

Report of independent certified public accountants in accordance with
Government Auditing Standards and Circular A-133

State of Hawaii, Department of Transportation, Harbors Division

June 30, 2006

Submitted by
The Auditor
State of Hawaii

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Report of Independent Certified Public Accountants on
Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards*

The Auditor
State of Hawaii

We have audited the financial statements of the Harbors Division, Department of Transportation of the State of Hawaii relating to the Public Undertaking (Harbors Division) as of and for the year ended June 30, 2006, and have issued our report thereon dated November 16, 2006, which included an explanatory paragraph describing the restatement of net assets as of July 1, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Accordingly, we express no such opinion. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Harbors Division's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-01 to 06-04.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 06-01 to 06-03 to be material weaknesses.

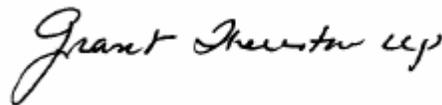
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State of Hawaii

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Harbors Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives, and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to you in a separate letter dated November 16, 2006.

This report is intended solely for the information and use of the Auditor, the Department of Transportation's management, the Harbors Division's management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Honolulu, Hawaii
November 16, 2006

Report of Independent Certified Public Accountants
on Compliance With Requirements Applicable to
Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133

The Auditor
State of Hawaii

Compliance

We have audited the compliance of the Harbors Division, Department of Transportation of the State of Hawaii relating to the Public Undertaking (Harbors Division) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2006. The Harbors Division's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Harbors Division's management. Our responsibility is to express an opinion on Harbors Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Harbors Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Harbors Division's compliance with those requirements.

In our opinion, the Harbors Division complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2006.

Internal Control Over Compliance

The management of the Harbors Division is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Harbors Division's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and

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report on internal control over compliance in accordance with OMB Circular A-133 and not to provide an opinion on the internal control over compliance. Accordingly, we express no such opinion.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Harbors Division as of and for the year ended June 30, 2006, and have issued our report thereon dated November 16, 2006. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Auditor, the Department of Transportation's management, the Harbors Division's management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Honolulu, Hawaii
November 16, 2006

State of Hawaii
 Department of Transportation
 Harbors Division

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2006

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA number</u>	<u>Pass-through entity identifying number</u>	<u>Federal expenditures</u>
U.S. Department of Transportation - Federal Highways Administration			
Pass-through from State of Hawaii, Department of Transportation - Highways Division			
Highway Planning and Construction	20.205	FB-0300	\$ 139,294
U.S. Department of Homeland Security			
Direct Programs			
Port Security Grant Program for Critical National Seaports	97.056		15,125
Pass-through from U.S. Department of Energy, Pacific Northwest National Laboratory			
Installation of Radiation Portal Monitors	97.13439	13439	<u>436,214</u>
Total Department of Homeland Security			<u>451,339</u>
Total Expenditures of Federal Awards			<u><u>\$ 590,633</u></u>

The accompanying note to the schedule of expenditures of federal awards is an integral part of this schedule.

State of Hawaii
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NOTE TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2006

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of State of Hawaii Department of Transportation Harbors Division and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the presentation of, the basic financial statements.

State of Hawaii
Department of Transportation
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year ended June 30, 2006

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditors’ report issued: Unqualified.

Internal control over financial reporting:

- Material weakness(es) identified? Yes No
- Reportable condition(s) identified that are not considered to be material weaknesses? Yes No
- Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? Yes No
- Reportable condition(s) identified that are not considered to be material weakness(es)? Yes None reported

Type of auditor’s report issued on compliance for major programs: Unqualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? Yes No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
97.13439	Installation of Radiation Portal Monitors

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

State of Hawaii
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

Section II – Financial Statement Findings

Ref.

No. Internal Control Findings

06-01 Improve Management of Financial Records

The fiscal office continues to address issues encountered with the implementation of the financial management package of the Comprehensive Information Database System (CIDS) effective July 1, 2002 and the lack of sufficient staff resources. See Internal Control Findings 05-01, Prior Year Audit Findings. Although many improvements were again noted during the current year, continued efforts in implementing additional improvements are still needed in the Harbors Division fiscal office.

Periodic account reconciliations, including the thoroughness of subsequent review and approval of such reconciliations, help to ensure the accuracy of financial information provided to management and aide the decisions made, based on such information. The lack of these controls could affect the accuracy of such information. Furthermore, the probability that additional errors will occur and go undetected is greatly increased. Finally, when accounts have not been reviewed and reconciled during the year, attempts to perform year-end account analyses can become a time-consuming and costly process. During our audit, we noted instances where the lack of these controls led to certain of the Harbors Division's subledgers not reconciling to the general ledger at year end. In addition, we noted that there continues to be some unresolved credits within the account receivable subledger in CIDS.

The Harbors Division maintains various CIP schedules between the Fiscal Office and the Engineering Branch. The Engineering Branch should provide the Fiscal Office with timely information regarding the status of the projects such as project completion dates, whether facilities are placed in use despite lack of final acceptance, estimated useful lives, and allocation of CIP costs among various capital asset categories such as land improvements, building improvements, equipment, etc., to enable the Fiscal Office to properly record these types of transactions. While the Fiscal Office prepares their schedules from the Engineering Branch's schedules, the Engineering Branch should also review what the Fiscal Office is recording. Policies and procedures should be developed by these two departments to ensure timely communication and review. Lack of such policies and procedures could lead to errors in the financial records.

Recommendation

We continue to recommend that significant accounts on the statement of net assets be reconciled in a more timely manner. Timely reconciliations should be assured by establishing a realistic schedule and having completion monitored by a designated individual. A staff accounting person (rather than a supervisor) should be assigned to reconcile account balances on a routine basis. This would allow supervisors to perform review activities, thereby improving the control system in the fiscal office. In addition, all reconciliations should be reviewed by a designated individual to ensure accuracy and completeness, and to verify that reconciled items have been properly handled. This should be evidenced by having the reviewer initial the reconciliation. Although this reconciliation procedure is currently in place, greater care needs to be exercised in preparing and reviewing such reconciliations to ensure the effectiveness of such controls.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

We also recommend that the communication between the Fiscal Office and the Engineering Branch continue to ensure that completed projects are transferred out of CIP and into the appropriate fixed asset classification, including items to be classified as capital versus repairs and maintenance expenses. The Engineering Branch should continue to review the Fiscal Office's final CIP schedule as of year end to ensure that these amounts are reported correctly.

06-02 Properly Maintain All Fixed Asset Subledgers

The Harbors Division is responsible for reporting the acquisition and disposal of fixed assets to the State Procurement Office. The Department of Accounting and General Services (DAGS) compiles forms submitted by all State departments to compile and maintain the state property inventory records. During the audit, we noted the following conditions:

- The Harbors Division does not report the acquisition and disposal of fixed assets to the State Procurement office in a timely manner. Equipment and construction-in-progress activity is generally reported to the State Procurement Office from three to twelve months after the activity occurs. This condition appears to be due to the lack of policies and procedures to ensure timely communication of activities between the project engineers and the accounting department. See Internal Control Finding 06-01.

The Harbors Division also maintains a separate fixed asset schedule. This schedule is used in the compilation of the Harbors Division's fixed assets and related depreciation for the year. During the audit we noted the following conditions:

- There were six instances where the useful life on the depreciation schedule was incorrect, resulting in depreciation expense for certain assets to be overstated by approximately \$550,000 and depreciation expense for certain assets to be understated by approximately \$500,000. Accumulated depreciation for these assets was overstated by approximately \$3,102,000.
- Due to staffing issues within the accounting department in the current year, the Harbors Division did not maintain a reconciliation between its records and the state property inventory records maintained by DAGS.

Recommendation

We recommend that the Harbors Division implement policies and procedures to ensure all fixed asset acquisitions and dispositions are posted to the state property inventory records timely.

We also recommend that all changes to the fixed asset schedule maintained by the Harbors Division be documented on a change form, or an equivalent, and that the schedule be reviewed for propriety. Depreciable lives should be reviewed annually. A reconciliation between the Harbors Division's records and the state property inventory records maintained by DAGS should be performed. In addition, we recommend

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2006

that Harbors Division personnel implement spreadsheet controls to protect the formulas used in computing depreciation to ensure accuracy and completeness.

06-03 Segregation of Duties

Segregation of duties is a critical piece of the internal control framework. No one individual should be responsible for the processing of a complete transaction. During the audit we noted a lack of segregation of duties in the Harbors Division fiscal department, specifically with regard to the duties of the Fiscal Officer. Due to staffing issues within the Fiscal Office, certain journal entries were being prepared and posted by the Fiscal Officer to accounts that were subsequently reconciled by the Fiscal Officer.

Recommendation

We recommend that the Harbors Division management re-evaluate the duties and responsibilities assigned to each individual in the fiscal department to ensure responsibilities are appropriate for each position, as well as to address and mitigate the lack of segregation of duties.

06-04 Preparation of Vacation and Sick Leave Accrual

The Harbors Division prepares a summary leave schedule to determine the amount of its accrued compensated absence liability and reports the liability to the State Comptroller. The liability is based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly rate as of the fiscal year end per the Employee Personnel Action Report (E-PAR). During our testing of accrued vacation and sick leave for 44 individuals, we noted the following conditions:

- There was 1 instance where the individual's accrued hours on the summary leave schedule did not agree to the Form DPS-7.
- There was 1 instance where the individual's hourly rate on the summary leave schedule did not agree to the E-PAR in effect at June 30, 2006.

Recommendation

The summary leave schedule should be reviewed and validated against personnel and payroll records to ensure accuracy and completeness before reporting the balances to the State Comptroller. Once the summary leave schedule is prepared, a review of the amounts being reported should be performed by someone other than the preparer.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

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Harbors Division

SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS

Year ended June 30, 2006

Ref.
No. **Internal Control Findings**

05-01 Improve Management of Financial Records

The fiscal office continues to address issues encountered with the implementation of the financial management package of the Comprehensive Information Database System (CIDS) effective July 1, 2002 and the lack of sufficient staff resources. This is a repeat finding that is substantially similar to internal control finding 04-01. Although many improvements were again noted during the current year, continued efforts in implementing additional improvements are still needed in the Harbors Division fiscal office.

Periodic account reconciliations, including the thoroughness of subsequent review and approval of such reconciliations, help to ensure the accuracy of financial information provided to management and aide the decisions made, based on such information. The lack of these controls could affect the accuracy of such information. Furthermore, the probability that additional errors will occur and go undetected is greatly increased. Finally, when accounts have not been reviewed and reconciled during the year, attempts to perform year-end account analyses can become a time-consuming and costly process. During our audit, we noted instances where the lack of these controls led to certain of the Harbors Division's subledgers not reconciling to the general ledger at year end. In addition, we noted that there continues to be some unresolved credits within the account receivable subledger in CIDS.

The Harbors Division maintains various CIP schedules between the Accounting Department and the Project Engineers. While the Accounting Department prepares their schedules from the Project Engineer's schedules, the Project Engineers should also review what the Accounting Department is recording. Lack of communication and review between these two departments could lead to errors.

Recommendation

We continue to recommend that significant accounts on the statement of net assets be reconciled in a more timely manner. Timely reconciliations should be assured by establishing a realistic schedule and having completion monitored by a designated individual. A staff accounting person (rather than a supervisor) should be assigned to reconcile account balances on a routine basis. This would allow supervisors to perform review activities, thereby improving the control system in the fiscal office. In addition, all reconciliations should be reviewed by a designated individual to ensure accuracy and completeness, and to verify that reconciled items have been properly handled. This should be evidenced by having the reviewer initial the reconciliation. Although this reconciliation procedure is currently in place, greater care needs to be exercised in preparing and reviewing such reconciliations to ensure the effectiveness of such controls.

We also recommend that the communication between the Accounting Department and the Project Engineers continue to ensure that completed projects are transferred out of CIP and into the appropriate fixed asset classification, including items to be classified as capital versus repairs and maintenance expenses. The project

State of Hawaii
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Harbors Division

SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2006

engineers should continue to review the Accounting Department's final CIP schedule as of year end to ensure that these amounts are reported correctly.

Status

Similar instances noted in the current year. See Finding 06-01.

05-02 Improve Monitoring of Self-Reporting Revenue

Significant portions of the Harbors Division revenues are of a self-reporting nature. The Harbors Division has formal comprehensive policies and procedures to ensure the completeness of revenues. Due to the self-reporting nature of the Harbors Division's revenues the completeness of recorded revenues should be monitored closely. The Harbors Division has policies and procedures to perform audits of self-reported wharfage revenue, as both a detective and preventative control measure to ensure accuracy and completeness of the reported amounts. Audit of shipping lines and agents are based on errors noted on filed reports, type of commodities reported and the dollar amount of the wharfage reported. Due to the lack of sufficient resources in the financial management office, the Harbor Division's auditors have been assisting with various accounting functions and did not perform the number of audits usually conducted.

Recommendation

We continue to recommend that since wharfage is the Harbors Division's largest source of revenue, this area should be closely monitored. We recommend that the Harbors Division schedule audits on a more frequent basis. We also recommend that the auditors adjust their audit selection criteria to include larger revenue shipping lines and shipping agents such as Matson, Young Brothers, and Horizon Lines. If staff resources are limited, we recommend that the Harbors Division consider hiring independent contractors to perform such tasks.

Status

The Harbors Division has requested additional funding to enable them to perform audits on larger revenue shipping lines and shipping agents, and has subsequently hired an independent contractor. Such audits are currently in-progress.

05-03 Preparation of Vacation and Sick Leave Accrual

The Harbors Division prepared a summary leave schedule to determine the amount of its accrued compensated absence liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly rate. We noted the following conditions:

State of Hawaii
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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2006

During our testing of accrued vacation, we noted that some of the formulas on the supporting schedules were incorrect, resulting in the initial recording of incorrect amounts, which were subsequently revised by Harbors Division personnel.

Recommendation

We recommend that Harbors Division personnel implement spreadsheet controls to protect the formulas used in computing the accrued vacation liability to ensure accuracy and completeness before reporting the balances to the State Comptroller.

Status

Similar instances noted in the current year. See Finding 06-04.

RESPONSE OF THE AFFECTED AGENCY

LINDA LINGLE
GOVERNOR



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BARRY FUKUNAGA
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IN REPLY REFER TO:
HAR-SF
3193.07

March 16, 2007

Grant Thornton LLP
1132 Bishop Street, Suite 1000
Honolulu, Hawaii 96813

Gentlemen:

The Harbors Division appreciates the opportunity to provide comments on your Report of Independent Certified Public Accountants in Accordance with Government Auditing Standards and Circular A-133 for the fiscal year ended June 30, 2006. We concur with the audit's findings and the need to improve the division's internal control over financial reporting.

The fiscal office underwent a long needed organizational review to improve upon its performance of functions and make more efficient use of its personnel. Notification of the approved reorganization was made in September, 2006 and we are currently in the process of establishing the new positions with recruitment to follow. The division also recognizes the critical need to fill the recently vacated Fiscal Officer position.

We acknowledge that the lack of adequate staff resources have challenged our financial management capabilities. We expect that with the filling of the vacant Fiscal Officer position to provide leadership along with additional staff, our performance will be improved to resolve these findings.

The findings also identified the need for improvements in the management of CIP project information that are needed for the proper recording of transactions. Corrective action will be taken by the Engineering Branch and the Fiscal Office to address the issues identified in the report.

The audit's findings are a useful management tool to identify areas of concern and we will work to correct these shortcomings and meet our responsibilities.

Very truly yours,


BARRY FUKUNAGA
Interim Director of Transportation