summary of the Judiciary's more significant accounting policies:

Funds and account groups

The accounts of the Judiciary are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The financial position and operations of each fund are accounted for in

separate self-balancing accounts which represent the fund's assets, liabilities, fund equity, revenues, and expenditures. Account groups are used to establish accounting control and accountability for the Judiciary's general fixed assets and general long-term obligations. Account groups are not funds as they do not reflect available financial resources and related liabilities.

Governmental fund types

General fund – The general fund is the general operating fund of the Judiciary. It is used to account for all financial activities except those required to be accounted for in another fund. The general fund of the Judiciary is a part of the State's General Fund and the accompanying general fund financial statements are limited to and reflect only the appropriations, expenditures, and obligations of the general fund accounts used by the Judiciary, and the general fund allotments received by the Judiciary.

Special revenue funds – Special revenue funds are used to account for resources legally restricted to expenditures for specific current operating purposes. Federal awards received by the Judiciary to fund various programs are accounted for as special revenue funds.

Capital projects funds – Capital projects 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 – Trust and agency funds are used to account for assets held by the Judiciary in a trustee or agency capacity. These include expendable trust funds which account for cash collected and expended by the Judiciary for designated purposes and agency funds which account for the receipts and disbursements of various amounts collected by the Judiciary on behalf of others as their agent.

Account groups

General fixed assets account group – Fixed assets acquired for use by the Judiciary 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 date of donation. Structures and land within the Honolulu, Maui, Hawaii, and Kauai Civic areas and certain other properties utilized by the Judiciary are reported by the Department of Accounting and General Services, State of Hawaii, and are not reflected in the Judiciary's general fixed assets account group. No depreciation is recorded on general fixed assets.

General long-term obligation account group – The general long-term obligation account group of the Judiciary is used to account for long-term obligations of the Judiciary and includes accrued vacation benefits and other long-term liabilities.

Basis of accounting

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

The Judiciary uses the modified accrual basis of accounting for the general, special revenue, capital projects, and expendable trust and agency funds. Under the modified accrual basis of accounting, revenues and related current assets are recognized in the accounting period when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year end. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after year end to liquidate liabilities existing at the end of the fiscal year.

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 obligation account group.

Use of estimates

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

Appropriations

Appropriations are authorizations 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. The appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for appropriations related to capital projects.

Encumbrances

Encumbrances are recorded obligations in the form of purchase orders or contracts. The Judiciary records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at year end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

Accumulated vacation and sick leave

Expenditures are recorded for vacation and sick leave when actually taken or paid. Employees of the Judiciary are entitled to receive cash payments for accumulated vacation leave upon termination of employment. Employees' accumulated vacation is expected to be liquidated with future expendable resources and therefore is accrued in the general long-term obligation account groups. Sick leave is not convertible to pay upon termination of employment and is recorded as an expenditure when taken.

Risk management

Under the provisions of Statement No. 10 of the Government Accounting Standards Board, liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees), are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

Intrafund and interfund transactions

Significant transfers of financial resources between activities included within the same fund are eliminated. 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 other federal reimbursement type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

Total columns on financial statements

The total columns are captioned “memorandum only” to indicate that they are presented only to facilitate financial analysis. Information in these columns do not present financial position, results of operations, or changes in fund balance of the Judiciary 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.

Note B – 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 are those estimates as compiled by the Judiciary. 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 authorizations contained in 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, Expenditures – Budget and Actual – General and Special Revenue Funds. For purposes of budgeting, the Judiciary’s budgetary fund structure and accounting principles differ from those utilized to present the combined financial statements in conformity with generally accepted accounting principles (GAAP). Under Act 355 of the 1997 Regular Session as amended by Act 109 of the 1998 Regular Session, staff salaries and wages amounting to \$2,253,262 and \$34,135 in the general and special revenue funds, respectively, for the period from June 16, 1999 through June 30, 1999 are to be funded with moneys appropriated for fiscal 2000 and, accordingly, are excluded from the Combined Statement of Revenues and Expenditures – Budget and Actual – General and Special Revenue Fund Types for the year ended June 30, 1999 for budgetary purposes.

For accounting purposes, these salaries and wages are reflected in the Combined Balance Sheet – All Fund Types and Account Groups at June 30, 1999 and Combined Statement of Revenues, Expenditures, and

Changes in Fund Balances – All Governmental Fund Types and Expendable Trust Funds for the year ended June 30, 1999, in accordance with generally accepted accounting principles. Under Act 355 of the 1997 Regular Session, staff salaries and wages amounting to \$2,409,430 and \$40,037 in the general and special revenue funds, respectively, for the period from June 16, 1998 through June 30, 1998, were funded with moneys appropriated for fiscal year 1999 and, accordingly, are included in the Combined Statement of Revenues and Expenditures – Budget and Actual – General and Special Revenue Fund Types for the year ended June 30, 1999 for budgetary purposes. For accounting purposes, these salaries and wages were excluded from the Combined Balance Sheet – All Fund Types and Account Groups at June 30, 1998 and Combined Statement of Revenues, Expenditures, and Changes in Fund Balances – All Governmental Fund Types and Expendable Trust Funds for the year ended June 30, 1998, in accordance with generally accepted accounting principles.

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

	Fiscal year ended June 30, 1999	
	General	Special revenue
Excess of revenues and other sources over expenditures and other uses – actual on budgetary basis	\$ 126,523	\$1,598,834
Current fiscal year appropriations included in reserved for encumbrances at June 30, 1999	2,866,559	617,303
Expenditures for liquidation of prior fiscal year encumbrances	(2,133,082)	(47,042)
Fiscal 1998 salaries and wages funded by 1999 appropriation	2,409,430	40,037
Fiscal 1999 salaries and wages funded by 2000 appropriation	(2,253,262)	(34,135)
Excess of revenues and other sources over expenditures and other uses – GAAP basis	<u>\$ 1,016,168</u>	<u>\$2,174,997</u>

Note C – Unallotted appropriations

State appropriations of the capital projects fund consist of allotments made during fiscal 1999, which amounted to \$1,976,127.

Unallotted appropriations for capital improvement projects at June 30, 1999, aggregated \$17,044,395, which were authorized by Act 255 of the 1997 Regular Session and Act 126 of the 1998 Regular Session.

Note D – Cash and short-term cash investments

The Judiciary's Trust and Agency Funds maintain cash and short-term cash investments outside of the State Treasury. The cash and short-term cash investments are generally under the custody of the respective Courts and are held in Hawaii-based financial institutions. Guidelines for authorized investments are mandated by Court Orders or provided by the Judiciary's administrative policy. At June 30, 1999, authorized investments consisted of federally-insured checking and savings accounts and time certificates of deposits.

At June 30, 1999, the carrying amount of the Judiciary's cash deposits outside of the State Treasury aggregated \$31,732,660 and the bank balance aggregated approximately \$32,074,466. Of the bank balance, approximately \$1,417,000 was covered by federal depository insurance and approximately \$20,535,000 was covered by collateral held in the pledging bank's trust departments in the Judiciary's name. Approximately \$10,123,000 of the Judiciary's cash deposits outside of the State Treasury were uninsured and uncollateralized as instructed by a court order.

Cash available in State Treasury aggregated \$23,911,208 at June 30, 1999, and was held by the State Treasury, which requires that the depository banks pledge collateral (primarily investment securities) based on the daily available bank balances.

Note E – General fixed assets

The changes in the general fixed assets were as follows:

	Land	Buildings and improvements	Equipment	Construction in progress	Total
Balance at July 1, 1998	\$695,623	\$ 658,380	\$37,752,164	\$1,007,069	\$40,113,236
Additions	–	–	3,283,140	273,423	3,556,563
Deductions	–	–	(1,527,551)	–	(1,527,551)
Balance at June 30, 1999	\$695,623	\$ 658,380	\$39,507,753	\$1,280,492	\$42,142,248

Note F – General long-term obligation

The following is a summary of the general long-term obligation transactions for the year ended June 30, 1999.

	Accrued vacation payable	Obligations under capital leases	Total
Balance at July 1, 1998	\$11,473,021	\$1,404,781	\$12,877,802
Net increase in accrued Vacation payable	671,340	–	671,340
Additions and payments, net	–	(676,743)	(676,743)
Balance at June 30, 1999	<u>\$12,144,361</u>	<u>\$ 728,038</u>	<u>\$12,872,399</u>

The Judiciary leases various office equipment under noncancelable leases expiring at various dates through the year 2004. These leases meet the criteria for capitalization established by Financial Accounting Standards Board Statement No. 13, as amended. The leases are financed from general government resources. The estimated value of the leased equipment at the inception of the capital leases, aggregating approximately \$3,719,000, is included in the general fixed assets account group. The future minimum payments under capital leases as of June 30, 1999 are as follows:

	<u>Amount</u>
Year ending June 30,	
2000	\$652,900
2001	67,500
2002	25,070
2003	16,934
2004	<u>3,742</u>
Total minimum lease payments	766,146
Less amounts representing interest at 3.43% to 17.50%	<u>38,108</u>
Obligation under capital leases (including current portion of \$624,433)	<u>\$728,038</u>

Debt service expenditures for the year ended June 30, 1999 approximated \$744,000 and \$73,000 for principal and interest, respectively.

Note G – Changes in assets and liabilities of the agency fund

The agency fund is custodial in nature (assets equal liabilities) and does not involve measurement of results of operations. The changes in assets and liabilities of the agency fund for the year ended June 30, 1999 were as follows:

ASSETS	Balance July 1, 1998	Additions	Deductions	Balance June 30, 1999
Cash, accrued interest Receivable and other assets held in trust	\$34,076,387	\$57,689,031	\$57,589,433	\$34,175,985
LIABILITIES				
Due to individuals and others	\$34,076,387	\$57,689,031	\$57,589,433	\$34,175,985

Note H – Retirement benefits

Substantially all employees of the Judiciary 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 contributory 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 the Judiciary 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 nonvested 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. The Judiciary'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 the Judiciary's combined financial statements. The entire ERS's 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 supplementary information. That report may be obtained from the ERS.

During the plan year ended June 30, 1997, the ERS adopted Government Accounting Standards Board Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans." The provisions of this statement revises the financial reporting standards of defined benefit pension plans and provides for investments held by such plans to be accounted for at fair value rather than at cost. In addition, effective July 1, 1997, the State adopted Government Accounting Standards Board Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers." The provisions of this statement revises the standards for the measurement, recognition and financial statement presentation of pension expenditures, assets and liabilities.

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all Judiciary employees who retire from the State on or after attaining age 62 with at least 10 years of service or age 55 with at least 30 years of service under the noncontributory option and age 55 with at least 5 years of service under the contributory option. There are currently approximately 20,200 state retirants receiving such benefits. 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.

Effective July 1, 1996, certain changes were made to the post-retirement medical benefits offered to Judiciary employees hired after June 30, 1996. The State will pay 50% of the monthly medical insurance premiums for those retirants with at least 10 years of service but less than 15 years, 75% with at least 15 years of service but less than 25 years, and 100% with 25 or more years of service.

Note I – Operating leases

The Judiciary leases office facilities and equipment under noncancelable operating leases expiring at various dates through the year 2004. These leases, most of which provide for annual renewals after the initial lease term, are reported in the general fund. The following is a schedule of future minimum payments under these leases at June 30, 1999:

	<u>Amount</u>
Year ending June 30,	
2000	\$1,879,296
2001	1,225,584
2002	929,844
2003	267,985
2004	<u>95,431</u>
	<u>\$4,398,140</u>

Rent expenditures, including rents under short-term arrangements, for the year ended June 30, 1999 approximated \$2,733,000.

Note J – Commitments and contingencies

1. Accumulated Sick Leave

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a Judiciary employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 1999 approximated \$36,920,000.

2. Litigation

The Judiciary is involved in several lawsuits and complaints arising in the normal course of operations. Based on discussions 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 the Judiciary.

3. Insurance

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. All benefits paid for workers' compensation are reflected in the respective department or agency's financial statements. Benefits paid by the Judiciary for the year ended June 30, 1999 approximated \$379,000. Expenditures for other insurance claims are made by the Department of Accounting and General Services, State of Hawaii, and are not reflected in the Judiciary's combined financial statements.

4. Deferred Compensation Plan

In 1983, 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. Prior to July 1, 1997, participants' rights under the plan were equal to those of the general creditors of the State in an amount equal to the fair market value of the

deferred account for each participant. Effective July 1, 1997, the 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.

5. Other

At June 30, 1999, substantially all of the reserve for encumbrances in the capital projects fund relates to construction contracts.

**Report of
Independent
Certified Public
Accountants on
Required
Supplementary
Information**

To the Auditor
State of Hawaii

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole of The Judiciary, State of Hawaii (Judiciary), as of and for the year ended June 30, 1999, which are presented in the preceding section of this report. The year 2000 supplementary information is not a required part of the combined financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the Judiciary is or will become year 2000 compliant, that the Judiciary's year 2000 remediation efforts will be successful, in whole or in part, or that parties with which the Judiciary does business are or will become year 2000 compliant.

Honolulu, Hawaii
November 3, 1999

State of Hawaii
The Judiciary

YEAR 2000 ISSUE
June 30, 1999

The year 2000 issue is the result of shortcomings in many electronic data processing systems and other electronic equipment that may adversely affect the Judiciary's operations.

The Judiciary has prepared an inventory of computer systems and other electronic equipment that may be affected by the year 2000 issue that are necessary to conducting the Judiciary's operations:

The Judiciary utilizes electronic data processing systems maintained by the Department of Accounting and General Services (DAGS) for all financial operations not handled by the Judiciary. These systems include the Financial Accounting and Management Information System (FAMIS), Payroll System, Central Warrant Writing System, Warrant Reconciliation System, and Fixed Asset and Inventory System. DAGS is responsible for remediating these systems.

The Judiciary has identified the following electronic data processing systems which will be responsible for remediating, and the status of the remediation process:

Description	Stage and Status			
	Awareness	Assessment	Remediation	Validation and Testing
Circuit and Family Court Case Management System (HAJIS)	C	C	C	C
Traffic Violations and Case Management System (TRAVIS)	C	C	C	C
District Court Criminal Case Management System	C	C	C	C
Jury Selection System	C	C	C	C
Court Statistic Reporting System	C	C	C	C
Trust Accounting for Fees, Fines and Restitutions	C	C	C	C
District Court Civil Case Management System	C	C	C	C
Supreme Court Case Management System	C	C	C	C
Payroll Reporting System	C	C	C	C
Personnel Reporting System	C	C	C	IP
Surplus Management Reporting System	C	C	C	C
Expenditure Reporting System	C	C	C	C
Revenue Tracking System	C	C	C	C
DILOG Accounting System	C	C	C	C

C – Completed; IP – In progress

The remediation of the Judiciary's electronic data processing systems was performed primarily by personnel of the Judiciary. Management estimates that it spent approximately \$255,000, related primarily to additional payroll costs and equipment purchases, for its remediation efforts.

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot be certain that the Judiciary is or will be year 2000 ready, that the Judiciary's remediation efforts will be successful in whole or in part, or that parties with whom the Judiciary does business with (including DAGS) will be year 2000 ready.

State of Hawaii
The Judiciary
COMBINED BALANCE SHEET - ALL FUND TYPES AND ACCOUNT GROUPS
June 30, 1999

ASSETS	Governmental fund types			Fiduciary fund types	Account groups		Total (Memorandum only)
	General	Special Revenue	Capital projects (note C)	Trust and agency (note G)	General fixed assets (note E)	long-term obligation (note F)	
Cash and short-term cash investments held in trust outside of State Treasury (note D)	\$ -	\$ -	\$ -	\$31,732,660	\$ -	\$ -	\$ 31,732,660
Cash available in State Treasury (note D)	9,154,851	5,753,910	8,842,903	159,544	-	-	23,911,208
Accrued interest receivable	-	-	-	582,059	-	-	582,059
Other assets held in trust	-	-	-	1,861,266	-	-	1,861,266
Land (note E)	-	-	-	-	695,623	-	695,623
Buildings and improvements (note E)	-	-	-	-	658,380	-	658,380
Equipment (note E)	-	-	-	-	39,507,753	-	39,507,753
Construction in progress (note E)	-	-	-	-	1,280,492	-	1,280,492
Amounts to be provided for the retirement of long-term obligation (note F)	-	-	-	-	-	12,872,399	12,872,399
TOTAL ASSETS	\$ 9,154,851	\$5,753,910	\$8,842,903	\$34,335,529	\$42,142,248	\$12,872,399	\$113,101,840
LIABILITIES, FUND EQUITY AND OTHER CREDITS							
LIABILITIES							
Vouchers payable	\$ 1,520,500	\$ 50,502	\$ -	\$ 17,750	\$ -	\$ -	\$ 1,588,752
Accrued wages payable (note B)	6,926,489	130,033	-	-	-	-	7,056,522
Trust accounts payable	-	-	-	33,256,996	-	-	33,256,996
Due to other funds	-	-	-	59,643	-	-	59,643
Due to State General Fund	-	-	-	859,346	-	-	859,346
Accrued vacation payable (note F)	-	-	-	-	-	12,144,361	12,144,361
Other long-term liabilities (note F)	-	-	-	-	-	728,038	728,038
Total liabilities	8,446,989	180,535	-	34,193,735	-	12,872,399	55,693,658
COMMITMENTS AND CONTINGENCIES							
(notes H, I and J)	-	-	-	-	-	-	-
FUND EQUITY AND OTHER CREDITS							
Investment in general fixed assets (note E)	-	-	-	-	42,142,248	-	42,142,248
Fund balances							
Reserved for encumbrances	2,961,124	617,303	7,783,159	17,750	-	-	11,379,336
Unreserved (note B)	(2,253,262)	4,956,072	1,059,744	124,044	-	-	3,886,598
Total fund equity and other credits	707,862	5,573,375	8,842,903	141,794	42,142,248	-	57,408,182
TOTAL LIABILITIES, FUND EQUITY AND OTHER CREDITS	\$ 9,154,851	\$5,753,910	\$8,842,903	\$34,335,529	\$42,142,248	\$12,872,399	\$113,101,840

The accompanying notes are an integral part of this statement.

State of Hawaii
The Judiciary
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES -
ALL GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS
Year ended June 30, 1999

	Governmental fund types			Fiduciary fund type	Total (Memorandum only)
	General	Special revenue	Capital Projects (note C)	Expendable trust	
Revenues					
State appropriations	\$93,848,905	\$ -	\$ 1,976,127	\$ -	\$ 95,825,032
Driver education and training program	-	1,796,974	-	-	1,796,974
Intergovernmental revenues	-	503,628	-	86,751	590,379
Other revenues	-	2,400,135	-	-	2,400,135
	<u>93,848,905</u>	<u>4,700,737</u>	<u>1,976,127</u>	<u>86,751</u>	<u>100,612,520</u>
Expenditures					
Courts of Appeal	3,364,057	-	-	932	3,364,989
Land Court and Tax Appeal Court	219,483	-	-	-	219,483
Circuit Courts	26,448,839	-	-	-	26,448,839
Family Courts	26,426,551	-	-	7,088	26,433,639
District Courts	18,665,783	-	-	932	18,666,715
Office of the Administrative Director	16,469,038	-	-	37,872	16,506,910
Supreme Court Law Library	1,238,986	-	-	-	1,238,986
Driver education and training program	-	1,176,330	-	-	1,176,330
Federal funds	-	506,210	-	-	506,210
Capital outlays	-	-	692,650	-	692,650
Other expenditures	-	843,200	-	-	843,200
	<u>92,832,737</u>	<u>2,525,740</u>	<u>692,650</u>	<u>46,824</u>	<u>96,097,951</u>
Excess of revenues over expenditures	1,016,168	2,174,997	1,283,477	39,927	4,514,569
Other financing sources (uses)					
Operating transfers in	(2,543,878)	-	(1,894,127)	-	(4,438,005)
Operating transfers out	2,543,878	-	1,894,127	-	4,438,005
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Excess of revenues and other sources over expenditures and other uses	1,016,168	2,174,997	1,283,477	39,927	4,514,569
Other changes in fund balances					
Lapsed appropriations	549,663	-	242,094	-	791,757
EXCESS OF REVENUES AND OTHER SOURCES OVER EXPENDITURES, OTHER USES AND OTHER CHANGES IN FUND BALANCES	466,505	2,174,997	1,041,383	39,927	3,722,812
Fund balances at July 1, 1998	<u>241,357</u>	<u>3,398,378</u>	<u>7,801,520</u>	<u>101,867</u>	<u>11,543,122</u>
Fund balances at June 30, 1999	<u>\$ 707,862</u>	<u>\$5,573,375</u>	<u>\$ 8,842,903</u>	<u>\$141,794</u>	<u>\$ 15,265,934</u>

Exhibit C

State of Hawaii
The Judiciary

COMBINED STATEMENT OF REVENUES AND EXPENDITURES – BUDGET AND ACTUAL –
GENERAL AND SPECIAL REVENUE FUND TYPES (note B)

Year ended June 30, 1999

	General fund			Special revenue funds		
	Actual on a Budgetary Basis	Budget	Variance favorable (unfavorable)	Actual on a budgetary basis	Budget	Variance favorable (unfavorable)
Revenues						
State appropriations	\$93,848,905	\$93,848,905	\$ -	\$ -	\$ -	\$ -
Driver education and training program	-	-	-	1,796,974	1,686,979	109,995
Intergovernmental revenues	-	-	-	503,628	-	503,628
Other revenues	-	-	-	2,400,135	1,665,684	734,451
	<u>93,848,905</u>	<u>93,848,905</u>	<u>-</u>	<u>4,700,737</u>	<u>3,352,663</u>	<u>1,348,074</u>
Expenditures						
Courts of Appeal	3,388,233	3,456,511	68,278	-	-	-
Land Court and Tax Appeal Court	225,227	245,604	20,377	-	-	-
Circuit Courts	26,814,458	27,429,142	614,684	-	-	-
Family Courts	26,941,185	27,113,238	172,053	-	-	-
District Courts	18,879,952	18,760,123	(119,829)	-	-	-
Office of the Administrative Director	16,226,205	15,811,165	(415,040)	-	-	-
Supreme Court Law Library	1,247,122	1,033,122	(214,000)	-	-	-
Driver education and training program	-	-	-	1,148,523	1,686,979	538,456
Federal funds	-	-	-	506,210	-	(506,210)
Other expenditures	-	-	-	1,447,170	1,665,684	218,514
	<u>93,722,382</u>	<u>93,848,905</u>	<u>126,523</u>	<u>3,101,903</u>	<u>3,352,663</u>	<u>250,760</u>
Excess of revenue over expenditures	126,523	-	126,523	1,598,834	-	1,598,834
Other financing sources (uses)						
Operating transfers in	2,543,878	-	2,543,878	-	-	-
Operating transfers out	<u>(2,543,878)</u>	<u>-</u>	<u>(2,543,878)</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER EXPENDITURES AND OTHER USES	<u>\$ 126,523</u>	<u>\$ -</u>	<u>\$ 126,523</u>	<u>\$1,598,834</u>	<u>\$ -</u>	<u>\$1,598,834</u>

The accompanying notes are an integral part of this statement.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Judiciary on April 14, 2000. A copy of the transmittal letter to the Judiciary is included as Attachment 1. The response of the Judiciary is included as Attachment 2.

The Judiciary generally agrees with most of our findings although it believes that the findings should no longer apply inasmuch as it has begun to take corrective action. This belief is not correct. Our findings apply to the year under audit. However, we commend the Judiciary for its efforts to address the findings and for already beginning to implement some of the recommendations. For some of our findings, the Judiciary did not respond, but chose to explain the reasons for the problems.

The Judiciary agrees that it can further reduce the potential for problems by separating cash handling functions, limiting access to bail receipts, and securing access to data files. The Judiciary also identifies interim or proposed procedures to improve its accountability over cash.

The Judiciary agrees that there is room to improve in collecting restitution. The Judiciary feels that it has done much in this area and that it has exceeded what is required. The Judiciary indicates that the U.S. Supreme Court recognized that restitution orders imposed in criminal proceedings operate for the benefit of the state, since these proceedings focus on the state's interest in rehabilitation and punishment of the offender rather than the victim's desire for compensation.

However, the Judiciary's current policy imposes restitution as a means of compensating for the losses incurred by victims and confronting the offender/juvenile with the direct personal consequences of the crime. The purpose of the Judiciary's policy is to provide procedures for the determination of appropriate amounts of restitution and for the monitoring and enforcement of restitution payments. The Judiciary's inability to effectively monitor and enforce restitution undermines its fulfillment of this purpose. Moreover, the inaccurate restitution balances identified during the audit raise questions about the Judiciary's system for reporting on restitution and whether efforts to enforce restitution are based on inaccurate balances.

The Judiciary also states that its rate of restitution compliance is high. In a study conducted by the Judiciary, it reports that approximately 93 percent of the cases surveyed involved situations where restitution was satisfied, probation was revoked, or victims utilized other civil remedies.

However, it fails to explain the \$30 million of outstanding restitution, where 65 percent were more than five years outstanding.

The Judiciary also reports efforts to improve on collection and monitoring of fines. However we note that its efforts are processes after cash is received. The Judiciary needs to improve its computer systems and procedures if it expects to effectively monitor and collect fines.

The Judiciary also agrees with our findings that decentralized operations result in inefficiencies and that it did not adhere with the procurement code, policies, and procedures. The Judiciary explains why two contracts identified in the audit could not comply with the procurement law.

Regarding our findings related to financial reporting, the Judiciary states that it will consult with its outside auditors on the financial reporting deficiencies identified in the report. However, we wish to reiterate that it is the Judiciary's responsibility to ensure accurate financial statements.

Finally, we commend the Judiciary for its efforts to address the findings and implement some of the recommendations.

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



ATTACHMENT 1

MARION M. HIGA
State Auditor

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

April 14, 2000

COPY

The Honorable Michael Broderick
Administrative Director of the Courts
The Judiciary
Aliiolani Hale
417 South King Street
Honolulu, Hawaii 96813

Dear Mr. Broderick:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Judiciary*. We ask that you telephone us by Monday, April 17, 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 Wednesday, April 19, 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
State Auditor

Enclosures



Office of the Administrative Director of the Courts — THE JUDICIARY • STATE OF HAWAII
417 SOUTH KING STREET • ALI'ĪOLANI HALE • HONOLULU, HAWAII 96813-2902 • TELEPHONE (808) 539-4900 • FAX 539-4855

Michael F. Broderick
ADMINISTRATIVE DIRECTOR
Clyde W. Namu'o
DEPUTY ADMINISTRATIVE DIRECTOR



April 24, 2000

The Honorable Marion M. Higa
State Auditor
Office of the Legislative Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Dear Ms. Higa:

Thank you for the opportunity to comment on your report, Financial Audit of the Judiciary. We appreciate the efforts of the contract auditors and your staff, and welcome the comprehensive analysis.

As you know, for the past ten (10) months contract auditors and your staff thoroughly examined the financial workings of the Hawaii State Judiciary. We agree with many of your findings and recommendations and have implemented, or are in the process of implementing, these recommendations. (Because the audit covered the period ending June 30, 1999, some of the findings no longer apply because the Judiciary has already taken corrective action.) There also are certain findings with which we respectfully disagree. In these instances, we explain our perspective, and how we intend to resolve the specific issues.

No Critical Findings By Auditor In Certain Areas Extensively Examined

The Auditor performed extensive fieldwork in a number of areas not mentioned in the Report. These areas included the collateralization program for cash deposits, accounting and administering of federal reimbursable grants, and the operations of the Traffic Violations Bureau. No problems were identified in any of these areas.

Accountability Over Cash And Other Receipts

The Auditor concluded that the Judiciary failed to: (1) separate key cash handling and reporting functions, (2) limit access to bail receipts, and (3) secure access to data files. Though the Auditor explained that "[f]ailure to implement these key internal controls puts the Judiciary's resources and assets at risk," the Auditor did not find any actual discrepancies.

The Judiciary agrees with the Auditor that good management practice dictates the separation of the reconciling function. The Judiciary's Financial Administration Manual does require that to the extent feasible, the functions of receiving collections and preparing deposit slips and that of depositing collections and recording amounts in the accounting records shall be separated and performed by different persons.

Although the Auditor did not find any actual discrepancies, and merely focuses on the "possibility" of problems, the Judiciary agrees that it can further reduce the potential for problems.

Procedural Controls In Place And Additional Measures Being Implemented

The Judiciary will augment existing policies on segregation of functional duties by establishing blind count reconciliation procedures. We will work with the State Procurement Office to review the armored car services contract. We have implemented interim measures to improve the bail refund process. Finally, we are making changes to the trust accounting system software to provide for additional data controls and augment existing procedural controls. Each of these reforms is discussed below.

Judiciary Implements Blind Count Procedures

Numerous checks and balances presently exist to ensure that cash collections and bail funds turned over by the police and sheriff's

department to the district courts are safeguarded and accurately recorded in the records. Nevertheless, the audit has been helpful in identifying certain weaknesses in internal controls. To avoid any potential problems or any perception that problems might be occurring, and to address the concerns expressed in the audit, the courts will be reminded of the need to separate the cash collecting, depositing, and recording functions to the maximum extent practicable, taking into consideration available resources. In addition, the Judiciary has established blind count procedures at each of the First District Court's Divisions and acquired new cash registers for all Divisions of the First District Court. Blind count procedures require someone other than the cash register operator to print the "Z" totals (summary of the day's collections rung up in the cash register) and the cashier's cash count for the day is reconciled to these totals. The new cash registers have two drawers per register and a secret passcode to be used by each cashier; these features will ensure that each cashier is responsible for the collections he/she takes in. Blind count procedures will be established at all the district courts and additional two-drawer cash registers will be obtained where appropriate.

***Armored Car Service Contract
To Be Reviewed***

The Auditor recommended that the Judiciary review its current contract with the armored car service to determine if adequate contract provisions ensure that cash is deposited daily. The armored car service and pick-up times are specified in an agency-wide contract administered by the State Procurement Office. We will work with the State Procurement Office to review the contract and amend it, if need be, to accommodate these requirements. We are also in the process of changing procedures and cashier cut-off times to ensure that cashiers can close out

and prepare the collections for deposit before the armored car pick-up times.

Cash receipts are collected via a lockbox system or over-the-counter. Cash collected in the lockbox is mailed and automatically forwarded to the bank by the Postal Service the business day following receipt. Cash collected over-the-counter is required to be picked up at regular pre-determined times by armored car service and transported to the bank on the same day of pickup, or on the next business day if the armored car cannot get to the bank before the bank's drop-off deadline. In addition to instances of the armored car not meeting the banks' drop-off times, there have been delays that have since been corrected through the consolidation of the Koolaupoko and Koolauloa divisions (now known as the Kaneohe Division). This consolidation meant that separate accounting records did not need to be maintained for the two (2) divisions. Delays also had occurred when cashiers could not close out and prepare the collections for deposit before the armored car pick-up times.

Improved Interim Bail Refund Procedures

We have implemented interim measures to improve the bail refund process, pending full implementation of the fiscal component of the automated statewide case management system. These measures include an automated bail subsidiary ledger system, automatic daily reconciliation of the subsidiary ledgers, mailing of refund checks to district court defendants and sureties, and in the near future using the automated bail subsidiary ledger instead of the copy of the bail receipt for the refund process. These interim measures enhance control over bails. In addition, access to the court's copy of the bail receipts is now restricted to appropriate personnel.

***Data Controls to Augment
Existing Procedures***

No actual discrepancies were found in the area of trust accounts. Previous audits of the Judiciary by independent auditors, likewise, have reported no discrepancies. Nevertheless, to enhance data integrity, we are changing system software to provide for additional data controls. This will augment procedural controls in place since 1992 and which require supporting documentation for transactions and independent review of supporting documents and disbursements by persons other than the cashiers.

Judiciary's Responsibility Relating To Collecting Restitution

The Auditor states that the Judiciary needs to improve its "responsibility to victims" by implementing adequate controls and procedures to ensure that all restitution amounts due (receivables) have been properly accounted for, monitored, and evaluated for collectibility. The Judiciary agrees that there is room to improve in collecting restitution. However, the Judiciary has done much in this area.

The Judiciary Developed Restitution Policy and Procedures Which Exceed What Is Required

In response to the Legislative Auditor's 1998 Audit of Fines, Fees and Restitution, the Judiciary developed Restitution Policy and Procedures. The policy indicates that, "When the Judiciary imposes restitution as a means of compensating the losses incurred by victims and confronting the offender/juvenile offender with the direct personal consequences of the crime, the Judiciary will seek enforcement through the procedures and means herein set forth..."

The Judiciary's policy exceeds the guidance which the United States Supreme Court provides to the states in Kelly v. Robinson, 479 U.S. 36 (1986), which recognized that "[b]ecause criminal proceedings focus on the State's interests in rehabilitation and punishment, rather than the victim's desire for compensation...restitution orders imposed in such proceedings operate 'for the benefit of the State'." The Judiciary's restitution policy demonstrates its commitment to *restorative justice* which strives to make defendants accountable for their actions and, in the process, to *restore* victims so that they may be made "whole." Inherent in this policy is the understanding that the availability of resources will always dictate the extent to which the Judiciary may fulfill this function.

Accounting Discrepancies Are Explainable

The Auditor concludes that the Judiciary failed to increase the amount on the ledger by \$375,000. The case the Auditor cites is more than 15 years old and the Judiciary is presently reconciling the alleged discrepancy.

The second instance involved a case more than 14 years old. In this case the defendant was ordered to prison at the time of sentencing. In addition, the defendant was ordered to make restitution in the amount of \$105,543.13 and **one-half** (emphasis added) of \$353,940.55. The court order indicates the "manner and amount of payment to be handled by Hawaii Paroling Authority and to commence upon parole with credit for any contribution made." As the Auditor acknowledged previously, the responsibility for providing notice to the Court Cashier that an account should be opened belongs to the agency responsible for monitoring the collection of the restitution. In the case of Probation, the Probation Officer should be responsible. In the case of Hawaii Paroling Authority, the parole officer would be responsible for notifying the Court Cashier. Our records indicate that the Hawaii Paroling Authority inadvertently instructed the Court Cashier to open a restitution account totaling \$457,482.68 (all of the \$353,940.55, rather than just one-half of it). The correct amount should have been \$280,512.41. The inadvertent error did not result in an over-collection.

It is also important to note that the responsibility for collecting restitution for individuals in prison or under the jurisdiction of the Hawaii Paroling Authority belongs to the Department of Public Safety. For a number of years, the Judiciary has assisted the Department of Public Safety in collecting

restitution as they were not previously equipped to perform this function. The Director of the Department of Public Safety has recently advised the Judiciary that with the acquisition of a new computer system, they will be able to assume this responsibility sometime in the near future.

***Regarding Restitution,
Defendants Can Only Be
Ordered To Pay What They
Can "Afford"***

The Auditor explains that more should be done in the area of monitoring a defendant's compliance with a restitution order. It is important to note that the law establishes certain limitations on the court's ability to require a defendant to pay restitution. Pursuant to HRS §706-605(d), the court cannot order a defendant to pay more than he or she can "afford" to pay. This means that regardless of what the victims' "out of pocket" expenses are, defendants can only be ordered to pay what they can afford. The Auditor's Report does not distinguish between the amount ordered to be paid, and the amount which the defendant can afford to pay. In many instances the amount which the defendant can afford is substantially less than the amount ordered.

***The Highest Priority Of
Probation Officers MUST Be
To Ensure The Safety Of The
Public***

The Auditor points out that "probation officers are required to monitor and enforce payments on restitution receivables under their jurisdiction." This is correct. It is important to note, though, that probation officers are responsible for more than restitution monitoring and that the safety of the public **must** be their highest priority. The mission of the Adult Probation Division is "...to enhance the safety of our community through efficient crime reduction and prevention services and activities that assist and guide offenders in their rehabilitation." The goal of supervision

(probation) is "...to assist the offender in improving their conduct and condition to reduce the likelihood of future criminal behavior(s). Supervision involves preventing crime and shaping behavior."

It should also be noted that each probation officer services at least 180 active clients at any given time. This number is significantly higher than the recommended national average.

The Judiciary's Rate Of Restitution Compliance Is High

In 2000, the Judiciary conducted a study to determine its effectiveness in satisfying restitution orders.

In the first circuit, a total of 329 cases involving 245 defendants were identified and a random sampling by probation officers was conducted. One-hundred-fifty-three (153) defendants were surveyed for restitution outcome information. Of the 153 defendants, only 11, or approximately 7%, involved cases where probation expired and a balance of restitution was not collected. Approximately 71, or 46%, involved cases where restitution was complete. Approximately 35% involved cases where probation was revoked and the defendant was resentenced to prison. Therefore, in approximately 81% of all cases, restitution is paid, or is removed as a condition of probation.

Further, approximately 10% of the cases surveyed involved instances where probation had expired, but, a separate order of restitution was filed which allowed the victim to utilize civil enforcement remedies.

Approximately 2% of the cases surveyed involved defendants who died during the period

of probation. In these cases, restitution was set aside.

In summary, approximately **93%** of the cases surveyed involved situations where restitution was satisfied, probation was revoked, or victims utilized other civil remedies.

***The Judiciary Has Supported
And Initiated Legislation To
Assist Victims***

Although the Judiciary is successful in collecting restitution, our efforts do not end there.

Over the past four years, the Judiciary has initiated and/or supported legislation to assist victims. In 1996 the Judiciary introduced legislation (Act 137, 1996) clarifying that the State of Hawaii has the same rights as a civil judgment creditor to use the garnishment process to collect costs and fines both in criminal matters and in "decriminalized" traffic proceedings. Act 137, 1996, added identical language to HRS Chapter 291C and HRS § 706-644.

In 1998, the Judiciary supported legislation enabling victims of crimes to enforce criminal judgments in the same manner as civil judgments. Therefore, rather than initiating a new civil lawsuit to collect restitution, victims may use the criminal judgment in the related case and file it as a special proceeding with the Circuit Courts. This legislation was passed by the legislature in 1998. (Act 269)

***The Judiciary Is Committed To
Improve Collection Of
Restitution***

As part of its legislative package for 2000, the Judiciary sought to waive the filing fees for individuals wishing to utilize the provisions of Act 269, 1998.

During the 2000 legislative session, the Judiciary also introduced a measure requiring

the collection of probation fees. These fees would be imposed on all individuals who are placed on probation as a result of having been convicted of crimes. The measure also calls for the establishment of a probation services special fund where these fees will be deposited. The bill also indicates that "[m]oneys in the probation services special fund shall be used by the Judiciary to monitor, enforce, and collect fees, fines, restitution, and other monetary obligations owed by defendants and to monitor and enforce other terms and conditions of probation."

The United States Department of Justice (DOJ), Office for Victims of Crime, administers the Victims of Crime Act (VOCA) Crime Victim Compensation and Assistance Grant programs. VOCA grants assist states in compensating and assisting victims of crime, provide funds for training and technical assistance, and assist victims of federal crimes. The Judiciary will soon finalize a grant application to the DOJ for a VOCA grant. The goals of our proposal are to increase the Judiciary's financial recovery of restitution, and increase victims' participation in restitution recovery. Grant funds will be used to hire an information system and victim services coordinator to empower participants in the restitution collection process. Another goal of the project is to allow for victim access to restitution information through an Internet web site.

***We Agree That The Trust
Accounting System Should Be
Replaced***

The Auditor recommends that the Judiciary "evaluate the feasibility of replacing the current trust accounting system." In March 1998, the Judiciary established a sub-committee of the Restitution Task Force to evaluate the

feasibility of replacing or modifying the trust accounting system. Enhancements to the trust accounting system are presently being made. In the near future, the Judiciary hopes to provide restitution balances "on line" to probation officers. The Judiciary is committed to establishing a comprehensive solution to our automation problems in the form of an automated case management system (JIMS). (See later discussion.)

The Judiciary's Efforts Regarding the Collection And Monitoring Of Fines

The Auditor acknowledges that the Judiciary has strengthened controls over the collection and enforcement of unpaid fines and fees. The Auditor notes that during FY 98-99, the Judiciary collected over \$55 million in fines, restitutions and other trust receipts. The Auditor also recognizes the Judiciary's efforts to clarify with the Department of the Attorney General, the Judiciary's authority to collect money owed the State. Pursuant to clarification provided by the Attorney General, the Judiciary is only responsible up to when payment is due. The Auditor also indicates that the Judiciary has developed procedures in the District Court of the First Circuit for transferring certain cases to the Attorney General's office. Although not noted by the Auditor, the Judiciary has taken additional measures in the last two (2) years to improve the collection and monitoring of fines.

Cash Collection And Accounting Task Force Established In March 1998

In March, 1998 the Judiciary established the Task Force on Cash Collections and Accounting Systems. The Task Force's mission was to review ways to improve collection and accounting for fees and fines. The Task Force concentrated its initial focus on the District Court of the First Circuit, where the majority of collections in the Judiciary occur. A number of improvements were implemented.

The "Hawaiian" Ledger Evolved From Manual To Automated In 14 Months

Prior to the inception of the Task Force, the rural district courts on Oahu recorded financial transactions in a manual ledger referred to as the "Hawaiian" ledger. As a first step, the Judiciary implemented a Lotus 1-2-3 version of the "Hawaiian" ledger in the rural district courts on Oahu. There were three (3) benefits realized: 1) rural court staff on Oahu became versed in the use of computers to perform accounting functions, 2) greater efficiency was

realized in posting financial entries and 3) communications between the rural courts on Oahu and the Honolulu office improved.

The automated "Hawaiian" ledger was fully implemented in all rural courts by May 1999. As of July 1999, the application is currently being utilized by the accounting staff in the District Court of the First Circuit in Honolulu.

Automated Bail Recording System Developed

In 1998 the Judiciary developed an automated Bail Recording System in the District Court of the First Circuit in an effort to improve the court's ability to collect, record and refund bails initially collected by the police. The automated bail recording and accounting system presently resides on a WANG VS computer and has limited functionality. This computer application was developed as an interim solution to the court's problem of accounting for bail refunds. Further enhancements are planned for the system such as providing staff the ability to generate bail refund checks utilizing the automated system.

"Point Of Sale" Cash Registers Purchased And Installed

The District Courts of Oahu have purchased a number of "Point of Sale" cash registers that have been installed in Honolulu and the rural courts. These "Point of Sale" cash registers will eventually enable the court to upload data from the cash registers to the courts' mainframe computers. Once accomplished, redundant data entry will be eliminated. Further, the "Point of Sale" cash registers will provide the cashiers with enhanced functionality as well as greater speed and efficiency in tallying daily cash receipts.

***Other Revenue Collection And
Accounting Enhancements
Implemented***

Over the past two (2) years, the Judiciary has implemented a number of accounting and collection enhancements. The Judiciary now has the ability to generate a report of all outstanding traffic fines and assessments. In addition, we also have the ability to identify all traffic cases which have been transferred to the Department of the Attorney General for collection.

***Revised Cash Collection
Procedures Adopted In
November 1999***

In November, 1999 the Judiciary adopted and implemented collection policies and procedures which help to augment systems in place prior to the Auditor's 1998 audit. These new procedures provide greater efficiency for the collection and accounting of financial obligations.

***Traffic Fine Payments Will
Soon Be Possible Over The
Internet***

In 2000, the Judiciary executed a contract which will enable the public to pay traffic fines by phone or over the Internet, 24 hours a day, 7 days a week.

***Numerous Public Information
Campaigns Initiated***

The Judiciary has implemented a number of public information projects over the past few years. In 1997, the District Courts implemented "Project Clean Slate." This project encouraged individuals with outstanding traffic cases to settle these matters and "clean the slate." A limited degree of "amnesty" was given to those responding during this period.

Between 1998 and 2000, the Judiciary implemented an informational program to improve the collection of fines, fees and restitutions. Features of the program included the posting and distribution of the "Don't Delay, Pay Today!" poster and flyer in courthouses and probation offices throughout

the state. The Judiciary also produced an 18-minute informational video for individuals granted Deferred Acceptance of a "No Contest" plea or Deferred Acceptance of a Guilty plea by the District Court of the First Circuit. This videotape reminds viewers that they must meet all court-ordered obligations.

***Self Help Centers Will
"Demystify" The Legal Process
And Provide Greater Efficiency***

The Judiciary's most recent project is entitled, "Hookele." Hookele is a self-help project which will provide assistance to individuals in need of court services. Though it will not focus exclusively on settling traffic cases, individuals stationed in our self-service kiosks will be available to assist and direct individuals to appropriate locations in the courthouse where they can settle traffic, civil and criminal matters. This effort will have a positive impact on those individuals who wish to settle fine-related matters.

***We Agree That Computer
Systems Used For Collecting
And Maintaining Fines Need
Improvement***

The Judiciary concurs with the Auditor's conclusion that despite the Judiciary's efforts, collection problems persist because computer systems used for accounting and tracking traffic fines remain inadequate and severely limit the courts' ability to effectively monitor and enforce unpaid balances.

The automated "Hawaiian" ledger, bail recording and accounting system, and "Point of Sale" cash registers discussed previously are viewed as interim solutions. The Judiciary's long-term solution is the Judiciary Information Management System, or JIMS.

***Judiciary Information
Management System (JIMS) Is
The Judiciary's Ultimate Goal***

The cornerstone of the Judiciary's technology effort is the JIMS project. This project is synonymous with the previous references to an automated statewide case management system. The Judiciary needs to integrate its

existing fragmented and obsolete case management systems through a new system. Today, the Judiciary is operating on primarily 1970's vintage case management systems. These systems were never designed to handle some of the fiscal issues that we are presently grappling with. Further, the current separate case management systems (five major systems) evolved when the courts operated independently and, therefore, pursued their own separate automation routes. It is difficult today to share data between the systems.

The JIMS project will enable the Judiciary to address the computer inadequacies noted by the Auditor. It is a large, multi-year, multi-million dollar effort. A computer special fund has been initiated to help pay for its implementation. In late November 1999, the Judiciary completed a requirements definition study. This lays the foundation for the Judiciary to generate a Request for Proposals (RFP) for implementing the system. The RFP is targeted to be completed by the end of 2000. The Judiciary anticipates awarding the contract for the system during the first half of 2001.

The project will be a phased implementation with the first target being the Traffic system, TRAVIS. Traffic will be followed by:

- 1) Criminal Courts; 2) Civil Courts; 3) Appellate Courts; and 4) Family Court.

Completion for all phases of this project is estimated at seven to ten years. While the technology to implement this system is readily available, we anticipate challenges in the areas of: 1) re-engineering of our processes to fully leverage the technology; 2) standardizing our processes and procedures; 3) standardizing our terminology; and 4) standardizing our forms. The JIMS project represents an exciting opportunity for the

Judiciary to revisit its operations and change them to fully leverage the efficiencies available through the use of automation and electronic communication.

Decentralized Operations

The Auditor concludes that the Judiciary's highly decentralized structure hinders implementation and enforcement of uniform policies and procedures among the courts and contributes to inefficient and ineffective operations. We agree with the audit findings, and believe that the Judiciary's current restructuring effort will address the concerns.

Restructuring To Provide Permanent Solutions

The Judiciary is in the process of a restructuring effort, called Achieving Court Excellence (ACE). A specific ACE initiative is to "promote uniformity and consistency in procedures, practices and operations within and across judicial circuits." The changes will result in a new executive-senior management team that will provide system-wide monitoring and enforcement of policies and procedures, including those related to fiscal matters. Implementation has begun in the Fifth Judicial Circuit and Central Administration. Implementation in other judicial circuits will follow.

COMPLIANCE WITH LAW AND POLICIES AND PROCEDURES

Two Contracts With Mitigating Circumstances Cited Out Of 279 Contracts Reviewed And Corrective Action Being Taken On Other Issues

A 17-Day Delay Did Not Jeopardize Public Safety or Adversely Affect The Contractor

From a detailed listing of 279 contracts, the report cites only two contracts where there were concerns. These contracts had mitigating circumstances involving a time line dilemma, privatization issues, and/or public safety concerns. The Auditor's concerns regarding escheating of unclaimed bails and government realization transfers are valid, and are being addressed.

Chapter 42D, HRS Contract for Sex Offender Treatment.

The Auditor found only one discrepancy in the Judiciary's purchase of services program. From a listing of sixty-nine purchases of services contracts, the Auditor selected twenty-five for detailed examination.

The single contract in question relates to the purchase of sex-offender treatment services, and the single concern is because the Judiciary notified the service provider on May 18, 1999, instead of by May 1, 1999, that the Judiciary wished to extend the contract for fiscal year 2000.

The late notification to the service provider did not result in any delay of the delivery of sex-offender treatment services. Moreover, the 18 day delay did not adversely effect the contractor.

Significantly, the statute which the Auditor cited (HRS Chapter 42D) was later repealed, and the successor statute, Chapter 103F, HRS, addresses this timeline dilemma by eliminating all provisions requiring issuance of extension letters by a specific date.

***Privatization Issue And Public
Safety Priorities Required
Thorough Contract Review***

Execution Date for Security Services Contract.

The audit found only one discrepancy in the Judiciary's procurement program. From a listing of 210 contracts, the Auditor selected 74 for detailed examination.

The single contract in question was for private security services to operate security checkpoints at entrances to buildings and courtrooms, and the only issue cited is that the contract extension was formally executed 20 days after the contract extension began.

The eight-month contract was originally put to competitive bid in 1996. The Auditor asked why the contract extension for fiscal year 1998 was executed on July 21, 1997 instead of by July 1, 1997.

As explained to the Auditor, the brief delay was due to the transition to new contract review procedures which the Judiciary initiated in light of the Supreme Court's decision in Konno v. County of Hawaii, 85 Haw. 61, 937 P.2d 397 (1997). The Supreme Court held that civil service, as defined by HRS § 76-77, encompasses services that customarily and historically have been provided by civil servants. All state and county contracts for such services, including security, were determined to be impacted by the Konno decision and were at risk. To ensure the legality of such contracts in the Judiciary, the Judiciary subjected each contract to a new and more lengthy and rigorous review by Judiciary attorneys and civil service specialists to determine, on a case-by-case basis, if such contracts should be exempted under HRS § 76-16. Pending the results of this review and formal approval of the contract extension for fiscal year 1998, services were allowed to continue under the same terms and conditions of the previous contract because of immediate safety concerns. Not allowing services

to continue would have seriously jeopardized courtroom security because deputy sheriffs assigned to secure defendants and provide security during court proceedings would have had to be redeployed to monitor entrances and operate the metal detectors.

The 1997 Konno decision noted that "clear guidance from the Legislature is indispensable." In 1998, Act 230 was enacted to address concerns stemming from the Konno decision. In 1999, a new contract for security services was put to competitive bid.

While sound business practice generally dictates avoiding retroactive contracts, a retroactive contract does not constitute an illegal contract and no problems developed during the twenty days. Also, because the retroactivity involved an extension of the term of the existing contract only, and did not change any of the underlying substantive terms affecting "conditions, covenants and terms," the Judiciary believed that its exposure to "unnecessary risk for events or occurrences during the [20 day period]" was minimal.

Interim Measures Implemented

Escheating of Unclaimed Property.

The Auditor raises valid concerns regarding the escheating of unclaimed property. Specifically, where money or property is abandoned and the Judiciary is required to deposit it into the State General Fund, the Auditor found that the Judiciary needs to be more timely. This problem stemmed from insufficient staffing to handle the high volume of transactions, and defendants not notifying the surety who posted bail that the court had ordered a refund. An interim measure that will help address these concerns and ensure compliance with existing policies is the automatic mailing of

refund checks to District Court defendants and sureties who are not in court when bail is ordered to be refunded. The mailing of refund checks will facilitate the escheating of bails. Additionally, the implementation of the fiscal component of the automated statewide case management system will provide a permanent solution to the concerns cited in the report.

Closer Monitoring To Be Required

Transfer of Government Realizations.

The Auditor's findings regarding the transfer of government realizations is also valid. Court administrators will be directed to provide closer monitoring to minimize delays and comply with existing policies. Of the transactions brought to our attention by the Auditor, most of the delays were due to staffing issues and unnecessary processing, which have since been corrected. The Judiciary also wishes to note that all funds that are in-transit to the State Treasury are in interest-bearing bank accounts. Consequently, the delay did not result in a loss of potential revenue to the State.

FINANCIAL REPORTING

Similar Findings Not Reported By Other Independent Auditors

The audit cited five concerns regarding financial reporting. One resulted from a recording error that has been corrected. The other four contradict the results of previous audits conducted by other independent auditors. We will consult with both auditors to resolve these four issues.

Workers' Compensation Liability

The Auditor explains that workers compensation liability should be based on the estimated ultimate cost of settling the claims. For fiscal year 1999, the Judiciary's independent auditor affirmed the non-disclosure of the potential liability. This view was consistent with the previous year's independent audit. We will consult with both auditors to resolve this issue.

Salary Lag

The Auditor explains that the Judiciary did not record the receivable and related revenue for these salaries and wages to be funded by the FY 1999-2000 appropriations. The Auditor's view is that the salary lag should have also been recorded as a receivable appropriation. However, according to the Judiciary's independent auditor, there is no accounting standards requirement for recording the lag as a receivable appropriation. We will consult with both auditors to resolve this issue.

Restitutions

The Auditor believes that the Judiciary should disclose outstanding restitution receivables in the appended notes of the financial statement. Accounting standards require recording of transactions such as restitutions only when they become both measurable and available, with "available" meaning "collectible in the current period or shortly thereafter." Restitutions are "measurable" at the time ordered, but are not available within the meaning of the accounting standard because they span the period of

probation. The absence of a disclosure has not been an issue in any of the previous independent audits conducted by the Judiciary's independent auditor. We will consult with both auditors to resolve this disclosure issue.

Operating Transfers

The Auditor concluded that operating transfers were not properly reported in the Judiciary's financial statements. During the course of a fiscal year, the Judiciary finds it necessary to transfer funds between its general fund appropriations to address unforeseen circumstances and contingencies. The practice has been to fully disclose such transfers in the preliminary unaudited financial statements to facilitate the internal review of the financial statements by administrators and other personnel, and to reconcile the transfers with other internal records. The practice has also been to subsequently remove the disclosure when the audited financial statements are prepared. The disclosure of such transfers in the preliminary financial statements has never been noted in any previous audit conducted by the Judiciary's independent auditor. The disclosure of the transfers has had a zero impact on the fund balances because the totals of the transfers-in and transfers-out are always identical. We will consult with both auditors to resolve this issue.

Fund Transfer

The Auditor explains that the Indigent Legal Assistance Funds which were transferred to the Judiciary in 1998 are appropriately categorized as a "residual equity transfer," and should therefore be reported as an addition to or deduction from the beginning fund balance of governmental funds and not as a fund revenue. The Auditor's finding is valid.

The Judiciary has corrected its error, and the incoming funds have been properly recorded as a transfer.

Again, we sincerely appreciate the efforts of the contract auditors and your staff. The audit has helped identify a number of areas deserving attention. In the coming months, we will contact your staff for information and further advice on how the Judiciary can continue to improve many of the areas mentioned in your report.

Yours very truly,



Michael F. Broderick
Administrative Director of the Courts