ACCUITY LLP
CERTIFIED PUBLIC ACCOUNTANTS

State of Hawaii
Deposit Beverage Container Deposit Special Fund

Financial and Program Audit

June 30, 2008

Submitted by
The Auditor
State of Hawaii

Quality *Integrity* *Insight*

Financial and Program Audit of the State of Hawaii Deposit Beverage Container Deposit Special Fund June 30, 2008

Executive Summary

Section 342G-107, HRS, requires the Office of the Auditor to conduct a management and financial audit of the Deposit Beverage Container Deposit Program and Special Fund in fiscal years ending in even-numbered years, after the initial audit for the fiscal year ended June 30, 2005.

The Office of the Auditor hired the certified public accounting firm of Accuity LLP to conduct this financial and program audit for the fiscal year ended June 30, 2008. For the full text of this report, visit the Auditor's website at http://www.state.hi.us/auditor.

The Deposit Beverage Container Program Is Poorly Managed

Despite previous findings and planned corrective actions reported in Office of the Auditor Report No.05-09, *Audit of the Deposit Beverage Container Program*, we continue to find several deficiencies indicating poor management of the Program.

Over-reliance on self-reporting increases financial risk

The Program lacks adequate procedures to prevent or detect whether distributors fraudulently or erroneously underreport beverage containers sold/distributed or certified redemption centers fraudulently or erroneously over-report beverage containers redeemed. Deposit and fee collections from distributors, as well as payments to certified redemption centers, are based on unverified numbers with limited inspections performed by Program personnel. Redemption center errors are passed on to the Program. Further, the Program lacks controls to prevent or detect unauthorized beverage containers from entering the redemption stream. Since inception of the Program, exempt commercial passenger-vehicle companies have not been inspected.

Consequently, the Program may be operating at a greater cost than necessary, and the reported redemption rate may not be reliable to justify increasing the container fee.

Management materially misstated the Fund's FY 2007 financial statements

Although Program management is responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, and the fair presentation of the financial statements in accordance with U.S. GAAP, it did not perform reconciliations or ensure proper cut-off, resulting in a $5 million restatement of the beginning fund balance. Accordingly, the Deposit Beverage Container Deposit Special Fund restated its opening fund balance as of July 1, 2007, to correct the error relating to the calculation of the beverage container deposit liability.

Agency response

The Department of Health concurred with the findings and conclusions in the report. However, the department objected to the formatting of the report, which it believes highlights criticisms without providing underlying reasons for existing problems. The department also provided specific comments for each of the recommendations, indicating it is working to address the findings reported.

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Chapter 1: Introduction

Background

In 2002, the Hawaii Legislature passed Act 176 (the "Bottle Bill") to establish the Deposit Beverage Container Deposit Program (the "Program"). The act, codified in Chapter 342G, Part VIII, Hawaii Revised Statutes ("HRS"), also established the Deposit Beverage Container Deposit Special Fund (the "Fund") to account for program activities. The purpose of the Bottle Bill is to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter.

Section 342G-107, HRS, requires the Office of the Auditor (the "Auditor") to conduct a management and financial audit of the Program in fiscal years ending in even-numbered years, after the initial audit for the fiscal year ended June 30, 2005.

The Office of the Auditor hired the certified public accounting firm of Accuity LLP to conduct this financial and program audit.

Deposit and Container Fee Collection Process

Manufacturers and distributors of beverage containers are responsible to pay deposits and fees into the Fund when they sell, donate, or otherwise distribute beverages in applicable containers in the State. Manufacturers and distributors may pass on the deposits and container fees they pay to their customers (e.g., retailers) who, in turn, may pass on the costs to end consumers. The deposit is $0.05 per container and the fee is $0.01 per container on each eligible beverage container manufactured in or imported into Hawaii.

The refundable deposits collected are initially recorded as a liability in the Fund and not as revenue, as they are specifically intended to reimburse certified redemption centers, which collect the empty containers and refund consumers for eligible containers redeemed. Subsequently, because not all deposits are expected to be redeemed, the Program records 20 percent of deposits as revenue. The revenues in the Fund are used to administer the Program.

If the statewide redemption rate exceeds 70 percent of deposits collected for a fiscal year, the Program can increase the per container fee to $0.015. The redemption rate is calculated as the ratio of containers redeemed to containers manufactured or distributed as represented by deposits collected from distributors. The Program has maintained the per-container fee at $0.01 since inception, even though the fiscal year ("FY") 2008 redemption rate was 72 percent, as reflected in Exhibit 1.1.

Exhibit 1.1 Deposit Beverage Container Redemption Rates

Year Ended	Redemption Rate
June 30, 2006	68%
June 30, 2007	68%
June 30, 2008	72%

Source: Department of Health

One group of containers is exempted from the deposit and fee mandate. Section 342G-101.5, HRS, exempts commercial passenger-vehicle companies from paying the deposit and container fees for beverages sold or delivered to such companies when the beverage container is intended for consumption on the commercial passenger-vehicle. Such vehicles include airplanes and cruise ships. To qualify for this exemption, eligible companies must have a beverage container recycling plan approved by the Department of Health (the “Department”).

Redemption Process

The Program utilizes redemption centers to receive empty beverage containers from and return deposits to consumers, as well as to deliver redeemed beverage containers to recyclers. During FY 2008, the Program paid Oahu redemption centers a handling fee of $0.02 per beverage container delivered to recyclers/recycling mills. The Program paid Neighbor Island redemption centers a handling fee of $0.03 per beverage container similarly delivered. As only a $0.01 container fee is paid into the Fund, each container recycled results in a loss.

An individual or business operating a redemption center must receive both a solid-waste permit and a redemption center certification from the Department. In addition to the conditions listed in the permit and certification, redemption centers must comply with the statutory requirements in Section 342G-114, HRS, which are: 1) accepting all types of empty deposit beverage containers for which a deposit has been paid; 2) verifying that all containers to be redeemed bear a valid Hawaii refund value; 3) paying the redeemer for the full refund value in either cash or a redeemable voucher for all deposit beverage containers, except as provided in Section 342G-116, HRS (lists conditions for refusal); 4) ensuring each deposit beverage container is recycled through a contractual agreement with an out-of-state recycler or an in-state recycling facility permitted by the Department (not applicable if redemption center is operated by a recycler permitted by the Department); and 5) forwarding the documentation necessary to support claims for payment as stated in Section 342G-119, HRS (redemption center reporting requirements).

As of June 2008, there was a total of 105 certified redemption centers statewide. Exhibit 1.2 provides a breakdown of sites on each island.

Exhibit 1.2 Certified Redemption Centers

Island	Number of Centers
Oahu	63
Maui	15
Hawaii	16
Kauai	7
Lanai	1
Molokai	3
Total	**105**

Source: Department of Health

When determining the deposit refund to be paid to consumers, redemption centers may weigh redeemed beverage containers in excess of 200 rather than counting them, using department-provided segregated rates to calculate the number of redeemed beverage containers. This practice may result in individual consumers receiving more or less than $0.05 per beverage container redeemed, but is intended to average $0.05 on a statewide basis. The number of beverage containers per pound by material type is required to be posted at all redemption centers. Exhibit 1.3 contains the segregated rates in effect during FY 2008, which were updated in June 2007. Redemption centers may not issue refunds for beverage containers redeemed without *HI-5¢* marking.

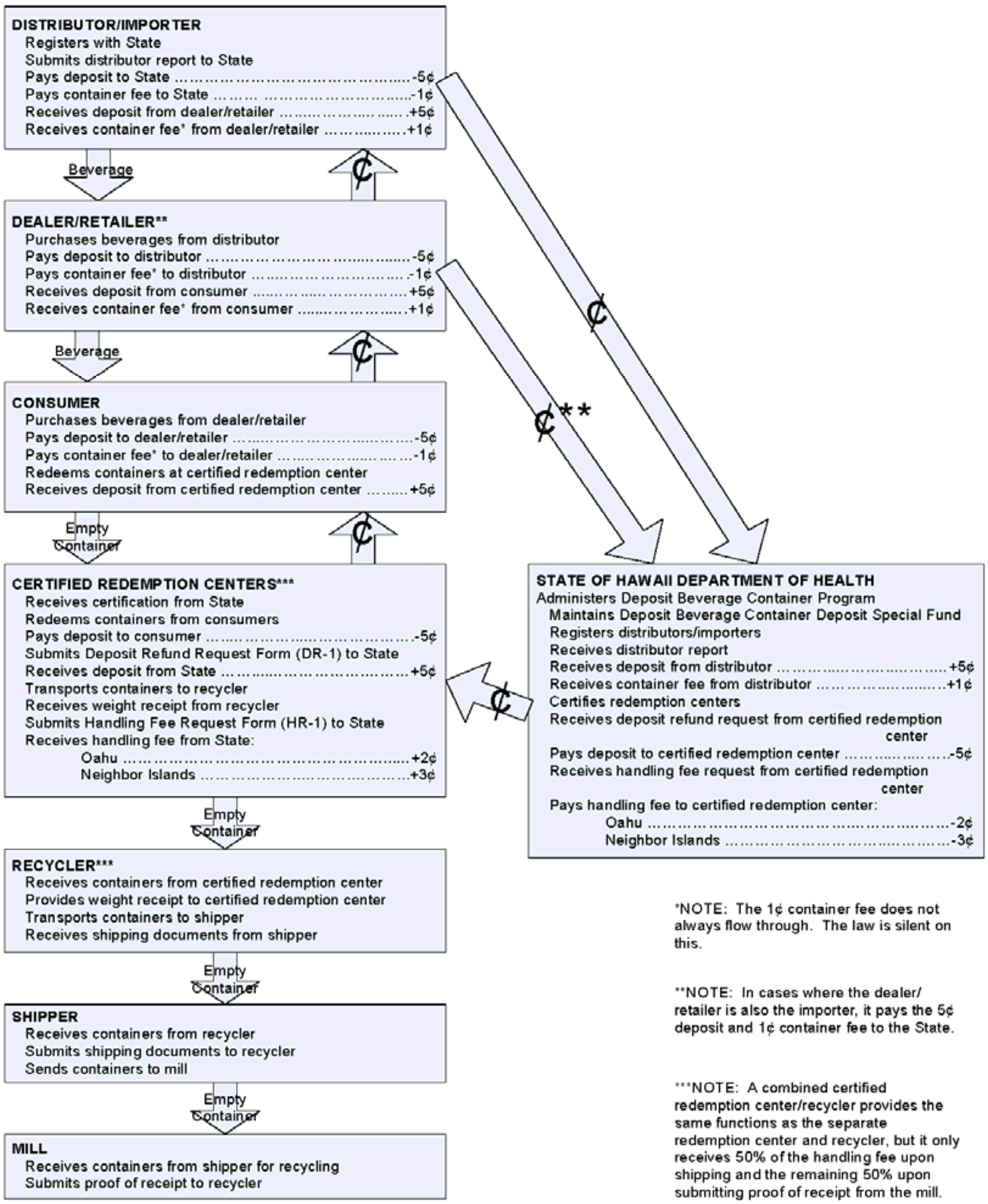
Exhibit 1.3 Hawaii Deposit Beverage Container Law Segregated Rates

Container Material Type	Number of Containers Per Pound
Aluminum	31.6
Bi-metal	8.0
Glass	2.3
Plastic	17.5
Plastic (17 oz. or less)	22.7

Source: Department of Health

Exhibit 1.4 provides a general overview of the complete deposit and redemption process.

Exhibit 1.4 Overview of Deposit and Redemption Process



Source: Office of the Auditor Report No. 05-09, Audit of the Deposit Beverage Container Program

The Department's Solid Waste Branch, Environmental Management Division, administers the Program and Fund. The Program consists of 12 approved positions managed by the Solid Waste Management Coordinator. In its *Report to the Twenty-Fifth Legislature State of Hawaii 2009* (November 2008), the Department reported three Program positions were vacant, as of June 30, 2008.

In FY 2008, the Program had total revenues of $19.5 million and total expenditures of $17.3 million, resulting in a $2.2 million increase in Fund balance to $18.9 million at June 30, 2008. The Program's container deposit liability also increased from $18.1 million at July 1, 2007, to $21.7 million at June 30, 2008. The fund had $40.8 million in cash and cash equivalents at June 30, 2008, to refund deposits and to pay for other liabilities and expenses. Additional information on the Program's financial information is included in the Fund's financial statements, in Chapter 3.

Prior Audits

In 2005, the Auditor conducted the initial audit of the Program and reported the following findings in Report No. 05-09, *Audit of the Deposit Beverage Container Program*:

1. Numerous delays in the Department of Health negatively impacted the Program's planning and implementation: the Department failed to submit a timely budget request for program funding, the Department was late in hiring staff to plan and implement the Program, redemption centers were poorly operated, public education efforts were untimely and overlooked the greater environmental message, a structure does not exist to ensure that funds were properly reported and paid by distributors, and payments to redemption centers are based on unverified numbers.

2. The Department failed to establish a financial accounting system to ensure that transactions are properly recorded and reported and that assets are safeguarded.

The Auditor made recommendations to address the findings noted above. By FY 2008, the Department and Program management implemented some of the Auditor's recommendations, including submitting timely budget requests, filling the Solid Waste Management Coordinator position, and hiring an experienced accountant, developing additional operating and accounting policies and procedures, and increasing public education efforts for the Program. However, as reported in Chapter 2, several of the findings from the fiscal year 2005 audit continue as of June 30, 2008.

Due to unforeseen circumstances, the independent auditor contracted by the Auditor to perform the FY 2006 audit was unable to complete its audit.

Objectives of the Audit

1. Perform a financial statement audit of the Deposit Beverage Container Deposit Special Fund.

2. Assess the adequacy of the Deposit Beverage Container Program's internal controls over financial reporting.

3. Make recommendations for improvements as appropriate.

Scope and Methodology

The scope of the audit was to perform a financial statement audit of the Fund for the year ended June 30, 2008. As part of our financial statement audit, we tested 25 deposit redemptions paid by redemption centers to consumers and 25 handling-fee payments from the Program to redemption centers. We recalculated the payments based on supporting documents provided by the Program stating the weight of containers redeemed multiplied by the segregated rates in Exhibit 1.3.

In addition to the financial statement audit procedures, we also performed limited testing of distributors' and redemption centers' compliance with Chapter 342G, Part VIII, HRS.

For the testing of beverage distributors, we obtained a listing of distributors as of June 30, 2008 (160 distributors) from the Program and judgmentally selected five distributors for further testing. We selected 40 invoices from each distributor's monthly detail of beverage container sales to determine whether all containers reported as sold (or otherwise distributed) on the distributor's invoice were properly reported and whether the proper deposit and container fees were paid to the Program.

Distributors	Menehune Water
	Safeway
	Sam's Club
	Anheuser Busch
	Coca Cola Bottling Co.

We physically visited five of the 105 certified redemption centers as of June 30, 2008, and observed whether the redemption centers were open during posted hours, informed customers of the procedures/policies of the redemption count, properly calibrated the scale used to weigh redeemed beverage containers, paid appropriate refunds to consumers, provided consumers with a receipt for their redemptions, and properly recorded the redemption transactions.

Redemption Centers and Locations	Goodwill Redemption and Donation Center Industries, 1075 Beretania Street, Honolulu
	Reynolds Recycling Hawaii Kai Park & Ride, 300 Keahole Street, Honolulu
	R.R.R. Recycling Services Times Supermarket, 1290 South Beretania Street, Honolulu
	Maui Disposal Maui Community College, Kahului
	Atlas Recycling 30 Makaala Street, Hilo

We redeemed beverage container deposits at each of the selected redemption centers and traced our redemption transaction through the redemption center's reimbursement request/reporting process and subsequent payment by the Program.

The audit fieldwork was conducted from March 2009 through June 2010, in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*. Those standards require that we plan and perform our audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Chapter 2: The Deposit Beverage Container Program Is Poorly Managed

The Deposit Beverage Container Deposit Program was established by the State Legislature to manage and administer a State-run recycling program to increase recycling of beverage containers, provide a connection between manufacturing decisions and recycling-program management, and reduce litter. The Program has grown into a multimillion-dollar operation with assets of $42.6 million, beverage container deposit liabilities of $21.7 million, and a Fund balance of $18.9 million as of June 30, 2008.

Despite previous findings and planned corrective actions reported in Office of the Auditor Report No.05-09, we continue to find several deficiencies indicating poor management of the Program. The Program over-relies on self-reporting from distributors and certified redemption centers. The Program lacks adequate controls to monitor the accuracy and completeness of information submitted by distributors and certified redemption centers, which exposes the Program to risks of underpayments by distributors and overpayments to certified redemption centers. Management must strengthen controls to ensure that the Program is properly collecting deposits and container fees from distributors and that the costs of administering the Program (e.g., reimbursements and handling fees paid to certified redemption centers) are minimized. Management's failure to ensure proper accounting over container deposit liabilities also resulted in a material misstatement of the Fund's financial statements for FY 2007. Accurate financial reporting is necessary for decision makers (Legislature, State administration, and Department and Program management) and the public to appropriately evaluate the operational and fiscal effectiveness of the Program.

Summary of Findings

We found a material weakness involving the Program and Department's internal control over financial reporting. As defined in *Government Auditing Standards*, a material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by an entity's internal control.

Significant deficiencies, which are less severe than material weaknesses, are deficiencies in internal control, or a combination of deficiencies, that adversely affect an entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles ("GAAP"), such that there is more than a remote likelihood that a more than inconsequential misstatement of an entity's financial statements will not be prevented or detected by an entity's internal control.

Significant deficiency:

The Program's over-reliance on self-reporting from distributors and certified redemption centers significantly increases the risk that the Program will unknowingly collect less container deposits and handling fees yet refund more deposits and pay more handling fees than it should.

Material weakness:

Management's failure to ensure the recognition of liabilities in the proper fiscal year resulted in a material misstatement of the Fund's financial statements as of and for the year ended June 30, 2007.

The Program's Over-Reliance on Self-Reporting from Distributors and Certified Redemption Centers Increases Financial Risk

We found that the Program lacks adequate procedures to prevent or detect whether distributors fraudulently or erroneously underreport beverage containers sold/distributed or certified redemption centers fraudulently or erroneously over-report beverage containers redeemed. Further, the Program lacks controls to prevent or detect unauthorized beverage containers from entering the redemption stream (e.g., redemption of beverage containers by exempt businesses).

Because these deficiencies affect both the amounts of deposits and redemptions, they significantly increase the risks that published redemption rates are inaccurate and the Program may be operating at a higher cost than necessary, ultimately placing a greater burden on consumers through unwarranted container-fee increases.

Deposit and fee collections from distributors are based on unverified numbers

Sections 342G-105 and -110, HRS, require distributors to report the number of deposit beverage containers sold/distributed and pay beverage container deposits and container fees to the Program on a monthly (semiannual for smaller companies) basis. While distributors are supposed to maintain adequate records and support for beverage sales, the Program relies on the unverified amounts reported by the distributors for collections. Distributors could fraudulently or erroneously underpay beverage container deposits and container fees since the Program lacks a systematic verification or inspection process.

<u>Program reliance on self-reported amounts increases risk of under-reporting by distributors</u>

Section 342G-105, HRS, states that payment of the deposit beverage container fee and deposits shall be made monthly based on inventory reports of the deposit beverage distributors. All deposit beverage distributors shall submit to the Department documentation in sufficient detail that identifies the net number of deposit beverage containers sold, donated, or transferred, by container size and type.

In addition, Section 342G-110, HRS, specifies that the deposit on each filled deposit beverage container shall be paid by the beverage distributor, who manufactures or imports beverages in deposit beverage containers. Beverage distributors shall also pay a deposit beverage container fee and register with the State.

Since distributors can pass on beverage container costs to retailers, they have an inherent incentive to underreport sales/distributions of deposit beverage containers. Distributors could collect deposits and container fees from retailers but not pay them to the Program. However, the only regular review of the reports submitted is the Solid Waste Management Coordinator’s scanning of the monthly distributor reports and an account clerk’s review for mathematical accuracy. No other support, such as shipping or sales support, is required.

Undetected underpayments from distributors will result in the Program having fewer funds available to pay for deposit redemptions and program administrative costs. This could also lead to an overstated redemption rate because the number of deposit containers sold (the denominator in the rate calculation) may be understated. An inaccurate redemption rate could then lead to an unjustified increase in container fee rates to sustain the Program’s operations.

<u>The Program lacks a systematic process to detect under and non-reporting by distributors</u>

Section 342G-103, HRS, requires all beverage distributors operating within the State to register with the Department and maintain records reflecting the manufacture of their beverages in deposit beverage containers as well as the importation and exportation of deposit beverage containers. The records shall be made available, upon request, for inspection by the Department.

By law, the Department and the Auditor may audit or inspect distributor records.

Exhibit 2.1 reports the total number of inspections of distributors, redemption centers, and recyclers performed and warning letters issued by the Program in FY 2008.

Exhibit 2.1 Total Inspections and Warning Letters Issued in Fiscal Year 2008

Month	Compliance Inspections	Complaint Inspections	Pre-Certification Inspections	Warning Letters	Follow Up to Warning Letters*
July 2007	12	7	0	5	1
August	19	0	0	6	0
September	24	0	0	2	1
October	20	3	0	1	1
November	1	0	0	3	0
December	8	2	0	4	0
January 2008	16	1	0	4	0
February	16	1	0	20	0
March	7	0	0	1	1
April	8	2	0	13	1
May	14	2	0	4	0
June	8	3	2	6	0
Total	**153**	**21**	**2**	**69**	**5**

Source: Department of Health, *Report to the Twenty-Fifth Legislature State of Hawaii 2009* (November 2008)

In addition to the 69 warning letters and five follow-up letters issued, the Program issued Notices of Findings and Orders to two distributors. These orders state violations of laws and program requirements, noncompliance with laws and regulations, and may include penalties. In addition to the required payment of all delinquent deposits and container fees, the two Notices of Findings and Orders issued to distributors in FY 2008 included penalties totaling $7,345. Penalties assessed require the approval of the Solid Waste Management Coordinator, Deputy Attorney General, and Deputy Director of Environmental Health.

Despite the performance of 176 inspections in FY 2008, these inspections are not designed to substantiate distributor reports. The Solid Waste Management Coordinator stated the two violations noted above were found through the Program accountant's review of monthly sales reports for delinquent submissions, rather than through compliance inspections performed. The Solid Waste Management Coordinator stated that detailed inspections of distributors by examining reports and supporting documents are not performed by the Program due to vacant positions. Therefore, the Program is unable to schedule and systematically perform compliance inspections of distributors with any regular frequency. The Department reported in its *Report to the Twenty-Fifth Legislature State of Hawaii 2009* (issued in November 2008) that the number of inspectors decreased after October 2007, resulting in a decrease in the number of inspections completed each month.

Although the Fund had an $18.9 million fund balance at June 30, 2008, the Program was also subject to a statewide freeze in filling vacant positions and was unable to hire additional staff, including a Planner and Environmental Health Specialist to develop control plans and perform inspections. However, the Solid Waste Management Coordinator also admitted that the length of the hiring process and poor recruitment and retention were also factors in position vacancies.

In our limited sample of five distributors, we found that one distributor, Coca Cola Bottling Co. ("Coca Cola"), failed to report and remit the beverage container deposits and container fees on $5,698 in beverage sales on one of the 60 sales (initial sample of 40 was expanded to 60 due to the exception) we tested for the distributor. Coca Cola was also unable to provide documents to support a reported transaction involving 143 deposit beverage containers sold and paid deposits of $7.15 and container fees of $1.43. Coca Cola is one of the State's largest deposit beverage container distributors, and the exceptions noted highlight the need for a systematic inspection process.

In other self-reporting programs, such as income and other tax filings, regulators have robust inspection/audit and enforcement programs that encourage compliance by penalizing subject entities for late and/or inaccurate filings, whether intentional or unintentional.

Although the Program has broad enforcement powers, including assessing an administrative penalty; ordering corrective action immediately or within a specified time; commencing civil action in circuit court; and/or revoking a certification or permit, lack of effective compliance inspections on distributors hobbles the Program from effectively deploying these enforcement tools.

Despite the inherent incentive for distributors to underpay beverage container deposits and container fees, the Program has failed to implement a systematic compliance inspection and enforcement process to limit this risk. Robust enforcement would encourage distributors to pay deposits and container fees. Public announcements of violations could hurt the distributors' reputations, creating an incentive to comply with the deposit beverage container laws. Such announcements could also heighten distributors' awareness of penalties, in addition to the required payment of underreported amounts.

Program payments to certified redemption centers are based on unverified numbers

The Program reimburses and pays handling fees for beverage containers redeemed by certified redemption centers on a monthly basis based on reports prepared by the certified redemption centers.

We found that the Program lacks adequate procedures to prevent or detect whether certified redemption centers fraudulently or erroneously over-report beverage containers redeemed and overcharge the Program.

<u>Program reliance on self-reported amounts increases risk of over-reporting by redemption centers</u>

Section 342G-119, HRS, specifies that the Department shall pay certified redemption centers handling fees and deposit refunds based on collection reports submitted by the redemption centers. The redemption reports include the number or weight of deposit beverage containers of each material type accepted at the redemption center for the reporting period; the amount of refunds paid out by material type; the number or weight of deposit beverage containers of each material type transported out of state or to a permitted recycling facility; and copies of out-of-state transport and weight receipts or acceptance receipts from permitted recycling facilities. Additionally, section 11-282-47, Hawaii Administrative Rules ("HAR"), states that the Department shall pay certified redemption centers handling fees and refund values based on reports submitted by the redemption centers to the Department.

Certified redemption centers can only receive 50 percent of the handling fees claimed at the time of initial request by submitting weight tickets for the amounts shipped to end user recycling facilities. The remaining balance is paid upon receipt of corroborating weight reports prepared by the end-user recycling facilities. Certified redemption centers are reimbursed by the Program for the amount of deposit refunds paid to consumers based on reports prepared by the certified redemption centers. The associated handling fees paid to the certified redemption centers are based on container equivalents from the weight of containers redeemed and sent to recycling facilities as reported by both the certified redemption centers and recycling facilities.

However, the Program does not require certified redemption centers to submit any supporting documents with deposit refund reimbursement requests. Similar to the monthly distributor reports, the Solid Waste Management Coordinator only scans the deposit refund ("DR-1") requests. Because the Program reimburses certified redemption centers for all deposits refunded, there is nothing to prevent redemption centers from overpaying and/or reporting more redemptions than actually occurred. In addition, overpayment of deposit refunds may encourage more consumers to redeem deposit beverage containers at such a certified redemption center, resulting in greater volume and, consequently, handling fees for the certified redemption center.

The Program acknowledged this concern in its 2007 report to the State Legislature, stating:

> This summer the program became concerned that the DBC quantity claimed by redemption centers is not a reliable indicator of the actual quantity of DBC material collected, which has been found to be affected/reduced by such factors as material shrinkage, theft, contamination, etc.

Despite seeing indicators that the risk of overpayment is real and occurring, the Program failed to adequately address these concerns by improving redemption support requirements.

Overpayments of redemptions will result in the Program having fewer funds available to pay deposit refunds and increase the handling fees on beverage containers redeemed. During FY 2008, the handling fees were $0.02 per container for certified redemption centers on Oahu and $0.03 per container for certified redemption centers on other islands, which was two to three times the amount of the container fees paid into the Fund by distributors. This could also lead to an overstated redemption rate, because the number of deposit containers redeemed may be overstated. An overstated redemption rate may lead Program management to erroneously conclude that a higher container fee is justified and necessary to continue to operate the program.

<u>The Program lacks a systematic process to detect over-reporting by redemption centers</u>

As shown in Exhibit 2.1, the Program performed 176 compliance inspections in FY 2008. However, the Program penalized only one certified redemption center $32,140 during fiscal year 2008 for multiple violations of program rules and certification requirements.

According to the Solid Waste Management Coordinator, many of the inspections are limited to checking the daily customer transactions at certified redemption centers to determine if refunds were properly calculated, including use of the proper segregated rates, and investigating complaints received from the public, rather than inspecting the deposit refund reimbursement request forms by obtaining and agreeing amounts reported to the certified redemption centers supporting documents. The Solid Waste Management Coordinator admits that the Program has not scheduled and systematically performed compliance inspections of redemption centers with any regularity due to vacant positions from the state-wide hiring freeze, as well as poor recruitment and retention efforts.

Redemption centers have an inherent incentive to overstate the amount refunded for deposit beverage containers redeemed to increase demand for their services and consequently increase the amount of handling fees generated. There is no financial disincentive to redemption centers for overpaying on deposit redemptions because the Program reimburses redemption centers for all that they refund to consumers. The Program has failed to conduct a systematic compliance inspection and enforcement process that would limit the risk of overpayment of redemptions.

Certified redemption center errors are passed on to the Program

In our testing of deposits refunded by certified redemption centers, we found various errors in the amounts refunded to consumers based on the weight of deposit beverage containers redeemed. We found that the Program's segregated rates used to convert deposit beverage containers to container equivalents was inaccurate compared to hand counting for several of the refunds we tested. We also noted errors in the redemption centers' calculations for other refunds tested. As the DR-1 forms submitted by redemption centers are based on weight, it is likely that these errors are passed on to the Program, resulting in more deposits and handling fees being paid out than justified.

<u>Program allows redemption of over-weight and under-weight containers</u>

Section 11-282-46, HAR, provides:

> Redemption centers are allowed to redeem deposit beverage containers and pay refund value based on the weight of these containers presented for redemption, as follows:
>
> 1) Empty beverage containers should be weighed, recorded, and reported in tons, pounds, or fractions thereof. . .
>
> 2) To be redeemed by weight, containers must be segregated by material.
>
> 3) Refund values should be posted and paid according to the container per pound conversion rates issued by the Department in section 11-282-61.
>
> 4) Redemption centers must inspect loads as required by 11-282-45.
>
> 5) If requested by a consumer, for loads of two hundred containers or less, redemption centers must compute redemption value by container count rather than by weight.

Exhibit 2.2 shows the differences we found between the deposit refunds we expected to receive, based on our hand count prior to taking the containers to the redemption centers, and the amounts actually received at the redemption centers, based on the weight of the containers redeemed.

While the program allows weighing of deposit beverage containers, based on the official segregated conversion rates (see Exhibit 1.3), the converted container equivalents are expected to approximate a hand count on average. However, we found that when containers are weighed, it results in significant differences (greater than 5 percent) from the refunds than would be received, based on hand counts, but are processed as redemptions anyway, as allowed under Section 11-282-46, HAR.

Exhibit 2.2 Differences Between Expected and Actual Refunds Due to Segregated Weights

Redemption Center	Date	Type	Container Count	Weight in lbs.	Containers per lb.	Equivalent Containers	Redemption Refund: By Count	Redemption Refund: By Weight	Redemption Refund: Actual refund	Count vs. Weight: Over (Under) Paid	Count vs. Weight: % Difference
Key:			A	B	C	D	E	F	G	H	
Formula:						= B x C	= A x $.05	= D x $.05		= F - E	= H / E
Maui Disposal	01/23/2009	Can	54	2.1	31.6	66.36	$ 2.70	$ 3.32	$ 3.32	$ 0.62	23%
Atlas Recycling	02/20/2009	Can	5	0.6	31.6	18.96	$ 0.25	$ 0.95	$ 0.95	$ 0.70	280%
Atlas Recycling	02/20/2009	Plastic	18	1.2	17.5	21	$ 0.90	$ 1.05	$ 1.05	$ 0.15	17%
Reynolds Recycling	04/18/2009	Plastic	50	3.1	17.5	54.25	$ 2.50	$ 2.71	$ 3.15	$ 0.21	8%
R.R.R. Recycling Services	04/04/2009	Can	16	1.8	31.6	56.88	$ 0.80	$ 2.84	$ 2.84	$ 2.04	255%
R.R.R. Recycling Services	04/04/2009	Glass	116	49.8	2.3	114.54	$ 5.80	$ 5.73	$ 5.73	$ (0.07)	-1%
Goodwill Redemption and Donation Center	04/04/2009	Glass	150	57.9	2.3	133.17	$ 7.50	$ 6.66	$ 6.94	$ (0.84)	-11%

Note 1: Test sample brought to redemption center by Accuity.
Note 2: Amount as weighed by redemption center -- Accuity did not weigh before hand.
Note 3: Slight difference in calculation may occur depending on the number of decimals places. Rounded to two decimal places.

Source: Accuity LLP

As part of our testing at the certified redemption centers, we noted that the scales used appeared appropriately calibrated. However, as illustrated in Exhibit 2.2 above, we found five redemption transactions resulting in payments of 8, 17, 23, 255, and 280 percent more than would have been paid based on hand counts. We also noted one payment that was 11 percent less than expected.

Although one payment was less than expected, we noted that the differences from calculating container equivalents more often resulted in refunds for a greater number of deposit beverage containers than actually returned at the certified redemption centers tested. These net overpayments result in the Program paying more in deposit redemptions than was originally collected and will eventually lead to a shortfall in the Program's available funds that will require the Program to charge a higher container fee to sustain operations.

<u>Calculation errors are passed on to the program</u>

In addition to the differences in expected refunds due to the segregated weights used, we also noted two errors in the calculation of the container deposit refund calculated by the certified redemption centers, which are shown in Exhibit 2.3.

Exhibit 2.3 Differences Between Expected Refund and Actual Refund Based on Weight

Redemption Center	Date	Type	Container Count	Redemption Refund: By Count	Redemption Refund: By Weight	Redemption Refund: Actual refund	Count vs. Weight: Over (Under) Paid	Count vs. Weight: % Difference	Weight vs. Actual Paid: Over (Under) Paid	Weight vs. Actual Paid: % Difference
Key:			A	E	F	G	H		J	
Formula:				= A x $.05			= F - E	= H / E	= G - F	= J / F
Reynolds Recycling	04/18/2009	Plastic	50	$ 2.50	$ 2.71	$ 3.15	$ 0.21	8%	$ 0.44	16%
Goodwill Redemption and Donation Center	04/04/2009	Glass	150	$ 7.50	$ 6.66	$ 6.94	$ (0.84)	-11%	$ 0.28	4%

Note 1: Test sample brought to redemption center by Accuity.
Note 2: Amount as weighed by redemption center -- Accuity did not weigh before hand.
Note 3: Slight difference in calculation may occur depending on the number of decimals places. Rounded to two decimal places.

Source: Accuity LLP

One of the refunds tested resulted in a 16 percent overpayment due to a multiplication error. The other error involving a 4 percent overpayment was due to the certified redemption center rounding the amount paid per container, rather than rounding the total amount paid for all containers.

In the case of the overpayment by 16 percent, the redemption center should have multiplied the equivalent containers calculated of 54.25 by the $0.05 deposit rate to determine the refund of $2.71 as shown in column F of Exhibit 2.3, rather than the $3.15 refunded. As noted in Exhibit 2.2 above, the properly calculated $2.71 was still 8 percent more than the $2.50 that the redemption center would have refunded if the segregated rates more closely approximated the actual number of containers returned.

Although less than a 5 percent difference, our beverage container deposit redemption transaction at the Goodwill Redemption and Donation Center was also miscalculated. The segregated rate of 2.3 glass containers per pound equals a refund of $0.115 per pound. If the proper rate of $0.115 was used, the redemption center would have refunded $6.66. Instead, the redemption center rounded the rate to $0.12 per pound, resulting in a higher refund of $6.94.

As previously noted, redemption centers are likely passing on these errors to the Program, which then reimburses the redemption center more than it should, leaving the Program less funds for future operations.

Exempt containers may be entering the redemption stream

Certain commercial passenger-vehicle companies are exempt from paying and charging their customers the beverage container deposits and related container fees. However, such companies are only exempt if they have a beverage container recycling plan approved by the Department. We found that the Program does not maintain an updated listing of exempt companies nor does it monitor exempt commercial passenger-vehicle companies once the initial beverage container recycling plan was approved. Consequently, the Program has no assurance that exempt companies are not redeeming the used beverage containers from their operations for the $0.05 per container deposit, rather than following their approved recycling plans, thus depleting the Program's funds and improperly increasing the reported redemption rate.

<u>Exempt commercial passenger-vehicle companies are not being monitored</u>

The Program is responsible for ensuring companies operating in Hawaii comply with the Deposit Beverage Container Program law. Section 342G-101.5 provides an exemption for certain passenger-vehicle companies if they have a recycling plan approved by the Department. It further states that exempt beverage containers shall not be redeemed for the refund value or the handling fee.

Implicit in the exemption is that any commercial passenger-vehicle companies that do not have approved recycling plans are not exempt and thus subject to the $0.05 deposit and $0.01 container fee for each deposit beverage container dispensed in its operations. We obtained the listing of exempt commercial passenger-vehicle companies shown in Exhibit 2.4 below from the Program.

Exhibit 2.4 Exempt Commercial Passenger-Vehicle Companies

(continued on next page)

Commercial Passenger-Vehicle Companies with Approved Recycling Plans			
Airline	**Island**	**Caterer**	**Recycler**
Air Canada	Oahu, Maui	Gate Gourmet Inc.	
Air New Zealand	Oahu	Gate Gourmet Inc	
Air Pacific	Oahu	Gate Gourmet Inc.	
Alaska Airlines	Oahu, Hawaii, Maui, Kauai	Gate Gourmet Inc.	Honolulu Recycling Services, Kona Recycles @ Kealaheke Transfer, Maui Disposal, Garden Island Disposal
All Nippon Airways	Oahu	Gate Gourmet Inc.	
Aloha Airlines	Oahu	Chelsea Food Services Gate Gourmet Inc., Mauna Kea Beach Hotel	
China Airlines	Oahu	Chelsea Catering	
Continental Airlines	Oahu	Chelsea Food Services	Honolulu Recovery System
Delta Airlines	Oahu, Maui	Gate Gourmet Inc.	Honolulu Recovery System, Maui Disposal
Japan Airlines	Oahu, Hawaii	International In-Flight Catering Company	
Korean Airlines	Oahu	International In-Flight Catering Company	
Go! Mokulele	Oahu		Honolulu Recovery System
Northwest Airlines	Oahu	Gate Gourmet Inc.	Honolulu Recovery System
Omni Air International	Oahu	Chelsea Food Service	Honolulu Recovery System
Philippine Airlines	Oahu	International In-Flight Catering Company	
Qantas Airways/Jetstar	Oahu	Gate Gourmet Inc.	
United Airlines	Oahu, Hawaii, Maui, Kauai		Honolulu Recovery Systems, Business Services Hawaii, Maui Disposal, Garden Island Disposal

Commercial Passenger-Vehicle Companies with Approved Recycling Plans			
US Airways	Oahu, Hawaii, Maui, Kauai	Gate Gourmet Inc., Hawaiian Airlines	Honolulu Recovery Systems, Maui Disposal
Cruise Line	**Island**	**Recycler**	
Holland America Line	Oahu	PSC environmental Service	
Norwegian Cruise Line	Oahu, Hawaii, Maui, Kauai	CM & RRR Recycling	
Transmarine Navigation Corporation	Oahu	PSC environmental Service	
Transportation Management Service	Oahu, Hawaii, Maui, Kauai, Lahaina	PSC environmental Service	

Source: Department of Health, Office of Solid Waste Management

Based on our review of the listing, we found that it does not include two of the largest airlines serving Hawaii – American Airlines and Hawaiian Airlines. Upon further inquiry, the Solid Waste Management Coordinator stated that American Airlines and Hawaiian Airlines both have approved recycling plans and were excluded from the listing due to an oversight by Program personnel. The listing is also obsolete as it includes Aloha Airlines, which ceased operations in March 2008. The Solid Waste Management Coordinator admitted that the listing has not been updated and inspected for accuracy on a regular basis since the inception of the Program. The Solid Waste Management Coordinator also stated that the list is not comprehensive of all commercial passenger-vehicle companies that should submit a recycling plan, again blaming low staffing levels.

We note that the Program could easily update the list by requesting from the Department of Transportation listings of all airlines, cruise lines, and other commercial passenger-vehicle companies operating in Hawaii.

Because the Program has little information on the volume of containers generated by exempt companies, we cannot estimate the magnitude that redemption of exempt containers may be skewing the redemption rate.

Without proper monitoring of commercial passenger-vehicle companies, the Program is unsure of the number of such companies operating in Hawaii and whether those companies are actually exempt from paying beverage container deposits and the related container fees. Commercial passenger-vehicle companies that are not exempt may not be paying the beverage container deposits and container fees, resulting in underfunding of the Program, while exempt companies may inappropriately redeem beverage containers for deposits that were not paid into the Program, depleting the Program's funds and overstating the redemption rate. More important, the Program is unable to ensure that such companies are recycling beverage containers consumed on their commercial passenger-vehicles, which was the primary purpose of the Bottle Bill – increase recycling of used beverage containers to reduce litter.

<u>Since inception of the program, exempt commercial passenger-vehicle companies have not been inspected</u>

The Solid Waste Management Coordinator stated that the Program has not developed controls, including inspections of exempt companies, to ensure that containers sold or otherwise disbursed on exempt commercial passenger-vehicles do not enter the redemption stream. Because the Program has failed to monitor whether exempt companies have a recycling plan and whether the plans are being followed, there is little confidence that the exemption is properly administered. The Solid Waste Management Coordinator further stated that the Program has not addressed this area since the inception of the Program due to vacant positions and the hiring freeze.

Consequently, although exempt companies do not pay the deposit and container fee on beverage containers, they could potentially redeem the exempt containers for deposits, resulting in the Program having fewer funds available to pay for operations and an overstated redemption rate. An overstated redemption rate may lead Program management to erroneously conclude that a higher container fee is justified and necessary to continue to operate the program.

Program Management Materially Misstated the Deposit Beverage Container Deposit Special Fund's FY2007 Financial Statements

Program management did not perform reconciliations or ensure proper cut-off resulting in a $5 million restatement of the beginning fund balance

Management is responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, and preventing and detecting fraud. In addition, management is responsible for the fair presentation of the financial statements in accordance with U.S. GAAP.

However, during our audit of the Fund's FY 2008 financial statements, we identified a $5 million accounting error in the Fund's financial statements as of and for the year ended June 30, 2007, due to the lack of oversight by fiscal management over the cutoff and proper recognition of the Program's deposit liabilities. The Program's management did not record an adjustment and thus the Fund's financial statements as of and for the year ended June 30, 2007, were materially misstated.

This material misstatement occurred due to reconciling differences between the Fund's accounting system ("QuickBooks") and the State's Financial Accounting Management and Information System ("FAMIS"). FAMIS is maintained on a cash basis of accounting and QuickBooks is maintained on an accrual basis. As FAMIS is the State's official system, its records are initially used to prepare the Department's and Fund's financial statements. Therefore, an adjustment was necessary to accrue for deposit liabilities incurred prior to June 30, 2007, but not reported to the Program until after that date.

Accordingly, the Fund restated its opening fund balance as of July 1, 2007, to correct the error, which related to the calculation of the beverage container deposit liability. The following table reconciles the Fund's fund balance at June 30, 2007, as previously reported, to the opening fund balance at July 1, 2007, as restated:

Fund balance at June 30, 2007, as previously reported	$ 21,741,830
Adjustment attributable to	
Understatement of deposit beverage container liability	(5,009,338)
Fund balance at June 30, 2007, as restated	$ 16,732,492

As financial statements are relied upon by users to evaluate the financial position and results of an entity's operations, materially misstated financial statements prevent readers from making informed assessments and may lead to poor decisions. As noted above, the Fund's fund balance as of June 30, 2007, was actually $5 million less than was previously reported. The $5 million overstatement of the fund balance and understatement of the deposit liability may have resulted in reader's concluding that the Fund was in a stronger financial position than it actually was.

Conclusion

Despite taking steps to address the findings noted in the Auditor's 2005 report, the Deposit Beverage Container Program and Department of Health's management continue to struggle with managing and administering the Program. The Solid Waste Management Coordinator must take further action to address internal control deficiencies related to properly reporting financial statements and ensuring compliance with Chapter 342G, Part VIII, HRS.

Reliance on self-reporting and lack of systematic compliance inspections increase the risks that the beverage container deposits and container fees are under-collected, deposit redemptions are overpaid, and exempt containers are entering the redemption stream. Consequently, the Program may be operating at a greater cost than necessary, and the reported redemption rate may not be reliable to justify increasing the container fee. Resolution of these deficiencies is necessary to alleviate public concern over the cost of the State's beverage container recycling program, including questions on the amount of the container fee necessary to operate the Program.

Recommendations

The Department and Program should:

1. Fill vacant positions and/or reevaluate staffing levels to allow sufficient time and resources to perform inspection and enforcement responsibilities over distributors and redemption centers to substantiate proper transactions and to detect and prevent improper ones;

2. In conjunction with additional and more robust inspections, utilize the enforcement tools granted to the Program under Chapter 342G, HRS, to encourage compliance;

3. Combine the deposit redemption reimbursement request and handling fee request to streamline the payment process, better link the amounts redeemed and actually sent to recyclers or other end users, and reduce potential overpayments;

4. Regularly evaluate the segregated rates used to convert the weight of deposit beverage containers redeemed into container equivalents to ensure rates approximate hand counts;

5. Obtain from the Department of Transportation Airports and Harbors Divisions a listing of exempt commercial passenger-vehicle companies subject to Chapter 342G, Part VIII, HRS;

6. Monitor and inspect exempt commercial passenger-vehicle companies to ensure approved recycling plans are being followed and that exempt containers are not being redeemed for deposit refunds; and

7. Ensure that procedures to review for proper cutoff dates for transactions and adjustments are enforced, including recording appropriate accrual adjustments to the State's cash basis budgetary accounting system, while preparing the Fund's financial statements included in the Department's annual financial statements.

Chapter 3: Financial Statements

CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying balance sheet of the State of Hawaii, Deposit Beverage Container Deposit Special Fund (the "Fund") as of June 30, 2008, and the related statements of revenues, expenditures and changes in fund balance, and budgetary comparison for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements referred to above include only the financial activities of the Fund, and are not intended to present fairly the financial position, or results of operations of the State of Hawaii or the State of Hawaii, Department of Health, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 7 to the financial statements, an error resulting in an overstatement of the previously reported fund balance as of June 30, 2007 was discovered during fiscal year 2008. Accordingly, the fiscal year 2007 financial statements have been restated and an adjustment has been made to the fund balance as of July 1, 2007 to correct the error.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2008, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2012 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of the report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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Honolulu, Hawaii 96813
Telephone: 808 531 3400 Facsimile: 808 531 3433

The Fund’s management has not presented management’s discussion and analysis for the year ended June 30, 2008 that accounting principles generally accepted in the United States of America require to supplement, although not to be a part of, the basic financial statements.

/s/ Accuity LLP
Honolulu, Hawaii
November 14, 2012

State of Hawaii
Deposit Beverage Container Deposit Special Fund
Balance Sheet
June 30, 2008

Assets	
Equity in cash and cash equivalents in State Treasury	$ 40,806,191
Accrued interest receivable	194,134
Accounts receivable	1,605,736
Total assets	$ 42,606,061
Liabilities and Fund Balance	
Liabilities	
Vouchers and contracts payable	$ 1,979,690
Accrued wages and employee benefits	30,243
Beverage container deposits	21,650,903
Total liabilities	23,660,836
Fund balance	
Reserved for encumbrances	17,646,069
Unreserved	1,299,156
Total fund balance	18,945,225
Total liabilities and fund balance	$ 42,606,061

The accompanying notes are an integral part of these financial statements.

State of Hawaii
Deposit Beverage Container Deposit Special Fund
Statement of Revenues, Expenditures and Changes in Fund Balance
Year Ended June 30, 2008

Revenues	
Deposit beverage container fees	$ 9,478,917
Unredeemed deposits	9,436,126
Interest income and other	557,030
Total revenues	19,472,073
Expenditures	
Administrative expenditures	1,394,861
Handling and redemption fees	14,215,697
Other operating expenditures	1,648,782
Total expenditures	17,259,340
Net change in fund balance	2,212,733
Fund Balance	
Balance at July 1, 2007, as previously reported	21,741,830
Prior period adjustment	(5,009,338)
Balance at July 1, 2007, as restated	16,732,492
End of year	$ 18,945,225

The accompanying notes are an integral part of these financial statements.

State of Hawaii
Deposit Beverage Container Deposit Special Fund
Statement of Budgetary Comparison
Year Ended June 30, 2008

	Budgeted Amounts		Actual Amounts
	Original	Final	(Budgetary Basis)
Revenues			
Current-year funds	$ 71,071,123	$ 71,080,376	$ 59,660,945
Total revenues	71,071,123	71,080,376	59,660,945
Expenditures			
Environmental health administration	71,071,123	71,080,376	65,551,191
Total expenditures	71,071,123	71,080,376	65,551,191
Excess of expenditures over revenues	$ -	$ -	$ (5,890,246)

The accompanying notes are an integral part of these financial statements.

1. Reporting Entity

In 2002, the State of Hawaii Legislature passed Act 176 (the "Bottle Bill") to establish the Deposit Beverage Container Deposit Program. The Deposit Beverage Container Program established the Deposit Beverage Container Deposit Special Fund (the "Fund"). The purpose of Act 176 was to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter.

Pursuant to Chapter 342G, Part VIII, Hawaii Revised Statues ("HRS"), the Fund was initiated to implement a deposit beverage container program, establish minimum standards for the collection of empty beverage containers, to foster systems of redemption which facilitate recycling of empty beverage containers, and to minimize costs without inconveniencing customers. Under the Fund, the State of Hawaii (the "State") collects from manufacturers and distributors, a $0.05 per container refundable deposit on eligible beverage containers manufactured in or imported to the State that are expected to be sold in the State. The deposits are used to reimburse redemption centers. In addition, the Fund assesses a per container handling fee of $0.01 per container if the beverage container redemption rate is less than 70 percent, however may increase the handling fee to $0.015 per container if the redemption rate exceeds 70 percent. The handling fee has been maintained at $0.01 per container since the Fund's inception although the redemption rate during fiscal year 2008 exceeded 70 percent.

The Fund is administered by employees stationed in the Solid Waste Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department").

The accompanying financial statements are intended to present the financial position and results of operations of only that portion of the State and Department that is attributable to the transactions of the Fund and are not intended to present the financial position, results of operations, and cash flows of the State or Department.

2. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the Fund are reported using the current financial resources measurement focus and modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Fund considers revenues to be available if they are collected within 60 days after the end of the current fiscal year. Revenues susceptible to accrual include a $0.01 per beverage container sold handling fee. In addition, the amounts for deposits of $0.05 per beverage container are deferred when collected, and the amount estimated to be forfeited is recognized into income at the end of the year. Management estimates that redemption rate will be 80 percent of the deposits collected during the fiscal year and thus the 20 percent forfeited is recognized as revenue.

Expenditures are generally recorded when a liability is incurred. However, expenditures related to compensated absences are recorded only when payment is due.

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

Had the financial statements been presented on the full accrual basis of accounting, additional adjustments would need to be recorded. These adjustments are recorded on a department-wide level for all governmental activities of the Department. The Fund's portion of these department-wide accruals includes adjustments for capital assets and accrued vacation. At June 30, 2008, the Fund's portion of these accruals was as follows:

Total fund balance on the modified-accrual basis of accounting	$ 18,945,225
Capital assets used in governmental activities are not financial resources and therefore not reported as an asset in the Fund.	24,541
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the Fund.	(41,832)
Total net assets on the full accrual basis of accounting	$ 18,927,934

At June 30, 2008, the Fund's portion of the Department-wide activities was not materially different from the Fund's activity.

Use of Estimates

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

Equity in Cash and Cash Equivalents in State Treasury

All monies of the Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2008, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available for the Fund since such information is determined on a statewide basis. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

In April 2009, the Department of Accounting and General Services ("DAGS") issued Comptroller's Memorandum No. 2009-11, informing State agencies participating in the State Treasury Investment Pool that the State's investments in auction rate securities were impaired as of and for the year ended June 30, 2008 and that each participating State agency would be allocated a portion of the impairment. The Fund's total allocated impairment loss for fiscal year 2008 approximated $1,044,000 and is included in interest income and other in the statement of revenues, expenditures and changes in fund balance.

Accounts Receivable
Revenue is earned when it is considered measurable and available. The accounts receivable balance represents the expected receipts from distributors based on deliveries of the containers as of June 30, 2008.

Beverage Container Deposits
Deposits of $0.05 are made by distributors to the Fund for each qualifying container. The Fund maintains all deposits until the redemption centers claim reimbursement for the deposits that they pay out to the consumers. The Fund maintains the deposits that are expected to be redeemed.

Amounts paid out to the consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e., aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management estimates, based on past collections and success of recycling in other states, that 80 percent of the containers will be recycled every year. The remaining 20 percent of the containers are expected to be unredeemed; therefore, 20 percent of the deposits collected are recognized into revenue each year.

Administrative Costs
The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the Fund, since they are not practical to determine.

New Accounting Pronouncements
In March 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This Statement provides clearer fund balance classifications that can be more consistently applied and clarifies the existing governmental fund type definitions. This Statement also establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds and provides for additional classifications such as restricted, committed, assigned, and unassigned fund balance. The provisions of this Statement are effective for financial statements for the fiscal year beginning after June 15, 2010.

In March 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP. The requirements of this Statement became effective upon its issuance and did not materially impact the Fund's financial statements.

In March 2009, the GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The objective of this Statement is to incorporate certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statement on Auditing Standards into GASB's authoritative literature. This statement was intended to improve financial reporting by bringing the authoritative accounting and financial reporting literature together in one place. The requirements of this Statement became effective upon its issuance and did not materially impact the Fund's financial statements.

In January 2010, the GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The objective of this Statement is to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, as an option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. The requirements of this Statement are effective for periods beginning after June 15, 2011. Management does not expect that this Statement will have a material effect on the Fund's financial statements as the Fund participates in the State's plan, which has more than 100 members.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Statement is intended to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The provisions of this Statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In June 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In June 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – an Amendment of GASB Statements No. 10 and No. 62*. The Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. Consequently, governments should base their decisions about fund type classification on the nature of the activity to be reported, as required in Statement No. 54 and Statement No. 34 , *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012 with earlier application encouraged. Management has not yet determined the effect the amendment to Statement No. 10 will have on the Fund's financial statements but does not expect the amendment to Statement No. 62 to have a material effect on the Fund's financial statements.

3. Budgeting and Budgetary Control

The Fund follows these procedures in establishing the budgetary data reflected in the basic financial statements:

- *The Budget* – Not less than 20 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.

- *Legislative Review* – The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs, and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.

- *Program Execution* – Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

A budget is adopted for the Fund and is prepared on the basis of cash receipts and amounts disbursed, which is a basis of accounting other than GAAP.

The major differences between the budgetary and GAAP bases are that: (1) the budget is prepared on the basis of cash receipts and amounts disbursed; and (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis.

Since budgetary basis differs from GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures on a budgetary basis at June 30, 2008, to revenues in excess of (less than) expenditures presented in conformity with GAAP follows:

Excess of expenditures over revenues – actual on a budgetary basis	$ (5,890,246)
Reserve for encumbrances at year end	17,646,069
Expenditures for liquidation of prior year's encumbrances	(8,329,377)
Accruals and other adjustments	(1,213,713)
Change in fund balance – GAAP basis	$ 2,212,733

4. Beverage Container Deposits

The changes to the beverage container deposit liability during fiscal year 2008 were as follows:

Balance at July 1, 2007, as restated	$ 18,134,114
Increase: Deposits received from distributor	47,501,031
Decrease: Payments made to redemption centers, net of refunds	(34,548,116)
Decrease: Unredeemed deposits recognized as revenue	(9,436,126)
Balance at June 30, 2008	$ 21,650,903

5. Employee Benefit Plans

Substantially all eligible employees of the Fund participate in the State's retirement and post-retirement benefit plans. The State's plans include the Employee's Retirement System ("ERS") of the State of Hawaii, post-retirement health care and life insurance benefits, a deferred compensation plan, and sick leave benefits. For information on the State's benefit plans, refer to the State of Hawaii and ERS' Comprehensive Annual Financial Reports ("CAFR"). The State's CAFR can be found at the DAGS website: http://hawaii.gov/dags/rpts. The ERS CAFR can be found at the ERS website: http://ers.ehawaii.gov/.

6. Commitments and Contingencies

Insurance Coverage

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2008, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Fund's portion of the State's workers' compensation expense for the year ended June 30, 2008 was immaterial.

Litigation

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Fund's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

Ceded Lands

The Office of Hawaiian Affairs ("OHA") and the State are involved in litigation regarding the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. The ultimate outcome of this matter is still unknown. Full discussion of this matter and other legal matters between OHA and the State are disclosed in the State's CAFR and the Department's audited financial statements.

7. Restatement

The Fund has restated its June 30, 2007 fund balance to correct an understatement of the Fund's beverage container deposit liability. As a result of the restatement, the Fund made the following adjustment to its previously reported June 30, 2007 fund balance.

Fund balance at June 30, 2007, as previously reported	$	21,741,830
Adjustment attributable to		
Understatement of deposit beverage container liability		(5,009,338)
Fund balance at June 30, 2007, as restated	$	16,732,492

8. Subsequent Events

According to HRS 342G-104, any funds that accumulate in the Deposit Beverage Container Fund shall be retained by the fund unless determined to be in excess by the Legislature. The Legislature passed Act 192 during the 2010 session, authorizing a transfer of up to $1,000,000 from the Deposit Beverage Container Fund to the State's general fund to address the fiscal year 2011 budget shortfall. The Legislature later passed Act 124 during the 2011 session authorizing an additional $300,000 to be transferred to the State's general fund. Acts 192 and 124 were applied to fiscal year 2011 resulting in a total of $1,300,000 transferred from the Fund to the State's general fund.

As the redemption rate has been over 70 percent since fiscal year 2008, in accordance with Chapter 342G, Part VIII, HRS, the director of health increased the beverage container fee to $0.015 per container, effective September 1, 2012.

Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors 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 State of Hawaii, Deposit Beverage Container Deposit Special Fund (the "Fund"), as of and for the year ended June 30, 2008, and have issued our report thereon dated November 14, 2012. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Fund'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 an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We identified two significant deficiencies in internal control over financial reporting in Chapter 2.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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Honolulu, Hawaii 96813
Telephone: 808 531 3400 Facsimile: 808 531 3433

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies, and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency related to the restatement of the Fund's previously issued financial statements to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated July 17, 2009.

The Fund management's responses to the findings identified in our audit are described in the attached response. We did not audit the Fund management's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor; the State of Hawaii Legislature; the State of Hawaii, Deposit Beverage Container Deposit Special Fund's management, and the State of Hawaii, Department of Health's management and is not intended to be and should not be used by anyone other than these specified parties.

/s/ Accuity LLP
Honolulu, Hawaii
November 14, 2012

Management Response

We transmitted drafts of this report to the Department of Health on November 13, 2012. A copy of the transmittal letter to the department is included as Attachment 1. The department's response is included as Attachment 2.

Comments on Agency Response

In its response, the department objected to the formatting of the report, which it believes highlights criticisms without providing underlying reasons for existing problems. However, the department concurred with the findings and conclusions of the report.

The department also provided specific comments for each recommendation, indicating it is addressing the findings.

ATTACHMENT 1

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

MARION M. HIGA
State Auditor

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

November 13, 2012

COPY

The Honorable Loretta J. Fuddy
Director
Department of Health
Kīna'u Hale
1250 Punchbowl Street
Honolulu, Hawai'i 96813

Dear Ms. Fuddy:

Enclosed for your information are three copies, numbered 6 to 8, of Accuity LLP's confidential draft report, *Deposit Beverage Container Deposit Special Fund Financial and Program Audit, June 30, 2008 and Deposit Beverage Container Special Fund Financial and Program Audit, June 30, 2010*. We ask that you telephone us by Thursday, November 15, 2012, 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, November 20, 2012.

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

Marion M. Higa
State Auditor

Enclosures

NEIL ABERCROMBIE
GOVERNOR OF HAWAII

LORETTA J. FUDDY, A.C.S.W., M.P.H.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P. O. BOX 3378
HONOLULU, HI 96801-3378

In reply, please refer to:

ASO-F13-199

November 19, 2012

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OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
Office of the Auditor, State of Hawaii
465 South King Street, Suite 500
Honolulu, HI 96813

Dear Ms. Higa,

Attached are the Department of Health's responses to the comments on the Audited Report for the Deposit Beverage Container Deposit Special Fund as of June 30, 2008.

We appreciate the opportunity to comment on this report.

Sincerely,

Loretta J. Fuddy, A.C.S.W., M.P.H.
Director of Health

Attachment

Subject: 2008 AUDIT OF THE DEPOSIT BEVERAGE CONTAINER PROGRAM

We appreciate the opportunity to comment on the subject report. Prior to stating our specific comments to your recommendations, we would like to make the following general observations.

This report correctly points out that most of the shortcomings cited are a direct result of lack of resources and to that extent, the Program essentially concurs with many of the findings of the report. However, it does require a thorough reading of the report and consideration of the Program's comments to ascertain that conclusion. The Department is concerned and wishes to go on record as noting that the practice of the Office of the Legislative Auditor in formatting the report in the manner of highlighting the criticisms in bold letters and not providing the underlying reasons for the existing problems, may have the unintended consequences of being misleading and creating confusion, particularly in light of the possibility that the media may choose to focus on the one particular highlighted point.

As with virtually all new programs, there is always an additional time factor involved before a program comes into fruition and begins to demonstrate the intended results. The Program recognizes it will continue to have a minimal presence to perform inspection and enforcement responsibilities over distributors and redemption centers while the inability to recruit and retain qualified personnel persists. In response the Department of Health is considering a reorganization to provide manpower and resources to accomplish recommendations in these audits.

Having stated the above, we now offer the following specific comments on the recommendations made in the report:

Recommendation No. 1

Fill vacant positions and/or reevaluate staffing levels to allow sufficient time and resources to perform inspection and enforcement responsibilities over distributors and redemption centers to substantiate proper transactions and to detect and prevent improper ones.

Program Comment No. 1

During the audit period ending June 30, 2008 the Deposit Beverage Container Program (Program) was actively hiring for all vacant inspector positions. Recruitment was limited due to the low number of applicants and low salary level of the positions. Two of the hires during this period unfortunately left the program within six months for personal reasons which did not provide sufficient time for them to become adequately trained to perform independent inspections and enforcement duties. Additionally, two inspector positions could not be filled during this period because of the limited number of applicants.

Recommendation No. 2

In conjunction with additional and more robust inspections, utilize the enforcement tools granted to the Program under Chapter 342G, HRS, to encourage compliance.

Program Comment No. 2

Field citations are the most important tool in every enforcement program to effectively maintain and achieve compliance. Similar to parking tickets, field citations can be issued to redemption centers, manufacturers, distributors and retailers. The penalty offers a rapid settlement of the violation and importantly expedites corrective actions. The Program during this audit period was actively going through the process of adopting new rules that would allow Program inspectors to issue field citations. The rules were approved by the Small Business Regulatory Review Board on October 19, 2007 and were presented at a Public Hearing on March 4, 2008. Unfortunately, the Governor did not approve the rules and effectively prevented the Program from utilizing this invaluable enforcement tool. This left the Program with the lengthy and unwieldy enforcement process of being able to issue only warning letters and administrative orders that are less effective in achieving compliance by distributors and redemption centers. The Program is currently drafting new rules that include field citations.

Recommendation No. 3

Combine the deposit redemption reimbursement request and handling fee request to streamline the payment process, better link the amounts redeemed and actually sent to recyclers or other end users, and reduce potential overpayments.

Program Comment No. 3

The Program has been exploring different methodologies that streamline the payment process that is more reflective of the actual amount of redeemed beverage containers. The Program is considering a methodology we describe as "Back-End Payment". This methodology combines the payment of the deposit and handling fees based upon the certified weight and commodity of deposit beverage containers (DBC) loaded into shipping containers that are subsequently sealed and ready to be shipped to end user markets. On October 29, 2012 the Program determined that it is feasible to certify the weight and commodity of DBC in sealed shipping containers either by using a Certified Marine Surveyor or by Program inspection staff. The Program will continue to evaluate the feasibility of certifying DBC loads and develop a claim and payment system that will accommodate the Back-End Payment methodology.

Recommendation No. 4

Regularly evaluate the segregated rates used to convert the weight of deposit beverages containers redeemed into container equivalents to ensure rates approximate hand counts.

Program Comment No. 4

The Program has been performing segregated rate studies since 2005. In 2007 the Program hired Capital Pathways, LLC to develop a systematic sampling procedure that could be performed in house. Utilizing the methodology by Capital Pathways, LLC the Program performed additional studies in 2009 and 2010. Each study resulted in the subsequent adjustment of the segregated rates to reflect the changes in beverage container sizes, construction and the associated changes in container numbers per pound.

Recommendation No. 5

Obtain from the Department of Transportation Airports and Harbors Divisions a listing of exempt commercial passenger-vehicle companies subject to Chapter 342G, Park VIII, HRS.

Program Comment No. 5

Prior to the publication of the draft audit, the Program obtained the list of airlines and cruise ships from the Hawaii State Department of Transportation and requested recycling plans from all companies that were on the list. The program will update its list on an annual basis by requesting the information from the Department of Transportation on all airlines, cruise lines and commercial passenger-vehicle companies that operate in Hawaii.

Recommendation No. 6

Monitor and inspect exempt commercial passenger-vehicle companies to ensure approved recycling plans are being followed and the exempt containers are not being redeemed for deposit refunds.

Program Comment No. 6

The Program recognizes and agrees with the audit that this is an important area that must be monitored and inspected. The Program will need to first overcome position vacancies in order to have the capacity to monitor and inspect exempt commercial passenger-vehicle companies. The Program has extended its search for qualified candidates beyond the State Human Resources Office and has attended several job fairs in an attempt to reach additional candidates. The Program is considering a reorganization to provide manpower and resources to accomplish this task.

Recommendation No. 7

Ensure that procedures to review for proper cutoff dates for transactions and adjustments are enforced, including recording appropriate accrual adjustments to the State's cash basis budgetary accounting system, while preparing the Fund's financial statements included in the Department's annual financial statements.

Program Comment No. 7

The State's Financial Accounting Management and Information System "FAMIS" is maintained on a cash basis of accounting, and the program's Fund Accounting System "QuickBooks" is maintained on an accrual basis. A procedure has been implemented to properly review and record expenses and related liabilities in the fiscal year in which they were incurred. The accrued cutoff date is determined to be prior to the closing date of issuing the department financial statements. We record invoices that post to FAMIS in July, August, September, October and maybe even November with goods/services dated June 30 and prior. The reconciliation for accrued liabilities has been verified in QuickBooks and FAMIS to ensure completeness and accuracy.