Financial Audit of the Department of Public Safety

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

Report No. 02-10
May 2002

THE AUDITOR
STATE OF HAWAII

Office of the Auditor

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

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

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

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

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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

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OVERVIEW

Financial Audit of the Department of Public Safety

Report No. 02-10, May 2002

Summary

The Office of the Auditor and the certified public accounting firm of KPMG LLP conducted a financial audit of the Department of Public Safety, State of Hawaii for the fiscal year July 1, 2000 to June 30, 2001. The audit examined the financial records and transactions of the department; reviewed the related systems of accounting and internal controls; and tested transactions, systems, and procedures for compliance with laws and regulations.

We found deficiencies in the financial accounting and internal control practices of the department. The department continues to experience unusual patterns of sick leave and overtime costs are significant. During the fiscal year under audit, an average of 27 sick leave days was taken for all uniformed staff. This is significantly higher than the average of ten days for all state employees.

During FY2000-01, the facilities incurred about $7 million in overtime costs, nearly 13 percent of facility salaries and wages. In our sample of 25 ACOs and medical and food service staff with highly unusual overtime compensation levels, approximately 40 percent of their total compensation was related to overtime or about $22,000 of overtime pay per employee. Some employees were paid more for overtime than for their regular salaries and wages.

The department continues to maintain a significant outstanding balance of salary overpayments—$1.8 million, of which the department estimates that approximately $598,000 will be uncollectible. The process of collecting salary overpayments typically takes between 11 and 20 months under optimal conditions.

The department is still unable to reconcile inmate trust account balances to bank balances. For example, the inmate trust bank account at the Women's Community Correctional Center has not been reconciled since 1999. The staff responsible for this task are not held accountable and the lack of proper reconciliation procedures makes it difficult to determine whether the unreconciled differences were caused by accounting errors or possible misappropriation of funds.

Furthermore, the department has not reduced the number of inmate accounts related to released or paroled inmates. On June 30, 2001, there were 2,554 inactive inmate accounts for paroled or released inmates totaling approximately $107,800. The department fails to withhold inmate funds for victim restitution and child support despite the fact that the inmates have available funds.

Finally, we found that the department is unable to document the reported value of its fixed assets of $134 million. Nor is it able to reconcile the amount of fixed assets reported in the internal service fund on June 30, 2001 to its Annual Inventory

Report of Property. The unreconciled difference is approximately $473,000. This is of concern since the department, in the fiscal year ending on June 30, 2002, will be required by governmental accounting standards to present financial statements similar to business type organizations, including the computation of depreciation expense for its fixed assets. Failure to comply with this requirement will have a serious impact on the accuracy of the department's financial statements in future audits.

Recommendations and Response

We recommend that the department work with the bargaining units to implement a more stringent policy for determining unusual patterns of sick leave abuse subject to investigation. At a minimum, the policy should restrict ACOs from being called in for overtime if they called in sick within the prior seven days. The department should also establish more specific criteria for determining when overtime is necessary, identify watches consistently incurring unusual overtime costs, and require that overtime for those watches be authorized by the chief of security or the warden prior to calling in ACOs to work overtime. The department should also prepare exception reports identifying employees and watches with unusually high sick leave pay and use this information to monitor and investigate sick leave abuse and minimize overtime costs, and monitor overtime costs by individual to ensure that allocation of overtime is equitable.

The department should perform required audits of salary overpayments in a timely manner and in compliance with laws and regulations. It should reduce the backlog of pending audits by setting monthly departmental goals for the number of audits and hearings to be performed. Also, the department should develop a program for the eventual responsibility of conducting salary overpayment hearings. The department should also consider contracting out the salary collection process on a contingency basis.

The department should immediately reconcile inmate trust accounts to bank balances. Inactive inmate accounts outstanding over 180 days should be identified and remitted to the Department of Budget and Finance. The department should also implement a system whereby all restitution and child support are identified and remitted to the proper agencies on a quarterly or semi-annual basis.

The department should document the reported cost basis of all fixed assets and should reconcile the Annual Inventory Report of Property to the financial statements.

The department generally agrees with most of our findings and recommendations; however, it commented that it believes some of the findings and conclusions "do not accurately reflect a full understanding of the issues."

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

Conducted by

The Auditor
State of Hawaii
and
KPMG LLP

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 02-10
May 2002

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Chapter 1
Introduction

This is a report of our financial audit of the Department of Public Safety, State of Hawaii (department). The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of KPMG LLP. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes (HRS), which requires the State Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State of Hawaii (State) and its political subdivisions.

Background

The department is responsible for: providing for the custody, care, and assistance in the rehabilitation of all persons incarcerated by the courts or otherwise subject to confinement based on commitment or an alleged commitment of a criminal offense; guarding State property and facilities; preserving peace and protecting the public in designated areas; enforcing specified laws, rules, and regulations for the prevention of crime; and serving process papers in civil and criminal proceedings. Section 26-14.6, HRS, further describes the department's responsibilities:

The department shall be responsible for the formulation and implementation of state policies and objectives for correctional, security, law enforcement, and public safety programs and functions; the administration and maintenance of all public or private correctional facilities and services; the service of process papers; and the security of state buildings.

The department manages the State's three correctional facilities and five community correctional centers. Exhibit 1.1 identifies the location and number of inmates in the State's correctional facilities and community correctional centers.

Additionally, the department contracts with the Correctional Corporation of America and Dominion Management to house Hawaii inmates in Oklahoma and Arizona to alleviate prison overcrowding. During FY 2000-01, the department spent approximately $20 million to house about 1,200 inmates in these out-of-state facilities.

Departmental funding

The department is funded primarily with state moneys. During FY2000-01, the department received approximately $154 million or about 94 percent of total funding from the State through appropriations and non-

Exhibit 1.1
Hawaii's Correctional Facilities and Community Correctional Centers

Island	Facility	Inmate Count*
Oahu	Halawa Correctional Facility	1,274
	Waiawa Correctional Facility	331
	Oahu Community Correctional Center	1,142
	Women's Community Correctional Center	286
Hawaii	Kulani Correctional Facility	167
	Hawaii Community Correctional Center	238
Maui	Maui Community Correctional Center	338
Kauai	Kauai Community Correctional Center	125
	Total	3,901

* Inmate count as of June 30, 2001.

imposed employee fringe benefits. The remainder of the department's funding is from federal grants and revenues of the Correctional Industries Program.

Organization

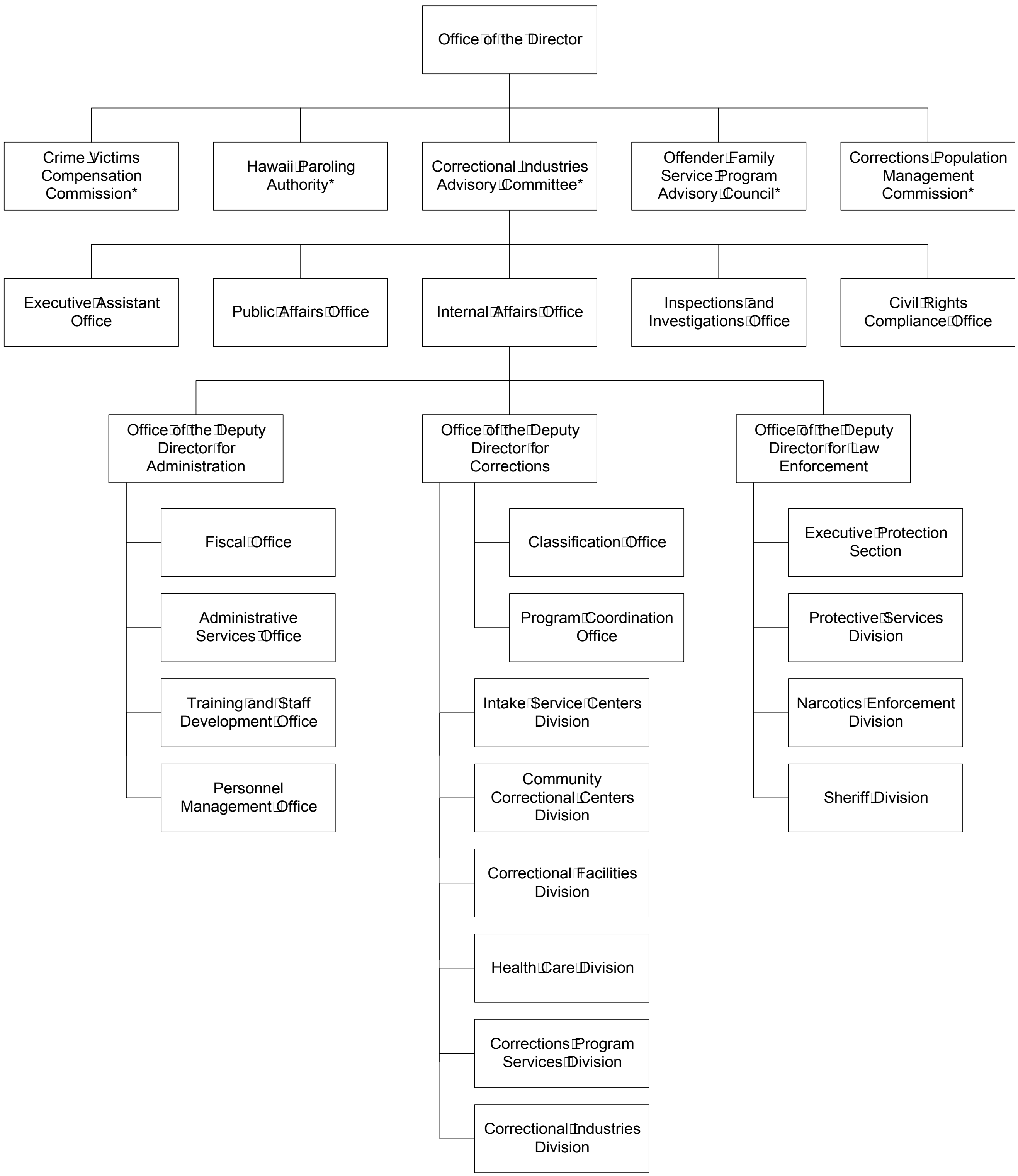
The director oversees, directs, and coordinates the plans, programs, and operations of the department to provide for the safety of people, both residents and visitors, from crimes against people and property. The director is supported by five administratively attached bodies; three deputy directors who are responsible for the offices for administration, corrections, and law enforcement; and five other offices. Exhibit 1.2 displays the department's organizational structure. The primary responsibilities of these units follows.

Administratively attached bodies

The Crime Victims Compensation Commission consists of three members appointed by the governor to mitigate the suffering and losses of victims and the dependents of deceased victims of certain crimes by compensating them for medical expenses, loss of earning power, pain and suffering, and other financial losses that were the direct result of injury or death of the victim; and to compensate private citizens for personal injury or property damage suffered in the prevention of a crime or the apprehension of a criminal.

The Hawaii Paroling Authority consists of three members nominated by a panel composed of members from the public and private sectors and

Exhibit 1.2
Organizational Structure of the Department of Public Safety



* Administratively attached to the department.

appointed by the governor to 1) evaluate and grant parole when there is reasonable probability that the prisoner concerned will live and remain at liberty without violating the law and that the prisoner's release is not incompatible with the welfare and safety of the public; and 2) utilize the agency and community resources as a link for parolees to reintegrate into society.

The Correctional Industries Advisory Committee consists of nine members appointed by the governor that advises the department on the feasibility of establishing venture agreements with private sector businesses to utilize the services of qualified, able-bodied inmates.

The Offender Family Service Program Advisory Council consists of seven members appointed by the director that reviews and makes recommendations to the director to improve the types of services provided to inmate families.

The Corrections Population Management Commission consists of 11 members from the public and private sectors that establishes maximum inmate population limits for each correctional facility and formulates policies and procedures to prevent the inmate population from exceeding the capacity of each correctional facility.

Offices under the direction of deputy directors

The Office of the Deputy Director for Administration manages the administrative systems, services, and operations in and for the department pertaining to general program planning, evaluating, and budgeting; capital improvements and repairs; fiscal accounting and auditing; procurement and supply; personnel; training; information technology; administrative rule-making; duplicating services; and other relevant functions.

The Office of the Deputy Director for Corrections provides for the custody, care, and assistance in the rehabilitation of all persons incarcerated by the courts or otherwise subject to confinement based on an alleged commitment of a criminal offense.

The Office of the Deputy Director for Law Enforcement guards state property and facilities; preserves the peace and protects the public in designated areas; enforces specified laws, rules, and regulations for the prevention and control of crime; and serves process papers in civil and criminal proceedings.

Other offices

The Executive Assistant Office assists the director by performing various staff functions in order to facilitate the director's oversight of departmental systems and operations.

The Public Affairs Office advises and assists the director in the management and conduct of a comprehensive program for effective public relations by informing the public of departmental plans, activities, and accomplishments, and providing reliable and timely responses to the media or other public inquiries regarding matters of special interest; advises departmental staff on public affairs policies and procedures; and manages the preparation and distribution of the departmental annual report.

The Internal Affairs Office conducts criminal, administrative, and civil investigations of the employees of the department and the lawful use and disposition of departmental resources.

The Inspections and Investigations Office administers the proper execution of laws, rules, regulations, standards, and directives set forth for the operations of the department.

The Civil Rights Compliance Office advises departmental management, supervisors, and employees on compliance with civil rights and related laws, and develops, updates, and oversees implementation of the departmental affirmative action plan.

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 department; to recommend improvements to such systems, procedures, and reports; and to report on the financial statements of the department.

2. To ascertain whether expenses or deductions and other disbursements have been made and all revenues or additions 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.

Scope and Methodology

We audited the financial records and transactions and reviewed the related systems of accounting and internal controls of the department for the fiscal year July 1, 2000 to June 30, 2001. We tested financial data to provide a basis to report on the fairness of the presentation of the financial statements. We also reviewed the department's transactions, systems, and procedures for compliance with applicable laws, regulations, and contracts.

We examined the existing accounting, reporting, and internal control structure and identified deficiencies and weaknesses therein. We made recommendations for appropriate improvements including, but not limited to, the forms and records, the management information system, and the accounting and operating procedures.

The independent auditors' opinion as to the fairness of the department's financial statements presented in Chapter 3 is that of KPMG LLP. The audit was conducted from July 2001 through November 2001 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Deficiencies

Internal controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the Department of Public Safety (department).

Summary of Findings

We found several reportable conditions involving the department's internal control over financial reporting and operations. Reportable conditions are significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Similar issues were communicated to the department in our Report No. 00-05, *Management and Financial Audit of the Department of Public Safety*.

We found the following reportable conditions:

1. Overtime costs are significant and unusual patterns of sick leave usage continue.

2. Collecting staff salary overpayments in a timely manner continues to be a problem for the department.

3. The department is not fulfilling its fiduciary responsibilities to the inmates and the victims and families of inmates.

4. The department is unable to provide sufficient documentation to support $134 million of fixed assets reported in the department's financial statements. In addition, fixed assets reported in the internal service fund (correctional industries programs) do not reconcile to the Annual Inventory Report of Property.

Significant Overtime and Unusual Sick Leave Usage Continue

Prior audits performed by our office highlighted the department's failure to control overtime costs and patterns of sick leave abuse among department employees, specifically the adult correctional officers (ACO) and medical and food service staff. Salaries and wages are the most significant facility expenditure, comprising 85 percent of total facility expenditures or approximately $52.9 million for the fiscal year ended

June 30, 2001. Of these expenditures, overtime wages comprise $7 million. Between the fiscal years ended June 30, 1999 and 2000, overtime cost decreased from $9.8 million to $7.6 million. Overtime at approximately 13 percent of total salaries and wages is still a significant departmental expense. Under these circumstances, the department should be especially vigilant in its efforts to minimize overtime and prevent sick leave abuse. However, despite the department's efforts to monitor overtime and sick leave, it continues to incur significant overtime costs and experience unusual patterns of sick leave.

Overtime is driven by sick leave and staff vacancies

We reviewed a sample of 22 ACOs and three food service staff who had unusual levels of sick leave usage. Our review of overtime costs identified vacation or sick leave as the documented reason for the vacant positions and the resulting overtime.

Overtime for ACOs normally occurs when an ACO who is not scheduled to work is called in to replace a vacant security post. In most cases, the facility watch commander determines whether an ACO should be called in to work overtime. This decision is based on staffing of the facilities' posts. Each facility has both essential and program posts. Essential posts are the minimum posts required to secure, house, clothe, and feed the inmates, and provide safety for the employees, inmates, and public. All essential posts must be staffed. If an essential post must be filled, the watch commander first determines whether any program posts can be closed and whether the ACO staffed at that post can be transferred to the essential post. Program posts are considered non-essential and exist to run programs, such as recreation, education, volunteer programs, and activities. We were informed that there is no set criteria for determining which program posts can be closed. If a program post is or becomes vacant, an ACO would not be called in on overtime to fill the vacancy. The facility chief of security reviews the decisions to close program posts and incur overtime, after completion of the shift. The lack of standard criteria for evaluating open posts and the untimely review of decisions to incur overtime continues to leave the department susceptible to overtime abuse.

Vacant ACO positions also contribute to overtime costs. During fiscal year ended June 30, 2001, there were approximately 90 ACO positions vacant, a decrease of nearly 50 vacancies from the fiscal year ended June 30, 2000.

Medical and food service staff also incur unusual levels of overtime and high sick leave usage. Specifically, we found that for the two food service staff and the two medical staff included in our overtime sample, over 40 percent of their total compensation related to overtime. In addition, all three food service staff included in our sick leave sample stook more than the allotted 21 days of sick leave per year, averaging approximately 330 hours or 41 days of sick leave taken per employee.

Unusual patterns of sick leave continue despite the department's sick leave abuse program

The department's existing sick leave abuse programs is ineffective against the misuse of sick leave. The collective bargaining agreement with the ACOs and medical and food service staff allows the department to investigate unusual patterns of sick leave. Patterns indicative of abuse occur over a six-month period, with six or more occurrences each of at least one of the following: sick leave of short durations or occurring before or after holidays, weekends, days off, paydays, or specific days of the week. Such unusual patterns are identified by the wardens at each facility through a manual review and analysis of employee sick leave records. When a pattern is detected, the employee is placed in a six-month follow up evaluation program. Once in the program, the department can require the employee to undergo medical evaluations by a doctor specified by the department to verify all absences due to sickness.

Despite the program, we found that unusual sick leave patterns continue to occur within the department. Our sample of 25 ACOs and food service staff who had unusual levels of sick leave usage revealed the following:

- All employees took more than the allotted 21 days of sick leave per year, averaging approximately 290 hours or 36 days of sick leave taken per employee.

- Nine employees (36 percent) had 20 hours or less of sick leave accrued on June 30, 2001, and two employees had sick leave balances of zero. One of the employees with a sick leave balance of zero was hired in 1983, which means that this employee used all of his allotted sick leave accumulated since 1983.

- Six employees (24 percent) had 51 instances in which they worked overtime within three days before or after taking sick or vacation leave.

- Nine employees (36 percent) had a total of six or more occurrences of different sick leave abuse indicators for the six-month review period, but were not investigated because the department's policy defines a pattern of sick leave abuse as six or more occurrences of the same type of abuse indicator within a six-month period.

- One of the two employees placed in the sick leave abuse program should have begun the program on June 16, 2001, but was not immediately notified and was consequently not placed in the program until July 4, 2001. Again, the employee took sick leave during this period; however, his program was not extended for the approximate half-month delay.

The high levels of sick leave usage are not confined to these individuals. An average of 27 sick leave days was taken during the fiscal year ended June 30, 2001 for all uniformed staff, which includes ACOs and medical and food service staff. This amount is significantly higher than (1) the average of ten days for all state employees, based on the estimate used by the actuary for the Employees' Retirement System of the State of Hawaii; (2) the national average[1] of nine days for all protective services, which includes police officers and prison and security guards; and (3) the national average[1] of 12 days for all government employees.

Average sick leave days per employee increased significantly between the three quarters ended June 30, 2001 and June 30, 2000 at the Waiawa Correctional Facility (29 percent increase) and the Women's Community Correctional Center (28 percent increase). We were informed that at the Waiawa Correctional Facility, it appeared that sick leave was used when employees were denied vacation leave. At the Women's Community Correctional Center, we were informed that employees used sick leave time to care for their children during breaks from school. We were informed that both situations were not investigated because no clear evidence existed and because the department did not want to jeopardize employee morale. However, the department has a fiduciary duty to taxpayers to ensure that sick leave usage is in accordance with state statutes. Any apparent abuse of sick leave should be investigated in a timely manner.

The continued unusual sick leave patterns and the high levels of sick leave usage raise doubts about the effectiveness of the department's sick leave abuse program.

High sick leave usage results in significant overtime costs to the department

During the fiscal year ended June 30, 2001, the facilities incurred approximately $7 million in overtime costs, comprising nearly 13 percent of total facility salaries and wages. We tested a sample of 25 ACOs and medical and food service staff with highly unusual overtime compensation levels. Our sample consisted of 21 ACOs, two food service staff, and two medical staff. We found that approximately 40 percent of their total compensation was related to overtime. This equates to approximately $22,000 of overtime pay per employee. Additionally, three employees at the Halawa Correctional Facility were paid more for overtime than for their regular salaries and wages. Exhibit 2.1 details the base compensation and overtime compensation for the three employees. The large overtime compensation is extremely unusual considering the average overtime compensation for all employees at this facility during fiscal year ended June 30, 2001 was $6,230. Also, the average overtime compensation for all employees at all facilities averaged $4,710 for the fiscal year ended June 30, 2001. The department was not aware of the situation and was unable to explain why this occurred. The department does not monitor individual ACOs' overtime but instead focuses on each facility's overtime costs in the aggregate.

Exhibit 2.1
Detail of Base Compensation and Overtime Compensation for Three Employees at the Halawa Correctional Facility

Employee	Base Compensation	Overtime Compensation
1	$28,380	$38,445
2	33,396	36,340
3	33,396	38,303
Total	$95,172	$113,088

The unusual levels of overtime costs indicate that the department's policies and procedures are inadequate

Once the watch commander decides to call in an ACO to work overtime, he/she asks the ACOs from the previous watch to fill the vacant post. At the larger facilities (Halawa Correctional Facility and Oahu Community Correctional Center) the watch commander chooses employees from a volunteer pool. The volunteer pool consists of ACOs who have signed up for overtime consideration. The list is prioritized based on seniority and the number of opportunities for overtime the ACO has had to date. At the smaller facilities, the watch commander selects the ACO from a call back list. The call back list is similar to the volunteer pool except that it is prioritized based on seniority and once the ACO on the top of the list is called, that ACO moves to the bottom of the list whether the ACO accepts, declines, or cannot be reached. The selection of individuals for overtime is reviewed by the facilities' chief of security.

A monthly overtime listing is reviewed by the captain or section head and the warden. However, the overtime listing does not include year-to-date information. As a result, the warden is unable to identify individuals with excessive overtime. Also, overtime patterns are not monitored, and individuals with excessive overtime are not placed on a "do not call" list.

The unusual overtime compensation for the previously mentioned individuals, especially the three individuals at the Halawa Correctional Facility, exemplifies the inadequacy of the department's policies and procedures.

Focused effort on overtime abuse has proven effective at one facility

The department has focused its efforts on the detection of unusually significant overtime costs by facility and has placed responsibility for correction with the wardens. The warden at the Waiawa Correctional Facility has been proactive in attempting to prevent unusual overtime costs. The warden identified unusually high amounts of overtime in July 2001 for a certain watch, and to prevent its further occurrence, instituted a policy specifically for that watch. The policy requires all overtime to be authorized by the warden or the chief of security. If proper approval is not obtained prior to any overtime being worked, the individual responsible for scheduling the overtime will be investigated based upon the Standards of Conduct (insubordination) of the department. This policy was instituted in August 2001 and is currently in effect. We were informed that the policy resulted in reduced overtime for that specific watch without compromising the health and safety of the inmates and department personnel. The policy implemented for the Waiawa Correctional Facility may not be practical for some of the other facilities due to their larger number of posts (fewer than 20 posts at Waiawa Correctional Facility, compared with 60 to 80 posts at Halawa Correctional Facility). However, the improvement at Waiawa Correctional Facility shows that it is possible to reduce overtime and the other facilities should consider reasonable alternatives.

Recommendations

We recommend that the Department of Public Safety consider the following:

1. Sick leave abuse

    a. Work with the bargaining units to implement a more stringent policy for determining unusual patterns of sick leave abuse subject to investigation. This could be accomplished by lowering the number of required occurrences of sick leave abuse indicators, terminating the policy of considering each type of pattern separately, and/or extending the review period for determining when an investigation into sick leave abuse is warranted.

    b. Institute a policy restricting ACOs from being called in for overtime if they called in sick within the prior seven days.

2. Overtime

    a. Establish more specific criteria for determining when overtime is necessary.

    b. Focus efforts on preventing overtime costs by identifying watches consistently incurring unusual overtime costs and requiring that overtime for those watches be authorized by the chief of security or the warden prior to calling in ACOs to work overtime.

    c. Prepare exception reports identifying employees and watches with unusually high sick leave usage and overtime pay. Use this information to monitor and investigate sick leave abuse and minimize overtime costs.

    d. Monitor overtime costs by individual to ensure that overtime is allocated equitably based on the department's policies.

$1.8 Million in Staff Overpayments Remain Uncollected

The department continues to maintain a significant outstanding balance of salary overpayments. As of June 30, 2001, the outstanding balance of salary overpayments amounted to $1.8 million, a decrease of about $200,000 from June 30, 2000. Of the amount outstanding as of June 30, 2001, the department estimates that approximately $598,000 will be uncollectible, an increase of about $38,000 from June 30, 2000. Although salary overpayments are inherent in the processing of salaries and wages, the department must improve its followup and collection procedures or the balance will increase in the future.

Salary overpayments are inherent in the process and collection is time consuming

Generally, employees are paid on the 20th and 5th of each month for services rendered during the first and second halves of the month, respectively. There is only a five-day time lag between the end of the pay period and the pay date. Therefore, a portion of salaries and wages is based on projected time and attendance. Salary overpayments occur when employees call in sick with no sick leave available or when they do not obtain a doctor's note for sick leave absences of five or more consecutive days. For example, if an employee turns in a timesheet indicating that he will be working through the end of the pay period, but instead calls in sick (even though he has no sick leave available), a salary overpayment will occur. This overpayment is usually identified within a month when time and attendance clerks at each facility or division review timesheets and update sick leave records.

The process of collecting salary overpayments is time-consuming because the department must adhere to hearing and audit requirements before collections can begin. Sections 91-9, 91-9.5, and 91-10, Hawaii Revised Statutes (HRS), provide that employees must be afforded the opportunity to dispute the overpayment through a hearing process. Prior to the hearing, the department must audit the employee's payroll records going back to the employee's hire date or the end of the last audited period. After the payroll records are audited, the department schedules a hearing with the employee and the state Department of Accounting and General Services, waits for the decision, addresses any appeals, and waits for the final decision. The department estimates that the process, under optimal conditions, typically takes between 11 and 20 months.

In September 2001, the state Department of Accounting and General Services informed the department that it will eventually be responsible for conducting its own salary overpayment hearings.

The delays in collection experienced by the department are unacceptable

Because salary overpayments are inherent in the payroll process, the department must implement procedures to identify, notify, resolve, and collect overpayments in a timely manner. If the department is unable to do this, employees are likely to continue calling in sick when no sick leave is available to them since they will not have to repay any excess salary until a much later date, if at all.

The department is unable to separately determine the number and dollar amount of salary overpayments pending audits and hearings. As of August 2001, the department had not collected any amounts for seven out of a sample of 15 employees with salary overpayments. The overpayments total $84,000 and have been outstanding for over a year. Four of the overpayments totaling $67,500 date back to calendar year 1999. As a result of the lengthy delay, two of the employees, with an aggregate overpayment of $6,693, have left employment with the State, making collection difficult. Staff who claim bankruptcy further hinder the department's collection efforts. The department identified approximately $242,000 in salary overpayments as uncollectible due to bankruptcy filings. These balances, along with salary overpayments related to employees no longer employed by the State, should be referred to the state Department of the Attorney General for collection. The department is unable to determine the amount of salary overpayments related to employees no longer employed by the State and estimates that only 10 percent of these accounts have been referred to the state Department of the Attorney General. Failure to notify the attorney general on a timely basis negates the State's ability to file a proof of claim for the salary overpayments.

Recommendations

We recommend that the department:

1. Perform required audits of salary overpayments in a timely manner and in compliance with laws and regulations.

2. Reduce the backlog of pending audits by setting departmental goals as to the number of audits and hearings to be performed each month. (This number should be greater than the average number of salary overpayments occurring each month.)

3. In preparation for the eventual responsibility of conducting hearings related to salary overpayments, the department should immediately develop plans to identify individuals who will conduct the hearings, determine the time and location for the hearings, develop procedural rules, and contact the state Department of Accounting and General Services to review existing policies and procedures.

4. Consider contracting out the salary collection process on a contingency basis in order to expedite the process and reduce the amount of uncollectible payments.

The Department Is Not Fulfilling Its Fiduciary Responsibilities to the Inmates and the Victims and Families of the Inmates

The department is responsible for accounting for and safeguarding inmates' funds while they are incarcerated, withholding and remitting restitution to victims, and providing child support to the families of inmates. However, the department has not fulfilled its responsibilities in these areas.

Management of inmate trust accounts continues to be a problem

The department continues to fail in its efforts to comply with Section 353-20, HRS, which requires it to maintain individual ledgers for inmate trust accounts. The inmate ledgers account for inmates' earnings from work, receipts from family and friends, and payments for store purchases and other necessities. The department has a fiduciary responsibility to the inmates to properly account for and safeguard approximately $1 million of funds belonging to inmates. The department's implementation of a new inmate trust accounting (ITA) system should have improved management of the funds. However, implementation of the ITA system has not resolved the department's inability to reconcile inmate trust account balances to bank balances, nor has it reduced the number of inmate accounts related to released or paroled inmates.

The department does not reconcile inmate trust accounts to bank balances

Reconciliation of accounting records to bank statements provides assurance that funds are properly accounted for and prevents the theft or misappropriation of funds. The inmate trust bank account at the Women's Community Correctional Center has not been reconciled since 1999. Additionally, for the other seven facilities, we found that the ITA system balance did not equal the reconciled bank balance. Exhibit 2.2 details the ITA system balances, bank reconciliation balances, and differences between the two for each facility.

Exhibit 2.2
ITA System Balances, Bank Reconciliation Balances, and Differences Between the Balances for Each Facility as of June 30, 2001

Facility	ITA System Balance	Bank Reconciliation Balance	ITA in excess (less than) Bank Reconciliation
Halawa Correctional Facility	$363,523	$259,870	$103,653
Waiawa Correctional Facility	57,352	65,657	(8,305)
Oahu Community Correctional Center	155,015	195,357	(40,342)
Women's Community Correctional Center	36,078	*	**
Kulani Correctional Facility	66,129	39,072	27,057
Hawaii Community Correctional Center	62,513	58,370	4,143
Maui Community Correctional Center	147,074	137,983	9,091
Kauai Community Correctional Center	64,055	63,505	550

* The bank account has not been reconciled since 1999.

** Unable to determine the difference as the reconciled balance of the bank account is unknown.

The department reconciles the current month's inmate account transactions and does not perform a reconciliation between the ITA system balance and the bank balance. We found discrepancies totaling $21,000 between the ITA system and the reconciled bank balances relating to transactions occurring between July 1, 2000 and June 30, 2001 for four facilities that had balances available for both dates. The business office for each facility is responsible for reconciling the ITA balances. The individuals responsible for performing the reconciliations are not held accountable for completing the task. The lack of proper reconciliation procedures makes it difficult to determine whether the unreconciled differences were caused by accounting errors or possible misappropriation of funds.

Unclaimed funds of paroled or released inmates are not remitted to the Department of Budget and Finance

Upon parole or release of an inmate, the department prepares a check payable to the inmate for the balance in his/her account. However, in certain instances, such transactions as wages may not be posted to the inmate trust account prior to the inmate's parole or release. The department informs the inmate that this may occur and requests the inmate to return to collect the pending wages or leave a forwarding address for a check to be mailed. If the inmate fails to return to collect the remaining balance or if the mail is returned as undeliverable, the department's policy is to hold the balance for 180 days, at which time the balance should be remitted to the Department of Budget and Finance for escheat to the state.

The department did not remit any funds to the Department of Budget and Finance during the fiscal year ended June 30, 2001. On June 30, 2001, there were 2,554 inactive inmate accounts for paroled or released inmates totaling approximately $107,800. Of these accounts, 1,833 totaling about $80,000 had been outstanding for over 180 days. Furthermore, the Halawa Correctional Facility had 1,150 inactive inmate accounts amounting to approximately $60,300 that dated back to 1990. As a result, the department is holding substantial funds that belong to former inmates or other parties.

The department has not fulfilled its fiduciary responsibility to victims and children of inmates

State law requires the department to enforce court-issued, victim restitution and child support orders. However, current departmental policies and procedures do not ensure compliance with state statutes. The department has failed to withhold inmate funds for victim restitution and child support despite the fact that the inmates have available funds. Compliance with these requirements is important to victims and families because once the inmates leave custody, it is extremely difficult to collect these amounts.

The department does not ensure that victim restitution and child support are withheld and paid to the appropriate agencies

Section 353-22.6, HRS, assigns responsibility to the department to enforce victim restitution orders on wages earned by inmates while incarcerated. The department should withhold 10 percent from the prisoner's annual earnings and should pay the amount withheld to the victim. Despite the law, five out of the eight facilities failed to garnish any inmate earnings for restitution. Only the Halawa Correctional Facility, Waiawa Correctional Facility, and Oahu Community Correctional Center withheld inmate earnings for restitution payments. Furthermore, out of a sample of 20 inmates from the three facilities, earnings for one inmate had not been withheld for over ten years. Although 10 percent of the inmate's earnings should have been garnished since February 1990 in accordance with a court order, the department only recently discovered the error and began deducting the 10 percent in June 2001. Additionally, the department does not plan to garnish an estimated $400-$500 from the inmate's wages earned between February 1990 and May 2001. Departmental personnel informed us that there may be other similar situations, but they could not estimate the number of such instances.

As of June 30, 2001, the department had withheld restitution from 260 inmates totaling approximately $19,500. Of this amount, $17,000 has not been remitted to the Judiciary for payment to the victims. Approximately $5,000 of the amount was withheld in the fiscal year ended June 30, 2001. The department currently does not have procedures in place to identify and remit withheld restitution. The current practice is to remit restitution to the Judiciary upon inmate release, parole, or transfer between facilities. There have been instances where restitution payments made to the Judiciary were remitted back to the department because the Judiciary was not able to locate the victim. These payments were credited back to the inmates' accounts.

In addition, facility and fiscal staff informed us that the department does not have procedures in place to identify inmates subject to court-ordered, child support. The department only withholds and remits child support to the Child Support Enforcement Agency (CSEA) when instructed by the inmate. Court orders regarding child support are sent directly to the inmate by CSEA instead of to the department. CSEA will only contact the employer of the individual responsible for child support payments or the individual himself. CSEA does not consider the department to be the inmates' employer and, as such, will not send court orders regarding child support to the department.

Basic internal controls and procedures need to be improved

The department has not implemented basic internal controls and procedures to identify and monitor inmates subject to court-ordered, victim restitution and child support, such as compiling and updating a complete listing of all inmates subject to these court orders. Currently, the department receives the court order for restitution upon imprisonment of the inmate and enters the information into the system. As noted earlier, it is possible the department may misplace or not be provided with the court order; may incorrectly enter or fail to enter the restitution information; or may not update the system when inmates are transferred between facilities.

Recommendations

We recommend that the department:

1. Immediately reconcile inmate trust accounts to bank balances.

    a. Assign responsibility for developing policies and procedures on reconciling the inmate trust bank account to personnel able to perform bank reconciliations and who are knowledgeable about the ITA system.

2. Identify inactive inmate accounts outstanding over 180 days and remit the balances to the Department of Budget and Finance.

3. Develop and implement a system whereby all court-ordered, victim restitution and child support are identified and remitted to the proper agencies on a quarterly or semi-annual basis.

    a. Obtain on a monthly or quarterly basis a list from the Judiciary and the CSEA of all inmates subject to court-ordered restitution and child support and update department records to ensure completeness and accuracy. For any inmates identified with court orders dating back to previous periods and whose wages have yet to be garnished for restitution and child support, the department should calculate and remit the amounts related to those previous periods to the appropriate agencies.

    b. Clarify with CSEA and the Department of the Attorney General whether child support orders can be sent directly to the department. If possible, the department should obtain these orders upon imprisonment of the inmate and enter the information into its system.

The Department Is Unable to Substantiate the Cost Basis of Its General Fixed Assets and Is Unable to Reconcile the Fixed Assets Reported by the Internal Service Fund to the Annual Physical Inventory of Property

The department was unable to provide documentation to support the reported value of its fixed assets amounting to $134 million. Invoices supporting the cost of the fixed assets, especially for older fixed assets, were not readily available. As a result, we were unable to determine if the reported fixed assets balance was fairly presented in all material respects. This will be extremely important to the department in fiscal year ending June 30, 2002, when the department will be required by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* to present financial statements similar to business type organizations, including the computation of depreciation expense for its fixed assets.

Also, the amount of fixed assets reported in the internal service fund on June 30, 2001, exceeded the amount reported on the Annual Inventory Report of Property by approximately $473,000.

If the department is unable to substantiate the cost basis of its general fixed assets and is unable to reconcile the fixed assets posted in its internal service fund to the annual physical inventory of property, the department will not be able to comply with the requirements of GASB Statement No. 34. The department's external auditor will therefore be unable to issue an unqualified opinion on the financial statements and would have to qualify, disclaim, or issue an adverse opinion.

Recommendation

We recommend that the department immediately obtain documentation to support the reported cost basis of all fixed assets, or if this information is not available, obtain other information to support the assets value, such as replacement cost estimates. The department should reconcile the Annual Inventory Report of Property to the financial statements.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Department of Public Safety, State of Hawaii (department), as of and for the fiscal year ended June 30, 2001. This chapter includes the independent auditors' report and the report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards* as they relate to the department. It also displays the combined financial statements of all fund types and account groups administered by the department together with explanatory notes.

Summary of Findings

In the opinion of KPMG LLP, based on their audit, except for the general fixed assets account group, the combined financial statements present fairly, in all material respects, the financial position of the department as of June 30, 2001, and the results of its operations and the cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America. KPMG LLP noted certain matters involving the department's internal control over financial reporting and its operations that the firm considered to be reportable conditions. KPMG LLP also noted that the results of its tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Independent Auditors' Report

The Auditor
State of Hawaii:

We have audited the accompanying combined financial statements of the Department of Public Safety, State of Hawaii (department), as of and for the year ended June 30, 2001. These combined financial statements are the responsibility of the department's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

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

The department has not maintained adequate records to support the amounts reported in the general fixed assets account group. It was impracticable to extend our procedures sufficiently to determine the extent to which the general fixed assets account group as of June 30, 2001 may have been affected by this condition. The assets and other credit in the general fixed assets account group amounted to $133,961,310 as of June 30, 2001.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to the amounts reported in the general fixed assets account group, as discussed in the preceding paragraph, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Department of Public Safety, State of Hawaii, as of June 30, 2001, and the results of its operations and the cash flows of its proprietary fund type for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1, the combined financial statements of the department are intended to present the financial position, results of operations and cash flows of only that portion of the funds and account groups of the State of Hawaii that is attributable to the transactions of the department.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2001 on our consideration of the department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Honolulu, Hawaii
November 30, 2001

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

The Auditor
State of Hawaii:

We have audited the combined financial statements of the Department of Public Safety, State of Hawaii (department), as of and for the fiscal year ended June 30, 2001, and have issued our report thereon dated November 30, 2001. Since we were not able to apply auditing procedures to satisfy ourselves as to the amounts reported in the general fixed assets account group, the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the general fixed assets account group as of June 30, 2001.

Except as discussed in the preceding paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether the department's combined financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes) and procurement rules, directives, and circulars, noncompliance with which could have a direct and material effect on the determination of combined financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in Chapter 2 of this report.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over financial reporting that, in our judgment, could adversely affect the department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the combined financial statements. Reportable conditions are described in Chapter 2 of this report.

A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the combined financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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

Honolulu, Hawaii
November 30, 2001

Description of Combined Financial Statements

The following is a brief description of the combined financial statements audited by KPMG LLP, which are located at the end of this chapter.

Combined Balance Sheet– All Fund Types and Account Groups (Exhibit A). This statement presents the assets, liabilities, and fund balances of all fund types and account groups of the department at June 30, 2001.

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances – All Governmental Fund Types and Expendable Trust Funds (Exhibit B). This statement presents the revenues, expenditures, and changes in fund balances for all governmental fund types and expendable trust funds of the department for the fiscal year ended June 30, 2001.

Combined Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – General and Special Revenue Fund Types (Exhibit C). This statement compares actual revenues and expenditures of the department's general and special revenue funds on a budgetary basis to the budget adopted by the State of Hawaii (State) Legislature for the fiscal year ended June 30, 2001.

Statement of Revenues, Expenses, and Changes in Retained Earnings – Proprietary Fund Type (Exhibit D). This statement presents the revenues, expenses, and changes in retained earnings for the proprietary fund type of the department for the fiscal year ended June 30, 2001.

Statement of Cash Flows – Proprietary Fund Type (Exhibit E). This statement presents the cash flows from operating and capital and related financing activities for the proprietary fund type of the department for the fiscal year ended June 30, 2001.

Notes to Combined Financial Statements

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

Note 1 – Financial Reporting Entity

Effective July 1, 1990, Act 281, Session Laws of Hawaii (SLH) 1990, created the department. This act transferred to the department, the administration of the state correctional facilities and related services formerly administered by the state Department of Corrections. This act also transferred to the department on July 1, 1990, all functions and powers to administer the Sheriff's Office – formerly administered by the state Judiciary, and the Narcotics Enforcement Division – formerly administered by the state Department of the Attorney General.

The department is part of the executive branch of the State. The department's combined financial statements reflect only its portion of the funds and account groups. The state comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which includes the department's financial activities.

The accompanying combined financial statements reflect the financial position, results of operations, and cash flows of the following offices, divisions, and administratively attached agencies of the department:

Office of the Deputy Director for Administration – Administration includes management, accounting, data processing, and other administrative services provided by the department. Also included in administration are activities related to certain federal financial assistance programs. Its operations are reported in both the general and special revenue funds.

Office of the Deputy Director for Law Enforcement – Law enforcement assists in guarding state property and facilities, preserving the peace and protecting the public in designated areas, and serving process papers in civil and criminal proceedings. Included in law enforcement are the Protective Services, Narcotics Enforcement, and

Sheriff Divisions, and the Executive Protection Section. Its operations are reported in both the general and special revenue funds.

Community Correctional Centers Division – This division operates the state community correctional centers. Its public safety mission includes the confinement, care, supervision, rehabilitation, and release of persons committed to those facilities. Its operations are reported in both the general and trust and agency funds.

Correctional Facilities Division – This division operates the state correctional facilities other than the state community correctional centers. Its public safety mission includes the confinement, care, supervision, rehabilitation, and release of persons committed to those facilities. Its operations are reported in both the general and trust and agency funds.

Inmate Stores – The inmate stores are operated by the department within the Community Correctional Centers and Correctional Facilities Divisions. The department contracts with an outside vendor to provide consumer goods for sale to the inmate population. The stores' operations are reported in the special revenue fund.

Intake Service Centers Division – This division provides service delivery coordination to the state's criminal justice agencies through intake, assessment, program services, and administrative functions. Its operations are reported in both the general and special revenue funds.

Corrections Program Services Division – This division develops operational guidelines and standards and provides technical and administrative support and assistance to all correctional facilities for the effective and efficient conduct of programs and services. It also assists in coordinating and maintaining oversight of institutional operations, programs, and services. Its operations are reported in both the general and special revenue funds.

Health Care Division – This division develops and maintains a program of health care services involving both in-house and community resources (public health, contract, and volunteer) for all correctional facilities. It also oversees the operation of such services to ensure adherence to contemporary standards and fiscal responsibility, uniformity of quality health care, and integration/coordination among health care providers. Its operations are reported in the general fund.

Correctional Industries Division – This division employs inmates who receive employment training and who provide printing, sewing, construction, and miscellaneous services to other operations of the department or other state agencies. Its operations are reported in the internal service fund.

Crime Victims Compensation Commission (administratively attached to the department) – This commission assists victims of criminal acts by providing compensation to victims or survivors of deceased victims of certain crimes. Its operations are reported in the special revenue fund.

Hawaii Paroling Authority (administratively attached to the department) – This authority is a quasi-judicial body that establishes minimum terms of imprisonment, considers requests for parole, and provides supervision for those granted parole. Its operations are reported in the general fund.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation

The financial transactions of the department are recorded in individual funds and account groups, reported by type in the combined financial statements, and described in the following sections. Each fund and account group is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, retained earnings, revenues, and expenditures or expenses. Account groups are used to establish accounting control and accountability for the department's general fixed assets and general long-term debt. Account groups are not funds as they do not reflect available financial resources and related liabilities. Financial resources are allocated to and are accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

Governmental Fund Types

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

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

Capital Projects Fund – The capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Proprietary Fund Type

Internal Service Fund – The internal service fund accounts for the financing of goods or services provided by this fund to other funds of the department or to other state agencies, on a cost-reimbursement basis.

Fiduciary Fund Type

Trust and Agency Funds – Trust and agency funds are used to account for assets held by the department in a trustee or agency capacity. These include expendable trust funds that account for cash collected and expended by the department as trustee and agency funds that account for the receipts and disbursements of various amounts collected by the department in a custodial capacity.

Account Groups

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

General Long-Term Debt Account Group – The obligation for the long-term portion of accrued vested vacations and compensatory time is recorded in the general long-term debt account group.

Basis of Accounting

Governmental Fund Types and Expendable Trust and Agency Funds – The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the combined 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 department uses the modified accrual basis of accounting for the general, special revenue, capital projects, 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 fiscal 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 fiscal year-end to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include federal grants and funds appropriated by the State Legislature and allotted by the governor. Expenditures are generally recorded when the related fund liabilities are incurred.

Proprietary Fund Type – The proprietary fund type, the internal service fund, is accounted for on the flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of this fund are included on the combined balance sheet. Proprietary fund-type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The accounts of the propriety fund type are reported under the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded when they are incurred. The department applies all Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued on or before November 30, 1989.

Use of Estimates

The preparation of combined financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenditures or expenses during the reporting period. Actual results could differ from those estimates.

Appropriations

Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.

Encumbrances

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

Accumulated Vacation and Sick Leave

Employees' vested annual vacation and sick leave are recorded as expenditures when actually taken. The employees of the department are entitled to receive cash payment for accumulated vacation leave upon termination. The liability for such accumulated vacation leave pay and related payroll taxes is not reflected in the governmental funds, but is reflected in the general long-term debt account group. Sick leave is not convertible to pay upon termination of employment and is recorded as an expenditure when taken.

Intrafund and Interfund Transactions

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

Receivables

Receivables in the general fund represent amounts due from individuals for whom salaries were overpaid by the department. Receivables in the internal service fund consist primarily of amounts due from other state agencies for services provided to those agencies on a cost-reimbursement basis.

Inventories

Inventory of goods, materials, and supplies is valued at cost (first-in, first-out method). Inventory in the internal service fund consists primarily of printing, construction, sewing, and computer supplies to be used in the correctional industries program.

Net Property, Plant, and Equipment

Property, plant, and equipment reported in the general fixed assets account group are recorded at cost. Those assets were acquired or constructed for general governmental purposes and were reported as expenditures in the funds that financed the assets at acquisition. No depreciation is provided on those assets.

Property, plant, and equipment reported in the internal service fund are recorded at cost, net of accumulated depreciation. Depreciation of equipment has been provided using the straight-line method over a five-year estimated useful life of the related assets. Capital improvements have been depreciated over a 40-year estimated useful life.

Due to Individuals

Due to individuals represents assets held by the department primarily in a trustee capacity for the inmate population.

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.

Risk Management

The department is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the combined financial statements and the amount of the loss is reasonably estimable.

Total Columns on the Combined Financial Statements

The total columns are captioned Memorandum Only to indicate that they are presented only to facilitate financial analysis. Data in those columns do not present financial position, results of operations, or cash flows in conformity with GAAP. Neither is such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

Note 3 – Budgeting and Budgetary Control

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues in the combined statement of revenues and expenditures – budget and actual (budgetary basis) – general and special revenue fund types are those estimates as compiled by the department. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various SLH.
To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

Summarization of the budgets adopted by the State Legislature for the "budgetary" general and special revenue funds is presented in the combined statement of revenues and expenditures – budget and actual (budgetary basis) – general and special revenue fund types. For purposes of budgeting, the department's budgetary fund structure and accounting principles differ from those utilized to present the combined financial statements in conformity with GAAP. The department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase order and contract obligations, (2) the recognition of certain receivables, and (3) special revenue fund program grant accruals and deferrals. These differences represent a departure from GAAP. The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2001:

	General	Special Revenue
Excess (deficiency) of revenues and other sources over expenditures and other uses – actual on a budgetary basis	$ (1,735,106)	$ 424,639
Reserved for encumbrances at fiscal year-end	5,371,833	399,180
Reserved for receivables	1,169,426	—
Expenditures for liquidation of prior fiscal year encumbrances	(7,944,242)	(198,172)
Net change in unreserved liabilities	(43,765)	(80,825)
Net adjustment for commissary revenue accrual	—	(31,805)
Net adjustment for grant accruals	—	28,021
Excess (deficiency) of revenues and other sources over expenditures and other uses – GAAP basis	$ (3,181,854)	$ 541,038

Note 4 – Cash

Cash consisted of the following as of June 30, 2001:

Cash in State Treasury	$ 15,129,406
Cash in banks	994,561
Cash on hand	23,950
	$ 16,147,917

The state Director of Finance is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). The state Director of Finance is authorized to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with State statutes. Deposits not covered by federal deposit insurance are fully collateralized by government securities held either by the State Treasury or by the State's fiscal agents in the name of the State.

The department also maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2001, the carrying amount of total bank deposits was approximately $994,561, and the corresponding bank balance was approximately $1,233,683.

Note 5 – Receivables

Receivables of the department, net of an allowance for doubtful accounts, consisted of the following at June 30, 2001:

	General	Internal Service
Salary overpayments	$ 1,767,426	$ —
Accounts receivable	—	898,892
	1,767,426	898,892
Less allowance for doubtful accounts	(598,000)	(35,400)
	$ 1,169,426	$ 863,492

Note 6 – Net Property, Plant, and Equipment

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

	Land and land improvements	Buildings and improvements	Equipment	Total
Balance at July 1, 2000	$ 107,570	$ 114,917,042	$ 16,776,271	$ 131,800,883
Reclassification of land improvements	1,881,923	(1,881,923)	—	—
Additions	16,342	875,000	2,317,558	3,208,900
Deductions	—	(24,570)	(1,023,903)	(1,048,473)
Balance at June 30, 2001	$ 2,005,835	$ 113,885,549	$ 18,069,926	$ 133,961,310

Net property, plant, and equipment in the internal service fund at June 30, 2001, consisted of the following:

Buildings, improvements, equipment, furniture, and fixtures	$	2,093,814
Less accumulated depreciation		(1,848,750)
		245,064
Leased equipment under capital leases, less accumulated amortization of $228,563		377,441
	$	622,505

Note 7 – General Long-Term Debt

The general long-term debt account group is used to account for the long-term portion of the obligation for accrued vested vacation and compensatory time. The obligation changed during the fiscal year ended June 30, 2001, as follows:

Balance at July 1, 2000	$	13,756,819
Net decrease		(620,545)
Balance at June 30, 2001	$	13,136,274

Note 8 – Non-Imposed Employee Fringe Benefits

Payroll fringe benefit costs of the department's employees funded by state appropriations (general fund) are assumed by the State and are not charged to the department's operating funds. These costs, totaling $18,939,403, for the fiscal year ended June 30, 2001, have been reported as revenues and expenditures of the department's general fund.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the department's special revenue fund.

Note 9 – Fund Balance Deficits

The general fund had a deficit in the unreserved fund balance at June 30, 2001, of $3,179,907. The deficit resulted primarily from reservations of the fund balance for encumbrances and receivables.

Note 10 – Changes in Assets and Liabilities of the Agency Fund

The agency fund is purely custodial in nature (assets equal liabilities) and thus does not involve the measurement of results of operations. The changes in assets and liabilities of the agency fund for the fiscal year ended June 30, 2001, were as follows:

	Balance July 1, 2000, as restated (note 15)	Additions	Deductions	Balance June 30, 2001
Assets	$ 2,587,146	$ 6,822,464	$ 7,261,132	$ 2,148,478
Liabilities	$ 2,587,146	$ 6,822,464	$ 7,261,132	$ 2,148,478

Note 11 – Lease Commitments

Capital Leases

The department's Correctional Industries Division has long-term equipment leases expiring through August 2004 that are accounted for as capital leases in the internal service fund. These leased equipment are amortized using the straight-line method over the estimated useful life of the equipment. The amortization is included in depreciation and amortization expense of the internal service fund and amounted to approximately $102,700 for the fiscal year ended June 30, 2001.

At June 30, 2001, the future minimum lease payments and the present value of net minimum lease payments (obligations under capital leases) were as follows:

Fiscal year ending June 30:	
2002	$ 154,698
2003	140,401
2004	90,621
2005	8,338
Total minimum lease payments	394,058
Less amounts representing interest at 3.45% – 10.47%	(41,277)
Present value of minimum lease payments	$ 352,781

Operating Leases

The department leases equipment on a long-term basis that are reported in the general and internal service funds. As of June 30, 2001, future minimum rentals on noncancelable operating leases are as follows:

Fiscal year ending June 30:	
2002	$ 230,000
2003	139,000
2004	122,000
2005	82,000
2006	27,000
	$ 600,000

Total rent expense for the fiscal year ended June 30, 2001, was approximately $349,000.

Note 12 – Retirement Benefits

Employees' Retirement System

All eligible employees of the department are required by Chapter 88, Hawaii Revised Statutes (HRS), 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. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii, 96813.

Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service for the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

Covered employees of the contributory option are required to contribute 7.8 percent or 12.2 percent of their salary. The department is required to contribute to both options at an actuarially determined rate. Measurement of assets and actuarial valuations are made for the entire ERS and are not separately computed for individual participating employers such as the department. Contributions by the department for the fiscal years ended June 30, 2001, 2000, and 1999, were approximately $71,000, $164,000, and $113,000, respectively, which were equal to the required contributions for each fiscal year.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all employees who retire from the department on or after attaining age 62 with at least ten years of service or age 55 with at least 30 years of service under the noncontributory option and age 55 with at least five years of service under the contributory option. Retirees credited with at least ten years of service, excluding sick leave credit, qualify for free medical insurance premiums; however, retirees with less than ten years of service must assume a portion of the monthly premiums. All disability retirees who retired after June 30, 1984, with less than ten years of service, also qualify for free medical insurance premiums. Free life insurance coverage for retirees and dental coverage for dependents under age 19 are also available. Retirees 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. The department's general fund share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2001, has not been separately computed and is not reflected in the department's combined financial statements. The department's special revenue fund share of the post-retirement health care and life insurance benefits expenditure for the fiscal year ended June 30, 2001, was approximately $198,000, and is included in the department's special revenue funds' expenditures.

Note 13 – Risk Management

The department is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally retains the first $250,000 per occurrence of property losses and the first $2 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is $100 million ($50 million for earthquake and flood), and the annual aggregate for general liability losses per occurrence is $50 million. The State is generally self-insured for workers' compensation and automobile claims. The estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year-end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the combined financial statements and the amount of the loss is reasonably estimable.

Note 14 – Commitments and Contingencies

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, an employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2001, amounted to approximately $19,510,000.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors and from diversion to any uses other than paying benefits to participants and beneficiaries. The department has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Therefore, in accordance with Governmental Accounting Standards Board Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, deferred compensation plan assets are not reported in the accompanying combined financial statements.

Note 15 – Prior Period Adjustment

The department's expendable trust fund balance at June 30, 2000 has been restated to record certain acquisitions of law enforcement equipment as agency transactions. In previous years, cash receipts and disbursements for these transactions were recorded in the expendable trust fund as revenues and expenditures. The effect of recording this prior period adjustment was to (1) decrease previously reported assets and fund balance of the expendable trust fund and (2) increase the assets and liabilities of the agency fund at June 30, 2000, by $1,380,065 as follows:

	Expendable Trust Fund	Agency Fund
Balance at June 30, 2000, as previously reported	$ 1,663,105	$ 1,207,081
Adjustment	(1,380,065)	1,380,065
Balance at June 30, 2000, as restated	$ 283,040	$ 2,587,146

Exhibit A

DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII

Combined Balance Sheet – All Fund Types and Account Groups

June 30, 2001

	Governmental Fund Types			Proprietary Fund Type	Fiduciary Fund Types	Account Groups		
Assets	**General**	**Special Revenue**	**Capital Projects**	**Internal Service**	**Trust and Agency**	**General Fixed Assets (Unaudited)**	**General Long-Term Debt**	**Totals (Memorandum Only)**
Cash (note 4)	$ 10,110,781	$ 2,910,497	$ 297,510	$ 398,477	$ 2,430,652	$ —	$ —	$ 16,147,917
Receivables, net (note 5)	1,169,426	—	—	863,492	—	—	—	2,032,918
Due from other funds	—	224,158	—	51,232	95,493	—	—	370,883
Due from others	—	75,264	—	—	—	—	—	75,264
Due from State of Hawaii	913,205	—	—	—	—	—	—	913,205
Inventories	—	—	—	531,907	—	—	—	531,907
Net property, plant, and equipment (note 6)	—	—	—	622,505	—	133,961,310	—	134,583,815
Amount to be provided for retirement of general long-term debt	—	—	—	—	—	—	13,136,274	13,136,274
Total assets	$ 12,193,412	$ 3,209,919	$ 297,510	2,467,613	$ 2,526,145	$ 133,961,310	$ 13,136,274	$ 167,792,183
Liabilities and Fund Equity and Other Credit								
Liabilities:								
Vouchers payable	$ 3,631,855	$ 41,416	$ —	$ 525,433	$ 28,013	$ —	$ —	$ 4,226,717
Accrued wages and employee benefits payable (note 7)	5,071,798	136,597	—	82,106	—	—	13,136,274	18,426,775
Due to other funds	128,407	454	—	17,864	224,158	—	—	370,883
Due to individuals	—	—	—	—	924,656	—	—	924,656
Due to others	—	—	—	—	1,058,424	—	—	1,058,424
Capital lease obligations (note 11)	—	—	—	352,781	—	—	—	352,781
Deferred revenues	—	163,299	250	312,249	—	—	—	475,798
Total liabilities	8,832,060	341,766	250	1,290,433	2,235,251	—	13,136,274	25,836,034
Fund equity and other credit:								
Investment in general fixed assets	—	—	—	—	—	133,961,310	—	133,961,310
Retained earnings	—	—	—	1,177,180	—	—	—	1,177,180
Fund balances:								
Reserved for encumbrances	5,371,833	399,180	—	—	3,207	—	—	5,774,220
Reserved for future appropriations	—	—	297,260	—	—	—	—	297,260
Reserved for receivables	1,169,426	—	—	—	—	—	—	1,169,426
Unreserved (note 9)	(3,179,907)	2,468,973	—	—	287,687	—	—	(423,247)
Total fund equity and other credit	3,361,352	2,868,153	297,260	1,177,180	290,894	133,961,310	—	141,956,149
Total liabilities and fund equity and other credit	$ 12,193,412	$ 3,209,919	$ 297,510	$ 2,467,613	$ 2,526,145	$ 133,961,310	$ 13,136,274	$ 167,792,183

See accompanying notes to combined financial statements.

Exhibit B

DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances
– All Governmental Fund Types and Expendable Trust Funds

Fiscal year ended June 30, 2001

	Governmental Fund Types			Fiduciary Fund Type	Totals
	General	Special Revenue	Capital Projects	Expendable Trust	(Memorandum Only)
Revenues:					
State allotted appropriations, net of lapses	$ 131,608,092	$ —	$ —	$ —	$ 131,608,092
Intergovernmental	—	995,349	107,257	—	1,102,606
Interest	—	—	—	24,906	24,906
Other (note 8)	18,939,403	3,204,553	—	18,293	22,162,249
	150,547,495	4,199,902	107,257	43,199	154,897,853
Expenditures:					
Confinement	111,244,359	681,598	—	—	111,925,957
Enforcement	10,217,712	2,224,776	—	—	12,442,488
Parole supervision and counseling	2,314,362	—	—	—	2,314,362
Criminal injuries compensation	—	1,629,515	—	—	1,629,515
General support – criminal action	28,781,243	—	—	—	28,781,243
Capital outlay	—	—	107,257	—	107,257
Other	—	—	—	35,345	35,345
	152,557,676	4,535,889	107,257	35,345	157,236,167
Excess (deficiency) of revenues over expenditures	(2,010,181)	(335,987)	—	7,854	(2,338,314)
Other financing sources (uses):					
Operating transfers in	—	877,025	—	—	877,025
Operating transfers out	(1,171,673)	—	—	—	(1,171,673)
	(1,171,673)	877,025	—	—	(294,648)
Excess (deficiency) of revenues and other sources over expenditures and other uses	(3,181,854)	541,038	—	7,854	(2,632,962)
Fund balances at July 1, 2000, as restated (note 15)	6,543,206	2,327,115	297,260	283,040	9,450,621
Fund balances at June 30, 2001	$ 3,361,352	$ 2,868,153	$ 297,260	$ 290,894	$ 6,817,659

See accompanying notes to combined financial statements.

DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII

Combined Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
General and Special Revenue Fund Types

Fiscal year ended June 30, 2001

	General Fund			Special Revenue Funds			Totals (Memorandum Only)		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
Revenues:									
State allotted appropriations, net of lapses	$ 135,394,505	$ 131,608,092	$ (3,786,413)	$ —	$ —	$ —	$ 135,394,505	$ 131,608,092	$ (3,786,413)
Intergovernmental	—	—	—	1,963,296	953,870	(1,009,426)	1,963,296	953,870	(1,009,426)
Other	—	—	—	6,470,716	3,176,367	(3,294,349)	6,470,716	3,176,367	(3,294,349)
	135,394,505	131,608,092	(3,786,413)	8,434,012	4,130,237	(4,303,775)	143,828,517	135,738,329	(8,090,188)
Expenditures:									
Confinement	95,958,932	94,649,832	1,309,100	2,956,198	863,560	2,092,638	98,915,130	95,513,392	3,401,738
Enforcement	8,946,081	8,813,837	132,244	3,370,839	2,105,454	1,265,385	12,316,920	10,919,291	1,397,629
Parole supervision and counseling	2,079,302	2,022,213	57,089	—	—	—	2,079,302	2,022,213	57,089
Criminal injuries compensation	—	—	—	2,984,000	1,613,609	1,370,391	2,984,000	1,613,609	1,370,391
General support – criminal action	27,533,165	26,685,643	847,522	—	—	—	27,533,165	26,685,643	847,522
	134,517,480	132,171,525	2,345,955	9,311,037	4,582,623	4,728,414	143,828,517	136,754,148	7,074,369
Excess (deficiency) of revenues over expenditures	877,025	(563,433)	(1,440,458)	(877,025)	(452,386)	424,639	—	(1,015,819)	(1,015,819)
Other financing sources (uses):									
Operating transfers in	—	—	—	877,025	877,025	—	877,025	877,025	—
Operating transfers out	(877,025)	(1,171,673)	(294,648)	—	—	—	(877,025)	(1,171,673)	(294,648)
	(877,025)	(1,171,673)	(294,648)	877,025	877,025	—	—	(294,648)	(294,648)
Excess (deficiency) of revenues and other sources over expenditures and other uses	$ —	$ (1,735,106)	$ (1,735,106)	$ —	$ 424,639	$ 424,639	$ —	$ (1,310,467)	$ (1,310,467)

See accompanying notes to combined financial statements.

Exhibit D

DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII

Statement of Revenues, Expenses, and
Changes in Retained Earnings – Proprietary Fund Type

Fiscal year ended June 30, 2001

Operating revenues – charges for sales and services			$	4,999,860
Operating expenses:				
Cost of sales and services	$	4,693,668		
Depreciation and amortization (note 11)		184,391		
Provision for uncollectible accounts		13,300		
				4,891,359
Operating income				108,501
Nonoperating expense – interest				(31,928)
Net income				76,573
Retained earnings at July 1, 2000				1,100,607
Retained earnings at June 30, 2001			$	1,177,180

See accompanying notes to combined financial statements.

Exhibit E

DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII

Statement of Cash Flows – Proprietary Fund Type

Fiscal year ended June 30, 2001

Cash flows from operating activities:		
Operating income		$ 108,501
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	$ 184,391	
(Increase) decrease in:		
Receivables	(243,328)	
Due from other funds	68,150	
Inventories	(268,161)	
Increase (decrease) in:		
Vouchers payable	(128,009)	
Accrued wages and employee benefits payable	129	
Due to other funds	(3,376)	
Deferred revenues	312,249	
Total adjustments		(77,955)
Net cash provided by operating activities		30,546
Cash flows from capital and related financing activities:		
Acquisition of property and equipment	(38,256)	
Principal payments on capital lease obligations	(114,431)	
Interest paid	(31,928)	
Net cash used in capital and related financing activities		(184,615)
Net decrease in cash		(154,069)
Cash at July 1, 2000		552,546
Cash at June 30, 2001		$ 398,477
Supplemental schedule of noncash capital and financing activities – acquisition of equipment under capitalized leases		$ 172,171

See accompanying notes to combined financial statements.

Notes

Chapter 2

1. The U.S. Bureau of Labor Statistics, "Current Population Survey 2000 Annual Averages."

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Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Public Safety (department) on April 25, 2002. A copy of the transmittal letter to the department is included as Attachment 1. The response of the department is included as Attachment 2.

The department responded that it appreciates that we recognized the work that has been done in its specific problem areas; however, the department believes that the report paints an incomplete and unfair picture. Yet the department has accepted several of our recommendations.

The department believes that our report oversimplifies the problems that exist with overtime. The department reports that "all seven-day-per-week, 24-hour-per-day operations will incur some level of overtime because no matter what the circumstance, staff must provide a certain level of coverage to maintain security and safety." The department notes that some facilities, especially the Women's Community Correctional Center and the Hawaii Community Correctional Center, have special challenges such as gender-specific posts and inmate transportation issues. While these examples may be relevant, overtime costs at 13 percent of total salary expense are still unacceptable and the department must continue to work on improving the overtime incurred.

Concerning our finding regarding the alleged sick leave abuse at the Waiawa Correctional Center and the Women's Community Correctional Center, the department's response is misdirected. It was the department's own staff who stated that the alleged abuse was not investigated because no clear evidence existed. But if an investigation is not made into the allegations, how can the department make the determination that "no clear evidence" exists? The allegations that sick leave was used when employees were denied vacation leave and that employees used sick leave time to care for their children during breaks from school could have been easily researched. We stand by our recommendation that any apparent abuse of sick leave should be investigated in a timely manner.

The department has stated that it is unfair to compare ACOs' levels of sick leave usage with that of other state agencies and national averages. We understand the department's concerns with the comparison; however, an average of 27 sick leave days taken during the fiscal year ended June 30, 2001 for all uniformed staff, which includes ACOs and medical and food service staff, is extremely high. The average of 27 sick leave days taken is more than twice the national average of 12 for all government employees, as stated in our report. It is also higher than the 21 days of sick leave days per year earned by employees hired before July 2001, which the department has stated is a "very liberal leave policy." Once again, we stand by our finding that the continued unusual sick leave patterns and the high levels of sick leave usage raise doubts about the effectiveness of the department's sick leave abuse program.

The department states that our report implies that "three ACOs had high overtime despite poor attendance records." This is an incorrect statement. Our report does not make that implication. Our report identifies two different samples used to test overtime and sick leave. The overtime sample consisted of 21 ACOs, two food service staff, and two medical staff. The sick leave sample consisted of 22 ACOs and three food service staff. Also, for the three individuals with overtime compensation greater than their base compensation, our report does not identify whether they are ACOs, food service staff, or medical staff.

The department disagrees that "[t]he delays in collection experienced by the department are unacceptable." The department further discusses what it has done to mitigate the salary overpayment problem. While we commend the department for its efforts, the fact remains that as of June 30, 2001, $1.8 million in salary overpayments remained uncollected. We understand the difficulties involved in the process, but consider $1.8 million a significant amount. The longer the balances remain outstanding, the more difficult it becomes to collect on them.

ATTACHMENT 1

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

MARION M. HIGA
State Auditor

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

April 25, 2002

COPY

The Honorable Ted Sakai
Director
Department of Public Safety
919 Ala Moana Boulevard
Honolulu, Hawaii 96814

Dear Mr. Sakai:

Enclosed for your information are three copies, numbered 6 to 8 of our confidential draft report, *Financial Audit of the Department of Public Safety.* We ask that you telephone us by Friday, April 26, 2002, 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 Tuesday, April 30, 2002.

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

ATTACHMENT 2

BENJAMIN J. CAYETANO
GOVERNOR

STATE OF HAWAII
DEPARTMENT OF PUBLIC SAFETY
919 Ala Moana Boulevard, 4th Floor
Honolulu, Hawaii 96814

TED SAKAI
DIRECTOR

PAULINE N. NAMUO
Deputy Director
Administration

MARIAN E. TSUJI
Deputy Director
Corrections

SIDNEY A. HAYAKAWA
Deputy Director
Law Enforcement

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

May 1, 2002

Ms. Marion Higa
State Legislative Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Ms. Higa:

Thank you for the opportunity to respond to the draft of the Financial Audit of the Department of Public Safety. The issues addressed in your report such as overtime, overpayments, and the inmate trust accounting systems are highly complex problems that have plagued the Department for many years. There are no easy explanations or solutions to these problems. Our Department appreciates any constructive input that your office has to offer.

I am pleased to report that the Department has made significant progress towards financial accountability and your audit report affirms this. The Department has significantly reduced both overtime expenditures and overpayments. As your report points out, the overtime costs for our correctional facilities decreased from $9.8 million in FY1999 to $7.6 million in FY2000. We're pleased to report that in FY2001, overtime expenditures dropped again, to $7.37 million. In fact, the net decrease in overtime expenditures from FY1999 is even more dramatic than implied by these statistics because during this period, the base salaries for adult corrections officers increased by about 10%-20%--a point that the audit report did not mention.

In addition, your report states that the outstanding balance of salary overpayments decreased from $2 million in June 2000 to $1.8 million in June 2001. When you consider that in June 1999, the overpayment balance was over $2.3 million, the total reduction in overpayments is significant.

We are pleased that your report points out these improvements. However, we must respond on some of the specific findings and conclusions contained in the report, because they do not accurately reflect a full understanding of the issues.

Overtime Driven by Sick Leave and Vacancies

Your report states that overtime is driven by sick leave and vacancies. This is a gross oversimplification. Overtime in correctional facilities is a highly complex matter that is driven by the interplay of a myriad of factors.

In 1999, we implemented new reporting systems designed to improve accountability among our managers. One of our initial goals was to institute controls on overtime spending. We identified more than 20 factors that cause overtime, and sick leave is just one of them. These factors can be grouped in two major categories. The first group includes factors that impact on the number of employees available to work on any given shift. These include sick leave, vacancies, vacation, workers' compensation, maternity leave, and military leave.

The second group involves the number of posts that must be filled over and beyond the regular posts found on the established schedule. The special duty posts are temporary and unforeseen. Often, they arise even after a shift has started. For example, an inmate may be placed on suicide watch, which requires one-on-one supervision by an Adult Correctional Officer (ACO). Or an inmate may be hospitalized, requiring the presence of an ACO at the hospital. Sometimes, there are an unexpected number of inmates who must be transported out of the facility to go to court (we usually do not receive the court calendar until the day before the appearance is required) or to an outside doctor's appointment.

What your report fails to mention, or perhaps, what your staff doesn't know is that all seven-day-per-week, 24-hour-per-day operations will incur some level of overtime because no matter what the circumstance, staff must provide a certain level of coverage to maintain security and safety. Therefore, a sufficient shift-relief factor is also important in controlling overtime costs.

For some facilities, especially the Women's Community Correctional Center (WCCC) and the Hawaii Community Correctional Center (HCCC), controlling overtime presents a special challenge. WCCC historically has had difficulty filling its high number of gender-specific posts. These are posts that can be staffed only by female officers. If a gender specific post is vacant because the designated ACO is absent, then we must find another woman to fill the vacancy, even if that woman will be on overtime, and even if there is a male ACO available on regular time. On the Big Island, the HCCC transports inmates from Hilo to courts in Kona, Waimea, and Puna and Ka'u, as well in Hilo. Because the Sheriff Division is inadequately staffed to cover these courts, HCCC must provide security for inmates who are in court. In other circuits, this duty is turned over to the Sheriff Division. We found that court duty has accounted for about 20% of HCCC's total overtime.

Staffing of Essential Posts

As in your previous report titled, Management and Financial Audit of the Department of Public Safety, you raise the issue of staffing of essential and program posts. Work schedules for ACOs are prepared in accordance with Section 61.04 of the Bargaining Unit 10 Agreement. The work schedule language was negotiated with the United Public Workers and must be followed by the Wardens. The Agreement requires that we identify essential posts, and that we keep these posts filled at all times. On the other hand, the Agreement does provide us with some flexibility with regard to program posts.

As your report notes, we have placed responsibility for control of overtime costs with the Wardens and we've done so because the Wardens have proven that they can fulfill this responsibility. Decisions about whether or not to fill a vacant post, how that post will be filled, and whether overtime will be incurred to fill the post is the responsibility of those directly in charge of post assignments for each watch—the watch commander. Control of overtime, therefore, can only be achieved at the facility level. It is the Wardens' responsibility to ensure that their watch commanders are making appropriate decisions.

Patterns of Absence Due to Sickness Program

The audit report states that the Department's "existing sick leave abuse program is ineffective against the misuse of sick leave." We strongly disagree. The Department took a proactive approach to the problem of sick leave abuse, and worked closely with the United Public Workers to develop and implement the only program in state government that deals with sick leave abuse. The program has been successful in improving the attendance of those employees who have been placed on the program. In fact, the program has been so successful that it is now being implemented statewide, and our staff have been used as consultants to other departments.

We continue to work with the unions to improve the program, but you must understand that sick leave abuse is an extremely difficult allegation to substantiate. As you know, we cannot require substantiation by a doctor unless the employee is on sick leave for five or more consecutive days. On the other hand, if an employee is on sick leave for less than five days, but brings in a doctor's note, we must accept it as substantiation. This is why some employees who appear to have patterns of absence are not placed on the program. They usually are able to substantiate their illness with a doctor's note, and we cannot use that absence as part of the pattern.

The report states that we did not investigate several cases of suspected sick leave abuse at Waiawa and WCCC. Apparently, the Auditors were told that staff took sick leave because vacation was denied, and that staff took sick leave to care for minor children. You further state that "no clear evidence exists" that these reports were true. How do we know that "no clear evidence exists" if an investigation did not take place? If there is "no clear evidence," then can we be expected to take action?

The report further compares ACOs' levels of sick leave usage with that of other state agencies and national averages. This is totally unfair. Corrections present one of the most difficult working environments imaginable. ACOs supervise criminals who are confined against their will. They must deal with this population throughout their workday, in a very confined setting, while always outnumbered. The stress inherent in the job is well documented. There are three major problems with your comparison. First of all, comparing ACOs' sick leave usage to departments who operate on a five-day workweek, with no rotation or shift work, who observe all holidays is a naively unfair comparison. It is akin to comparing apples to oranges. Secondly, the national averages that are cited in your report do not define "protective services." It could include police officers, but it could also include parking lot attendants. It also does not specify whether such data came from public and/or private unionized or non-unionized organizations. And finally, our State government as a whole, has a very liberal leave policy, which allows for 21 days of sick leave per year for staff who were hired before July 2001.

Overtime Compensation

The section of your report titled, "High sick leave usage results in significant overtime costs to the department" raises several issues. First, we are concerned that the sample that you selected to draw your conclusions about the high level of overtime compensation for three Halawa staff members is biased. Your staff obviously picked the worst cases, then generalized your conclusions to include the entire department. That is, you pick out the worst cases, and then conclude that out department's policies and procedures are inadequate because of these worst cases.

One of the conclusions you draw is that "[t]he unusual level of overtime costs indicates that the department's policies and procedures are inadequate." The basis for your conclusion seems to be the fact that when selecting ACOs for overtime work, watch commanders do not take into consideration the amount of overtime that the ACO has already worked. The Department worked with the UPW on the procedures for assigning overtime work on a fair and equitable basis for the larger facilities, Oahu Community Correctional Facility (OCCC) and Halawa Correctional Facility (HCF). For the other facilities, we follow statewide guidelines established by DHRD on assigning overtime work to ensure fairness and equity. We are bound by contract and by policies to follow these procedures. Each ACO is given the opportunity to work overtime. If an ACO passes up on an opportunity, then other ACOs are selected for overtime work. The reality is that there are a number of ACOs who do not want to work overtime, and there are a number of ACOs who seek overtime work. Therefore, it does not surprise us that there are some ACOs who have high overtime compensation. But the important thing is that the overall level of overtime in Hawaii's correctional facilities are in much better control today that ever before.

In your discussion, you imply that three ACOs had high overtime despite poor attendance records. This simply is untrue. Two of the three ACOs had outstanding leave records. The other did use 20 days during the year. However, ten of the twenty days were taken because of an extended illness. You then make a recommendation that we restrict ACOs from working overtime if they called in sick during the previous seven days. We could broach the subject with the union, but if the union does not concur, we will not be able to implement such a policy. Even before we decide to approach the union with such a proposal, however, we will have to determine if such a policy will restrict our flexibility to such an extent that we may not be able to keep essential posts filled.

Finally, we thank you for recognizing the efforts of the Waiawa Warden in reducing overtime at his facility. He has done a great job in managing his workforce. But we note that overtime has also been reduced significantly at OCCC, Halawa, and Maui Community Correctional Center (MCCC). In addition, Kulani and Kauai Community Correctional Center have historically had lower rates of overtime. The Wardens at these facilities have been able to keep their overtime costs down. The only facilities that have difficulty have been HCCC and WCCC, each of which as mentioned earlier, has special staffing challenges. The Wardens are in touch with the unique security and program needs of their facilities. They are also in touch with their staff power requirements, and they have all effectively focused efforts to curb overtime abuse at their facilities.

Overpayments

The report states that "Salary overpayments are inherent in the process and collection is time consuming," and as you point out, the problem with overpayments is the payroll system. In 1999, the State implemented a payroll lag, but the payroll process did not change. Departments are still required to submit their payroll to DAGS on the second day of each payroll cycle, and all amendments must be in by the seventh or eighth day of the cycle. As a result, an employee who takes leave, after the seventh or eighth day of the cycle, who does not qualify for paid leave or has exhausted his/her paid leave will be overpaid.

One of your conclusions is "[t]he delays in collection experienced by the department are unacceptable." We respectfully disagree. We do not believe that you reviewed the entire situation before you drew this conclusion. Since July, 1999, the Department has aggressively pursued the collection of overpayments through a two-pronged strategy. First, to minimize the growth of the overpayment balance, we have instituted procedures to collect on new overpayments immediately after they have occurred. By keeping current on employee leave records, we are able to quickly identify employees who are overpaid. The Department provides them with the option of making a repayment by adjusting the very next paycheck, or disputing our finding through a grievance or an administrative hearing. Most employees choose to make an immediate adjustment. As a result, in FY 2001, overpayments were collected within 2 pay periods after occurrence in 607 of 629 cases. This aggressive pursuit is also a preventive measure, in that these 607 cases are spared the longer, multiple-step collection process. In other words, we are collecting almost all new overpayments without delay. The results attest to the effectiveness of our efforts. In the four years up to June 30, 1999, our employees accrued $3,039,000 in overpayments. In the nearly three years since then, only $25,460 in overpayments have not been settled immediately.

For cases that are not resolved immediately, collections are a very difficult and time-consuming process. Overpayments that occurred prior to 1999 are subjected to this longer process, which provides employees with the right to a formal administrative hearing. Furthermore, you did not point out in 1999, the collective bargaining agreements were changed to require that we notify the unions of the overpayment. This adds an extra step in the process. If the employee and/or the union decide to dispute the overpayment, we must proceed through the formal process. This requires two audits. The Department is first required to audit the employee's time and attendance record. Once that audit is complete, we must then audit the employee's payroll record based on the audited time and attendance record. Each audit is done manually, and each is very time consuming.

Despite the challenges, we have collected $1.3 million to date. As of March 2002, 95 employees who owe $473,715 have been placed on repayment plans and 134 audits are being conducted.

Because we recognized the challenges we face with time and attendance in a twenty-four-hour-per-day, seven-day-per-week operation, our Department volunteered to be the pilot site for the state's new Time and Attendance System (KRONOS) spearheaded by the Department of Accounting and General Services (DAGS). In May 2001, we implemented at Oahu Community Correctional Center (OCCC), swipe cards that automatically record each employee's time and attendance into an electronic timecard that is directly linked to the state payroll system. Once implemented statewide, KRONOS will be instrumental in preventing overpayments because it will automate our labor intensive, manual time and attendance process.

We like your recommendation that we consider contracting out the salary collection process on a contingency basis. Our fiscal staff will be instructed to look into this immediately.

Inmate Trust Accounts

The Department acknowledges that it has had a long-standing problem with the inmate trust accounts—a problem that has distressed us for decades. The biggest barrier to resolving this problem is, quite frankly, the lack of resources. We simply do not have the staff to maintain the system. And although the lack of resources should not be an excuse for not fulfilling our responsibility, it is unfortunately the reality. We are fully aware of the problem and of what it will take to arrive at a solution, and we are making every effort to address it.

Nevertheless, we are pleased to report that we have made significant progress towards improving our inmate trust accounting system. Last year, the Department retained the services of a CPA firm to reconcile the bank balances of each account for the fiscal year ending June 30, 2001. Through this process, we identified and cleared all negative balances. As your report states, the Department also installed a new automated trust accounting (ITA) system that will assist us in reconciling all transactions that are entered. Implementation of this system has taken longer than we would like, because we have had to depend on our facility accounting personnel to help design it. These are the very personnel whose responsibility it is to keep the accounts current.

Regarding restitution, the Department is working with the Judiciary to rectify the problem of victim restitution. In some instances, payments made to the Judiciary have been returned because they are unable to locate the victim. Further, we expect that the ITA will soon be able to capture restitution information, so deductions from inmates' accounts will be done much more expeditiously than in the past.

As the audit report found, the Child Support Enforcement Agency does not consider our Department as an employer agency and as a result, they do not provide us with child support orders. This makes is very difficult for our Department to know when to withhold the inmate's wages.

Regarding your recommendations, we will proceed forthwith on your recommendation that we identify inmate accounts outstanding over 180 days and remit balances to the Department of Budget and Finance. Also, we will consult with the Attorney General regarding whether CSEA payments can be sent to the facility instead of directly to the inmate. Finally, we will continue to work with the Judiciary to improve restitution payment procedures.

General Fixed Assets and Physical Inventory

Currently, the Department is reconciling fixed assets purchased during the prior fiscal year. DAGS has provided us with FAMIS documentation to reconcile with Additions, Deletions, and Changes that have occurred in the inventory balances. The invoices supporting the value of old fixed assets will be a problem for all state agencies, because many of the purchases were done more than 10 years ago. In the past, we were not required to maintain a copy of the invoice for the purchased asset, so these records were only retained for the usual six-year period. We will be working with DAGS to determine an acceptable method to value old assets for which we do not have documentation.

The internal service fund fixed assets was initially reported incorrectly in large part due to the misrepresentation of leased equipment. Correctional Industries was not aware that capital leases must be reported at the time of acquisition rather than when the lease obligation was fully paid. All staff involved in fixed assets reporting for the Correctional Industries has been briefed and a new policy and procedure was put into place to address this problem.

As with your office's previous audit of our Department, we wanted to provide a more detailed response because there are still a number of issues raised in this report that we could not address within the three and a half days that we were given. I do want to restate my concern, however, that your reports do not paint a complete picture of our Department's state of affairs in the areas you studied. And, although you believe that your role is primarily to look only at areas where improvements are needed, you do so at the expense of accuracy. Be assured, however, that in our continuous and sincere effort to improve our operations, we will take your recommendations seriously. Thank you.

Very truly yours,

Ted Sakai

TED SAKAI
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