
Report on the Implementation of State Auditor's 2010 Recommendations

Business, Economic Development & Tourism
Budget and Finance
Aloha Tower Development Corporation
State Procurement Office, pCard Program
Public Safety, Sheriff Division
Public Safety, Prison Bed Contracting
Department of Taxation, Contracts

A Report to the
Governor
and the
Legislature of
the State of
Hawai'i

Report No. 13-03
April 2013



THE AUDITOR
STATE OF HAWAII

Office of the Auditor

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

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

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.
7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.
8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.
9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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



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**“Insanity is doing
the same things
and expecting a
different result.”**

*— Aloha Tower
Development Corporation
board member on altering
development strategies
and pursuing a non-retail
concept for the Aloha
Tower Marketplace area.*

Status of
Recommendations

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Report on the Implementation of State Auditor's 2010 Recommendations

Report No. 13-03, April 2013

*Fewer than half of 2010 recommendations have been
implemented; 30 percent are still in progress*

The 2008 Legislature amended the Auditor's governing statute to require follow-up reporting on recommendations made in various audit reports to ensure agency accountability over audit recommendations. The purpose of this change was to apprise the Legislature annually of recommendations not implemented by audited agencies, and to require such agencies to submit a written report not later than 30 days after issuance of our report explaining why the recommendation was not implemented and the estimated date of its implementation.

Our review focused on entities' implementation of audit recommendations made in calendar year 2010. We found that of 72 recommendations made in 2010, 29 were closed (40 percent), 12 were open (17 percent), 21 were open but in progress (29 percent), three were open and likely not to be pursued (4 percent), five were considered not applicable (7 percent), and two were not assessed (3 percent). This report details each recommendation, its status, and actions taken related to the recommendation.

Investigation of Specific Issues of the Department of Business, Economic Development & Tourism, Report No. 10-01

Our 2010 report found a variety of troubling actions by the department in its portrayal and use of federal reimbursement funds and ethical concerns stemming from actions related to a 2005 trade mission to China. Our follow-up found a change in department leadership has coincided with a greater emphasis on transparency and compliance among department personnel. Actions have also been taken to address our 2010 recommendations regarding the continued use of federal reimbursement funds.

Financial Examination of the Department of Budget and Finance, Report No. 10-03

Our 2010 report questioned the department's management of state funds and its decision to invest in auction-rate securities in violation of statutory and departmental policy. When the market failed, the department was left with more than \$1 billion in securities with maturity dates as far off as the year 2045. Our follow-up found the State has reached an agreement that provides an opportunity to sell the securities and preserve its principal. In addition, the department has taken steps as recommended to revise its investment policy and increase oversight of its investment program to improve compliance.

Management Audit of the Aloha Tower Development Corporation, Report No. 10-04

Our 2010 report found a corporation mired in litigation for every development it had undertaken and headed by a board that knowingly operated with an outdated master plan and rules, which affected its ability to accomplish its mission. Our follow-up found the corporation was not abolished as recommended. Instead, it was moved to the Department of Transportation and its board membership reduced. Actions have been taken to address a \$7 million debt owed by the corporation and all litigation has been resolved. However, the board continues to knowingly move forward with an outdated master plan and has adopted a philosophy that surrenders its development responsibilities.



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**"If our credibility
is shot, we can't
function."**

*– Director of business,
economic development
& tourism on the need
for the department to
establish a reputation of
compliance.*

Status of
Recommendations

For the full text of this and other
reports, visit our website:
<http://www.state.hi.us/auditor>

Program and Management Audit of the State's Purchasing Card Program, Report No. 10-05

Our 2010 report found the State Procurement Office (SPO) took a hands-off approach to administering the pCard Program by delegating significant responsibilities to executive agencies and failed to establish meaningful performance goals for the program. We concluded that this approach prevented the SPO from fully realizing the pCard Program's potential. Requests by our office to meet with the SPO to conduct our follow-up were not granted. As a result, we were unable to verify or clarify agency claims in relating to implementation of our recommendations.

Audit of the Department of Public Safety, Sheriff Division, Report No. 10-06

Our 2010 report found that a lack of proper guidance by management and inadequate training, coupled with expanded responsibilities, contributed to the division's struggles to uphold its law-enforcement duties. Our follow-up found the division has taken steps to provide clearer guidance for law enforcement and identify actions necessary to achieve strategic goals and objectives. However, ongoing personnel issues and unresolved disputes with other agencies continue to impact the division's ability to meet security needs at public venues such as courts and airports.

Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services, Report No. 10-10

Our 2010 report found the department did not provide reliable financial data for policymakers to make knowledgeable decisions regarding the State's prison overcrowding problem. Procurement issues were also raised about agreements for prison beds and services at mainland corrections facilities. Our follow-up found the department has improved the accuracy of its incarceration data through better methodology. However, while procurement compliance is considered a priority for the department director, we found a number of department staff still engage in procurement activity without having received any procurement training as recommended.

Management and Financial Audit of the Department of Taxation Contracts, Report No. 10-11

Our 2010 report found several factors contributed to the department's inability to finalize a decade-long effort to replace its aging computer system. A lack of long-term planning, coupled with the department's reliance on a contracted vendor, raised concerns about the department's ability to perform ongoing enhancements to its information technology (IT) system beyond 2011, when the vendor's services expired. Our follow-up found new leadership has resulted in an improved work environment with an emphasis on long-range planning and working together to achieve department goals. The department has also followed our recommendation to develop a transition plan enabling it to adequately assume all technical functions and responsibilities previously performed by its IT vendor.

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Submitted by

THE AUDITOR
STATE OF HAWAI'I

Report No. 13-03
April 2013

Foreword

This is a report on our follow-up review of the implementation of audit recommendations made to various entities in calendar year 2010. We conducted our work pursuant to Section 23-7.5, Hawai'i Revised Statutes, which requires the Auditor to report to the Legislature on each recommendation that the Auditor has made that is more than one year old and that has not been implemented by the audited agency.

We wish to express our appreciation for the cooperation and assistance extended to us by the Department of Business, Economic Development and Tourism, the Department of Budget and Finance, the Aloha Tower Development Corporation, the State Procurement Office, the Department of Public Safety, the Department of Taxation, and others whom we contacted during the course of our review.

Jan K. Yamane
Acting State Auditor

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Chapter 1

Introduction

To ensure agency accountability over audit recommendations, the 2008 Legislature amended the Auditor's governing statute to require follow-up reporting on recommendations made in various audit reports. The purpose of this change was to apprise the Legislature of recommendations not implemented by audited agencies. Section 23-7.5, Hawai'i Revised Statutes (HRS), now requires the Auditor to report to the Legislature annually on each audit recommendation more than one year old that has not been implemented by the audited agency.

Legislative Request

The 2008 Legislature intended to provide itself with greater oversight over the implementation of audit recommendations. Act 36, Session Laws of Hawai'i (SLH) 2008, was modeled after a 2006 California law, which enabled legislators to use agencies' claims of progress against audit recommendations in their budget discussions.

The Hawai'i Legislature requested the Auditor to report annually, for each unimplemented recommendation: 1) the agency that was audited; 2) the title and number of the audit report that contained the recommendation; 3) brief description of the recommendation; 4) the date the audit report was issued; and 5) the most recent explanation provided by the agency to the Auditor regarding the status of the recommendation.

In addition, agencies notified by the Auditor that a recommendation is not considered implemented must submit a written report to the Auditor, the Senate president, and the speaker of the House of Representatives within 30 days of being notified by the Auditor. The report must also include an explanation of why the recommendation was not implemented and an estimated date of when it will be implemented.

Objectives of the Review

1. Validate the claims made by agencies regarding implemented audit recommendations.
2. Report to the Legislature on audit recommendations not yet implemented.

Criteria

We relied on Chapter 23, *Auditor*, HRS; *GAO-07-731G Government Auditing Standards*, U.S. Government Accountability Office (GAO), December 2011 Revision; and *How to Get Action on Audit Recommendations*, U.S. General Accounting Office, July 1991, in the conduct of our review.

The GAO's criteria were especially useful for our purposes, since GAO also reports on the status of recommendations not fully implemented. The GAO's reports are intended to "help congressional and agency leaders determine the actions necessary to implement the open recommendations so that desired improvements to government operations can be achieved." In particular, GAO reports on whether:

- Monitoring and follow-up are done by staff members responsible for, and knowledgeable about, the recommendation;
- Each recommendation is followed up on an ongoing basis, with at least semi-annual updates, and an individual recommendation follow-up plan is developed for each assignment; and
- Results intended by each recommendation and benefits expected from its implementation are defined as a basis for determining the adequacy of implementation.

Scope and Methodology

We based our scope and methodology on GAO's guidelines in *How to Get Action on Audit Recommendations* (1991). According to GAO, saving tax dollars, improving programs and operations, and providing better service to the public represent audit work's "bottom line." Recommendations are the vehicles by which these objectives are sought. However, it is action on recommendations—not the recommendations themselves—that helps government work better at less cost. Effective follow-up is essential to realizing the full benefits of audit work.

Our review focused on departments' implementation of our prior reports' audit recommendations. We conducted interviews with department personnel, board members, legislators, and contractors. We reviewed relevant statutes and rules, policies and procedures, reports, and other documents to assess management's claims regarding implementation of recommendations. We conducted site visits to observe processes in place. Our review focused on audit reports issued in calendar year 2010.

Our review was conducted between December 2012 and March 2013. We followed standard office procedures for conducting audits pursuant

to the Office of the Auditor's *Manual of Guides*, and generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform our work to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our objectives. We believe the evidence obtained provides a reasonable basis for our conclusions based on our review objectives.

Determining progress

The rate of progress of a recommendation's implementation depends on the type of recommendation. While some fall fully within the purview of an audited agency and can be addressed relatively quickly, others may deal with complex problems and involve multiple agencies, resulting in a long implementation period. Therefore, ample time should be afforded to agencies implementing recommendations in order for a follow-up system to be useful and relevant. In addition, GAO has found that action on recommendations usually occurs within the first three years. After that time, few recommendations are implemented.

With those observations in mind, we decided that an active follow-up effort would be most effective and relevant if conducted three years after publication of an initial audit report. Too short an interval between audit report and follow-up might not give agencies enough time to implement a complex recommendation; too long might allow agencies to lose valuable personnel and institutional knowledge needed to conduct an adequate follow-up.

Eleven reports were issued in 2010, including a study related to mandatory health insurance coverage; a review of revolving funds, trust funds, and trust accounts; and two sunrise analyses. Because the recommendations made in these reports relate to specific legislation rather than operations of agencies and departments, we conclude that Section 23-7.5, HRS, does not apply. After excluding the above reports, we were left with seven reports from 2010 to review for audit recommendation implementation:

1. Report No. 10-01, *Investigation of Specific Issues of the Department of Business, Economic Development & Tourism*;
2. Report No. 10-03, *Financial Examination of the Department of Budget and Finance*;
3. Report No. 10-04, *Management Audit of the Aloha Tower Development Corporation*;
4. Report No. 10-05, *Program and Management Audit of the State's Purchasing Card Program*;

5. Report No. 10-06, *Audit of the Department of Public Safety, Sheriff Division*;
6. Report No. 10-10, *Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services*; and
7. Report No.10-11, *Management and Financial Audit of Department of Taxation Contracts*.

Our review procedures included interviews with selected administrators, managers, and staff from the respective agencies. We examined the various agencies' policies, procedures, and relevant documents and records to assess and evaluate whether their actions adequately fulfilled our recommendations. Our review efforts were limited to the inquiry, testing, and reporting on implementation of recommendations made in the above-mentioned reports. We did not explore new issues or revisit old ones that did not relate to our original recommendations. Site visits and observations were conducted as needed to achieve our objectives.

Identifying key recommendations

The extent of work done to verify implementation depends on the significance of individual recommendations. For instance, GAO notes that while all audit recommendations should be aggressively pursued, some are so significant that added steps are needed to implement them. The significance of a recommendation depends on its subject matter and the specific situation to which it applies. Significance can be addressed in terms of dollars; however, dollars are only one measure, and not necessarily the most important one. For instance, recommendations to ensure safe operations often take precedence, since their implementation could prevent the loss of life, substantial bodily injury, or environmental contamination.

Closing recommendations

In accordance with GAO guidelines, we considered recommendations "closed" for the following reasons:

- The recommendation was effectively implemented;
- An alternative action was taken that achieved the intended results; or
- The recommendation was not implemented despite the use of all feasible strategies.

Definition of terms

Closed: Recommendation has been addressed and implemented.

Open: Work on the recommendation has not started, or cannot start because a precursor event has not occurred.

Open but in progress: Agency has taken action, but implementation of the recommendation is not complete.

Open and likely not to be pursued: Agency has no intention of pursuing implementation of the recommendation.

Not applicable: Recommendation is no longer applicable.

Did not assess: Did not assess recommendation implementation.

Summary of recommendations

Our review covered a total of 72 recommendations. Twenty-nine of these were closed (40 percent), 12 were open (17 percent), 21 were open but in progress (29 percent), three were open and likely not to be pursued (4 percent), five were considered not applicable (7 percent), and two were not assessed (3 percent). Our report details each recommendation, its status, and actions taken related to the recommendation. Exhibit 1.1 lists the reports reviewed and each recommendation's status.

Exhibit 1.1
Reports Reviewed and Recommendation Status

Report No.	Report Name	Status of Recommendation						
		Closed	Open	Open but in progress	Open and likely not to be pursued	Not applicable	Did not assess	Total
10-01	<i>Investigation of Specific Issues of the Department of Business, Economic Development & Tourism</i>							
	Department	4		2				6
	State Procurement Office					1		1
	Governor					1		1
	Legislature					1	2	3
10-03	<i>Financial Examination of the Department of Budget and Finance</i>							
	Department	16	1	8	1	1		27
10-04	<i>Management Audit of the Aloha Tower Development Corporation</i>							
	Legislature	2				1		3
	Hawai'i Community Development Authority (HCDA)		1	1				2
10-05	<i>Program and Management Audit of the State's Purchasing Card Program</i>							
	State Procurement Office		7					7
10-06	<i>Audit of the Department of Public Safety, Sheriff Division</i>							
	Department		2	3				5
10-10	<i>Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services</i>							
	Department	2		5	1			8
	State Procurement Office	1	1					2
10-11	<i>Management and Financial Audit of Department of Taxation's Contracts</i>							
	Department	4		2				6
	Legislature				1			1
	TOTAL	29	12	21	3	5	2	72
	Percent of Total	40%	17%	29%	4%	7%	3%	100%

* The Aloha Tower Development Corporation was retained and its duties were not transferred to the Hawai'i Community Development Authority, contrary to our audit recommendation. As a result, these recommendations were applied to the corporation board instead of the authority.

Source: Office of the Auditor

Chapter 2

Actions at Business Department Reflect a Tone at the Top That Emphasizes Compliance

Our Investigation of Specific Issues of the Department of Business, Economic Development & Tourism, Report No. 10-01, released in January 2010, found a variety of troubling actions by the Department of Business, Economic Development & Tourism (DBEDT) in certain international activities. We found a director and department had provided state officials and lawmakers with incomplete, confusing, or misleading information that enabled the department to control expenditure of private funds as well as federal reimbursement funds with little or no spending restrictions. The department also provided misinformation regarding a 2005 trade mission to state agencies and lawmakers, who were trying to ascertain whether applicable laws and procedures had been violated. We also found ineffective oversight of expenditures and reporting requirements of the Out-of-State Offices, which created opportunities for fraud and abuse.

Our follow-up review found similar behavior by the department continued months after our report was issued and that actions to address a number of our recommendations did not take place until after a new department director was appointed. In our 2010 report, we recommended the department cease using federal reimbursement funds until the status of those moneys could be discussed between the department, Legislature, and director of finance. However, our current review found that the department continued to spend thousands in reimbursement moneys to pay for its employees' expenses related to a trade mission in 2010, including the former director's.

We also found the department, in 2012, eventually deposited the remaining balance of the reimbursement funds to the state treasury as suggested in our report. However, prior to closing the accounts, the department used the reimbursement funds in 2011 to pay for a financial audit of its Out-of-State Offices.

We note the current director's actions demonstrate that compliance with laws and rules regarding procurement is a priority. In addition, the department ensures staff are made aware of any available ethics training which addresses the intent of another of our recommendations. Subsequent to our 2010 report, we found the policies regarding reporting requirements for the Out-of-State Offices have been updated in accordance with our recommendations; however, we have some concerns regarding implementation of those policies.

Background

The Department of Business, Economic Development & Tourism (DBEDT) is Hawai‘i’s resource center for economic and statistical data, business development opportunities, energy and conservation information, and foreign trade advantages. Our 2010 investigation focused on the programs and activities of the Strategic Marketing and Support Division (SMSD), which has fiscal and operational control of the Out-of-State Offices. The State opened an overseas office in Taipei, Taiwan, in 1994 and another in Beijing, China, in 2001.

In 2003, the department participated in the federal Market Development Cooperator Program (MDCP) under the International Trade Administration of the U.S. Department of Commerce. Eligible non-profit groups, which include such entities as DBEDT, competed for a limited number of federal awards. In accordance with the program awards, each dollar of federal funding must be matched by the applicants on a 2:1 basis, with half being cash and the other half matching funds in the form of in-kind contributions. The department applied expenses associated with its Out-of-State Offices, including salaries and overhead, as matching funds. These costs were already included in the department’s budget. By the end of 2005, the department had received nearly \$400,000 in federal reimbursements, which was the maximum it was eligible to receive.

Prompted by a reduction-in-force action in 2009 and abolishment of positions within the department, DBEDT reorganized in 2011. As a result, the SMSD was renamed the Business Development and Support Division (BDSB) to better reflect the division’s scope of services, which include promoting industry development and economic diversification by supporting existing and emerging industries through the attraction of new business, investment, and support services. The BDSB continues to operate the Out-of-State Offices.

Questionable use of reimbursement funds took place under the former director

Our 2010 investigation report found the department had two accounts that held MDCP reimbursement funds. One was in Honolulu and the other in Beijing, China. The second account was primarily used to pay staff salaries, benefits, and overhead costs of the Beijing office. The money also allowed the department to keep its Beijing office in operation even as the budget for its overseas offices was cut by a legislative mandate. Our report noted that the finance director, budget chief of the House Finance Committee, and branch chiefs from the Department of Accounting and General Services agreed that reimbursements for general fund expenditures are expected to be deposited back into the general fund. But months after our investigation report was released in January 2010, the department spent more than \$11,300 in MDCP reimbursement funds to pay for airfare and hotel costs for the former department

director, SMSD administrator, and an SMSD branch chief in connection with a June 2010 trade mission to China and Japan. According to the BDSO administrator (the then-SMSD administrator), he wanted to close the MDCP accounts soon after our investigation report was issued, but the idea was rejected by the former director. It should be noted that the administrator was among the three department personnel whose costs associated with the 2010 trade mission were paid with MDCP reimbursement funds.

Our investigation report noted there was more than \$225,000 in the department's Honolulu MDCP account as of February 2009. In February 2012, under the current director, the division closed its MDCP accounts in Honolulu and China. The remaining balance in both accounts, totaling more than \$158,000, was deposited into the general fund.

Clarity concerns resurfaced regarding the characterization of MDCP funds

Before the MDCP accounts were closed in February 2012, the current director approved expending \$25,000 in MDCP funds for a financial audit of the Out-of-State Offices. However, the actions that led to the director's approval raise concerns similar to those in our 2010 report. Our 2010 investigation found the department obtained key approval from the director of finance and the Legislature that enabled it to keep its MDCP funds and spend those moneys at its discretion. However, the department characterized its MDCP funds as a federal grant, with no mention of reimbursements. According to the finance director and budget chief of the House Finance Committee, had it been made clear that MDCP moneys were reimbursements for the department's expenditure of appropriated funds, there would have been an expectation that those moneys would be returned to the general fund.

According to the department's fiscal officer, each year the department needs legislative authorization to use MDCP funds; this occurs by establishing a spending ceiling, which serves as an appropriation. The division administrator added that the department has done so, and that a budget proviso passed by the 2010 Legislature authorized the department to spend \$50,000 in MDCP funds to pay for the financial audit. However, the division administrator also said the department did not clarify to the Legislature that MDCP funds were reimbursements, and continued to portray them as a federal grant. He also did not brief the current director about the uncertain status of the MDCP funds before the director approved the use of MDCP funds to conduct a financial audit. Failure to brief the current director about whether the MDCP funds were available for department use or whether they should be returned to the general fund contributed to the director's decision to approve the expending of \$25,000 in MDCP money in 2011 for a financial audit.

Current director has demonstrated that compliance is a priority

Our 2010 investigation report found the department demonstrated a troubling pattern of nondisclosure over an extended period of time that reflected poorly on the department and its director, and could have damaged DBEDT's ability to function. The current director said the department's "primary currency" is its credibility. Upon his arrival, the director ordered an internal procurement compliance audit covering all of DBEDT's divisions. Those findings resulted in the director's 2012 decision to suspend procurement authority for two division administrators. Their authority was restored months later, after they completed procurement training. However, the administrators accepted that future violations could again result in suspension of their procurement authority. Interviews with department staff show the current director makes clear that compliance with laws and rules is a priority.

Status of Recommendations

Report No. 10-01, *Investigation of Specific Issues of the Department of Business, Economic Development & Tourism*, included a multi-part recommendation to the department; single recommendations to the State Procurement Office and the governor; and a multi-part recommendation to the Legislature focusing on actions to address oversight measures regarding trade missions, the Out-of-State Offices' reporting functions, and MDCP account funds.

Recommendations to the Department of Business, Economic Development & Tourism

We made a six-part recommendation to the department that focused on its use of MDCP funds; measures addressing expenditure reporting requirements for Out-of-State Offices and review of those reports; ensuring the Out-of-State Offices' accounting system is reviewed; adhering to federal guidance regarding trade missions; and providing ethics training to department employees. In our follow-up effort, we found the department's MDCP accounts in Honolulu and China were closed and their remaining balances deposited into the state treasury. Therefore, we deem recommendation No. 1a **Closed**.

We recommended that department personnel who review expenditure reports submitted by Out-of-State Offices be proficient in the Chinese language, since the documents include invoices and receipts written in Chinese. The department updated its Out-of-State Offices Procedures Manual to require that the review process involve at least one person who is literate in Mandarin. Since our office does not have the linguistic ability to verify whether employees involved in the review process are in fact, proficient in Mandarin, we reviewed those employees' position descriptions and found that none require any skill in reading or writing Mandarin. Therefore, we deem recommendation No. 1b **Open but in progress**.

The report also recommended the department update its Out-of-State Offices Procedures Manual to include specific reporting criteria regarding Overseas Offices' expenditures. Our review found the department did update its procedures manual regarding reporting requirements. However, the department employee assigned to interpret receipts and ensure expenditure reports are valid had not been following the manual because that employee was not aware it existed. Nevertheless, the manual was updated in accordance with the report's recommendation; therefore, we deem recommendation No. 1c **Closed**. We also found a financial review of the Out-of-State Offices was performed as recommended. Therefore, recommendation No. 1d is deemed **Closed**. We also found that the department director and deputy director completed mandatory ethics training and the department takes steps to notify employees of the availability of ethics training; therefore, recommendation No. 1f is deemed **Closed**. Finally, we recommended that future trade missions follow federal guidelines as provided by the U.S. Department of Commerce. Even though the Out-of-State Offices Procedures Manual now includes the federal trade mission policy, the former director did not use the policy as guidance in the planning of the most recent trade mission in 2010; therefore, recommendation No. 1e is deemed **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Business, Economic Development & Tourism			
(1a) Cease expending or transferring remaining MDCP funds until it consults with the Legislature and the Department of Budget and Finance to determine whether the funds should be deposited in the general fund.	The department failed to make clear to lawmakers and to the finance director that the MDCP funds were reimbursement moneys and not federal grant moneys.	Closed	In February 2012, the department closed its MDCP accounts and deposited the remaining funds into the general fund.
(1b) Ensure personnel engaged in both submitting and reviewing expenditures by overseas offices are proficient in reading and writing both English and Mandarin.	Many invoices and receipts regarding expenditures by the overseas offices were written in Chinese and the department personnel who reviewed them did not read Mandarin.	Open but in progress	
(1c) Update its <i>Overseas Offices Procedures Manual</i> to include specific reporting and enforcement criteria regarding the purpose for expenditures.	The procedure manual for the overseas offices required each invoice or receipt include a short English description of what was purchased. The manual did not provide any reporting criteria.	Closed	
(1d) Conduct a financial audit (as opposed to a financial review) of the overseas offices accounting system every two years.	Ensure accountability of state funds.	Closed	
(1e) Use the trade mission policy of the U.S. Department of Commerce as a guide to ensure future trade missions provide sufficient written criteria and transparency.	Delay in disclosure of records associated with a 2005 trade mission subjected the department to criticism by lawmakers and the public.	Open but in progress	The department included the U.S. trade mission policy in its <i>Out-of-State Office Procedures Manual</i> but did not use the policy as guidance in its last trade mission to China in 2010.
(1f) Provide additional ethics training to department employees.	Department use of funds following the return of the 2005 trade mission participants raised concerns about violations of the gift law under the ethics code.	Closed	

Recommendation to the State Procurement Office

We recommended the State Procurement Office (SPO) review fiscal material relating to the 2005 trade mission to determine whether the department director provided complete and accurate information about the department’s role in the expenditure of mission funds and whether those expenditures were subject to the procurement code. However, given that the department director who provided the information to the SPO is no longer with the department, recommendation No. 2 is deemed **Not applicable**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendation to the State Procurement Office (SPO)			
(2) Ask the Pacific and Asian Affairs Council to review its fiscal material related to the 2005 trade mission.	The department did not provide full disclosure to the SPO about the department's role in regards to the expenditure of the 2005 trade mission funds.	Not applicable	The assessment was performed without the assistance of the SPO, which elected not to meet with the Office of the Auditor for this project.

Recommendation to the governor

The investigation report concluded that, given the numerous acts carried out by the department administration under the direction of its director, the governor consider removing of the director. Department records indicate the director was not removed from office, but left the department when the administration changed. The director's successor took over in December 2010. Therefore, we deem recommendation No. 3 **Not applicable**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendation to the governor			
(3) Consider removal of the director as it is the director who sets the "tone at the top" for the entire department. A change in leadership would be appropriate.	Agency management plays a key role in setting and maintaining an organization's ethical tone, providing guidance for proper behavior and removing temptations for unethical behavior.	Not applicable	

Recommendations to the Legislature

We made a three-part recommendation to the Legislature to engage in discussions with the department to address issues involving the MDCP account and future federal awards and reporting requirements regarding the Overseas Offices. However, the lack of response from key lawmakers did not allow an adequate assessment of the implementation of our recommendations. Therefore, we deem recommendation Nos. 4a and 4c **Did not assess** and recommendation No. 4b **Not applicable**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Legislature			
(4a) Discuss with the department the course of action regarding the overseas offices and whether any changes need to be made to the reporting requirements to ensure it maintains legislative oversight.	The department is required to submit quarterly reports to the state comptroller of all receipts and disbursements of the overseas offices and an annual report to the Legislature on the operations of its overseas offices.	Did not assess	
(4b) Review whether to preserve, amend, or rescind the department's MDCP spending ceiling.	Ensure compliance with budget procedures and ensure transparency to prevent the department from exceeding its appropriations.	Not applicable	
(4c) Engage in discussions with the department to ensure there is a clear understanding regarding information provided by the department for any future federal award it may receive.	Same purpose stated for recommendation No. 4b.	Did not assess	

Chapter 3

Finance Department Improves Security and Diversification of State's Investments

Report No. 10-03, Financial Examination of the Department of Budget and Finance, released in March 2010, questioned whether the department effectively managed state funds. Our 2010 report found the department's purchase of student loan-backed auction-rate securities violated statutory maturity restrictions as well as the department's investment policy. At the time of our report's field work, the auctions and market for auction-rate securities had failed, leaving the department unable to sell its securities. The value of the securities, which at the time was in excess of \$1 billion, was significantly impaired, requiring the department to write-down the value of its investments by \$114 million. Our report called into question whether the finance director and department management could fulfill their statutory responsibilities to ensure safekeeping of moneys in the treasury and maximize returns.

Since we issued our audit report, the State has reached an agreement that provides an opportunity to sell its holdings in auction-rate securities without loss to its principal. The department has also substantially revised its state investment policy to emphasize safety as the foremost objective of an investment. In addition, increased oversight by the director and deputy director has allowed management to monitor its investment program and compliance with the investment policy.

Background

The Department of Budget and Finance is statutorily mandated to oversee and carry out vital financial responsibilities on behalf of the State, including managing the state treasury, developing financial plans and strategies, and administering the state budget. The department is also the custodian of state funds, responsible for their safekeeping, management, investment, and disbursement; and is responsible for administering the State's debt.

Our 2010 report found deficiencies in the department's investment process, which allowed for the purchase of auction-rate securities that violated statutory maturity restrictions as well as the department's own investment policy. Auction-rate securities are debt instruments with long-term maturities from underlying loans (in this case, student loans) that were marketed as highly liquid and safe short-term investments, since they could be purchased and sold at "Dutch auctions" held every seven to 49 days. In early 2008, the market—and thus, the auctions for these securities—failed, leaving the department unable to sell the

securities until either another auction was held, the securities were called, or the underlying loans matured. Unfortunately, the department had been significantly increasing investments in such securities in January and February 2008, when the auctions began failing. By the end of July 2008, the State's holdings of more than \$1 billion of these securities accounted for 29 percent of the State's investments.

Settlement provides the State an opportunity to recoup its investment

In November 2010, the State and the issuer of the auction-rate securities, Citigroup Global Markets Inc. (Citi), reached a settlement regarding the State's purchase of auction-rate securities. As of November 2010, the State owned approximately \$869 million in auction-rate securities; interest was being earned on the securities but the market value of the State's portfolio had significantly decreased. According to the settlement, in June 2015, the State has the option to require Citi to purchase any or all of the remaining auction-rate securities at face value. In addition, Citi must make up the difference between the liquidation price and the face value on any auction-rate security previously liquidated below face value, which means there is no loss of principal on any of the State's auction-rate securities investments. The agreement includes a provision for Citi to ask the State to sell certain blocks of its securities holdings. Under the agreement, the State will receive the principal balance for these securities and any accrued interest.

Citi may also elect to pay the State a portion of the value of securities at any given time. These payments are known as *partial calls*. However, the State will not lose any of its principal. Under the settlement, Citi will make good on the remainder of the State's auction-rate securities in 2015, as well as the remaining value of those sold under partial calls. As of February 2013, Citi has sent the State seven call notices for the purchase of auction-rate securities totaling more than \$400 million. Exhibit 3.1 shows the State's transactions in auction-rate securities holdings from FY2010–FY2012.

**Exhibit 3.1
Transactions Associated With the State's Auction-Rate Securities, FY2010–FY2012**

	FY2010	FY2011	FY2012
Beginning balance	\$1,006,675,000	\$916,525,000	\$558,500,000
Partial calls	(\$90,150,000)	(\$203,000,000)	(\$59,650,000)
Citi settlement calls	\$0	(\$155,025,000)	(\$19,250,000)
Ending balance	\$916,525,000	\$558,500,000	\$479,600,000

Source: Department of Budget and Finance

Updated investment policy mitigates risk for future investments

Our 2010 report found the department had managed the State's \$3.3 billion investment pool based on an investment policy that had not been updated since 1999 or reviewed in detail since 2002. Also, investment management was carried out through informal, manual processes that increased risk and hampered the department's efficiency. Investment decisions and activities were overseen by the then-director of finance and the Financial Administration Division (FAD) administrator, who did not provide proper oversight.

Our follow-up review found the State Treasury Investment Policy was updated in March 2011 and applies to the investment of all state funds within the state treasury administered by the department. The policy places safety as the foremost objective of the investment program to ensure the preservation of capital and mitigate credit and interest-rate risk. The policy specifies risk will be minimized by practices that include: limiting investments to securities specified in the investment policy, diversifying the investment portfolio, structuring the portfolio so securities mature to meet cash requirements for ongoing operations, and investing operating funds in shorter-term securities and mutual funds to limit the average maturity of the portfolio. The updated state investment policy also contains a provision prohibiting future investments in auction-rate securities as of February 2008. However, it should be noted that state law under Section 36-21, Hawai'i Revised Statutes (HRS), will permits the finance director to invest state moneys in student loan acution-rate securities. So while current policy may discourage such investments, state law does not prohibit the finance director from investing in these types of securities in the future.

Efforts are ongoing to address weaknesses in financial administration

A review of the division's practices found other procedural changes in the state investment program have been enacted. The director and deputy director of finance and the FAD administrator have initiated semi-monthly investment meetings that allow the director and deputy director to monitor state investments and the financial environment. The deputy director said the semi-monthly meetings also allow management to discuss investment strategy and ask questions to determine whether investments adhere to policy and provide the most benefit to the State. Our review found the director, deputy director, and FAD administrator have consistently attended these meetings.

Our 2010 report described the department's manual process for assessing the State's cash requirements as well as the amount deemed allowable for investment as laborious and prone to input and calculation errors. The report noted the staff member responsible for tracking state investments, which included more than \$1 billion in auction-rate securities, used a handwritten, monthly calendar to prepare daily informal cash projections and color-coded notes to track expected maturities of securities.

Currently, department staff use both an electronic spreadsheet that is updated daily and reports generated by the department's Great Plains system. Investments are monitored daily to track cash flow and the balance from banks with which the State conducts business.

Status of Recommendations

Report No. 10-03, *Financial Examination of the Department of Budget and Finance*, included 25 recommendations to the department to annually update the State Treasury Investment Policy; infuse best practices in the policy regarding the maturity of securities and liquidity objectives; provide oversight, reporting, and compliance mechanisms related to the policy; update and document operational procedures; and consider an automated system for daily cash projections.

Our 2010 report found the treasury policy had not been formally updated since 1999. Our review found the department updated the policy in March 2011 and reported that it is currently working to revise the policy as a result of its annual review process. Therefore, we deem recommendation Nos. 1 and 3 **Closed**. The updated policy also calls for structuring an investment portfolio so that securities mature concurrently with cash needs to meet anticipated demands and to ensure investments consist mainly of securities with active secondary markets to meet unanticipated cash demands. In addition, the policy states that securities must mature in five years or less and calls for non-specific performance benchmarks for the investment portfolio. Therefore, we deem recommendation Nos. 2a and 2b **Closed** and recommendation No. 2c **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(1) Formally review and update the State of Hawai'i Treasury Investment Policy on an annual basis.	Although the department has implemented an investment policy to delineate specific requirements and limitations, the policy has not been updated since 1999 or reviewed in detail since 2002.	Closed	The investment policy was updated in March 2011.
(2) Consider best practices related to managing market risk, benchmarking, and measuring total performance in a portfolio. These include the following areas:			
(2a) Understanding the maturity structure of a security.	The purchase of auction-rate securities violated the maturity restriction set in state law. The department erroneously believed the securities met the maturity limit as the securities could be auctioned every seven to 49 days.	Closed	The updated policy specifies the maturity date of a security shall not exceed five years from the trade settlement date, which is the sale date of the security.
(2b) Assess investment objectives, cash-flow needs, and risk tolerances when establishing maturity restrictions on securities investments.	State funds were illiquid, thereby threatening the State's ability to cover its anticipated disbursements.	Closed	The updated policy requires that a portion of the portfolio be continuously invested in readily available funds to ensure appropriate liquidity is maintained.
(2c) Establish benchmarks to serve as targets for a rate of return on investments.	Deficiencies in the department's investment process highlighted a need to update its investment policy and formally monitor transactions and holdings.	Open but in progress	The updated investment policy contains a provision stating benchmarks will be established, though it does not describe the benchmarks.
(3) Consider reviewing investment practices of other states.	Deficiencies in the department's investment process highlighted a need to update its investment policy and formally monitor transactions and holdings.	Closed	The Financial Administration Division (FAD) chief, consulted with private financial institutions and other government officials to revise the state investment policy.

We also found revisions had been made to address recommendations regarding review of investment decisions, internal reporting requirements, compliance with applicable laws, and obtaining proper approvals of investments that exceed certain guidelines. Therefore, we deem recommendation Nos. 4, 5, 6, 7, and 8 **Closed**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(4) Update operational procedures for performing daily cash projections to determine excess cash in the state treasury available for investment.	The manual nature of the department's cash and investment process was contrary to its objectives of safety and prudence and highly susceptible to errors.	Closed	The department provided reports from the treasury system which allowed it to track the state's cash flow on a daily basis and prepare a comprehensive report of the state's investments.
(5) Perform and document an appropriate level of review of investment decisions.	Investment decisions and activities were overseen by the director of finance and the FAD administrator, who did not provide proper oversight.	Closed	Increased oversight by the director and deputy director is provided through semi-monthly meetings with the FAD administrator and staff.
(6) Assess need to revise investment policy to address internal reporting requirements.	The director and FAD administrator did not exercise proper oversight of investment decisions and activities.	Closed	The department now produces investment reports that provide detailed information, including the purchase date, yield, invested amount, and interest of securities.
(7) Ensure that investments are in compliance with provisions of Section 36-21, HRS, and the investment policy.	The department's purchase of auction-rate securities violated state laws and the state investment policy regarding maturity limits and diversification.	Closed	The updated state investment policy says that the state investment program will be operated in conformance with Chapters 36 and 38, HRS.
(8) Follow investment policy guideline regarding approval requirements for certain investments.	Though the state investment policy allows exceptions upon approval, purchases of investments that violated the policy were made without approval.	Closed	According to the FAD administrator, the director was informed when an inadvertent breach of the policy occurred.

Our 2010 report also made five recommendations to ensure timely preparation and review of bank reconciliations. Our review found the department has made efforts to address these recommendations but they have not been fully implemented. Therefore, we deem recommendation Nos. 9, 10, 11, and 12 **Open but in progress**. We also found new procedures, reported to be in place regarding reconciliations between the department and the DAGS have changed. Therefore, we deem recommendation No. 13 **Not applicable**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(9) Establish formal policies and procedures for preparing and reviewing bank reconciliations.	Timely preparation and review of monthly bank reconciliations ensure financial records are properly stated and mitigate the risk of misappropriation of cash.	Open but in progress	Though the department has not formally drafted policies and procedures, the division has documented reconciliation procedures that allow new employees to perform reconciliations.
(10) Report unrecorded items to DAGS in a timely manner for proper adjustment.	Delays in completing financial statements can result in departments failing to submit their financial reporting package to federal agencies.	Open but in progress	The department is current on its reconciliations and completes them on a monthly basis. Efforts are underway to automate the reconciliation process.
(11) Record adjustments in a timely manner and provide the necessary information to DAGS for proper recording.	The failure to complete timely reconciliations and reviews can result in delays in the preparation of the State's Comprehensive Annual Financial Report (CAFR) and other financial statements.	Open but in progress	The 2012 CAFR had a timely release in January 2013, about seven months after the end of the fiscal year.
(12) Write off the difference with the fiscal agents of \$1,196,062.	The department's cash balance for fiscal agents' accounts was overstated by approximately \$1.2 million.	Open but in progress	Almost half of the \$1.2 million amount has been written off and the department is making efforts to clear the remaining amount, but admits some amount may not be cleared for a while because they are already decades old.
(13) Timely, complete reconciliation of FAD records to records received from DAGS.	If reconciliations are not completed and reviewed on a timely basis, it may result in delays in preparing the CAFR.	No longer applicable	The department implemented new reconciliation procedures, which greatly reduces the need to manually input data.

Our report listed three recommendations related to the department's treasury and bond investment pools that included documentation of methodology used in allocating interest earned and advising investment-pool participants of any methodology revisions. Our review found that current interest allocation distributions are occurring on a timely basis. We also found that, while the department has documented procedures to calculate interest allocations, it does not include any requirement to inform investment-pool participants of methodology changes as cited in our report recommendations. Therefore, we deem recommendation No.14 **Closed** and recommendation Nos. 15 and 16 **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(14) Regarding the treasury and bond investment pools, complete interest allocations for FY2009 and ensure allocations for FY2010 are completed in a timely fashion.	Delays in allocating interest earnings create a financial burden on departments and agencies that rely on those earnings for spending.	Closed	State treasury journal vouchers show current distributions are occurring about four weeks after the end of each month.
(15) Document the methodology in allocating interest earned as guidance for future staff.	A lack of documented policies for interest allocation affected the department's ability to communicate changes in the methodology used to allocate interest.	Open but in progress	Though not formalized, there are documented procedures that provide necessary instructions for qualified staff to perform this function.
(16) Inform investment-pool participants of revisions to interest earnings allocation methodology.	Agencies participating in the state investment pool may not know of changes or have a clear understanding of how interest earnings are allocated.	Open but in progress	Though not formalized, there are documented procedures that provide necessary instructions for qualified staff to perform this function.

Our report also issued three recommendations to the department and its Budget Division regarding documentation of current operational and administrative policies and procedures; utilization of cost-effective strategies to mitigate fiscal and personnel constraints; and for the department to develop, accurately report, and use measures of effectiveness to provide data to aid actual decision-making in budgeting. Our review found the department has placed an emphasis on the importance of formalization of policies and procedures, but has provided no documentation that such action has been completed or initiated. Therefore, we deem recommendation No. 17 **Open**. The department has also made efforts to implement cost-effective means to develop staff through job-shadowing and mentoring programs. Therefore, we deem recommendation No. 18 **Closed**. Our review also found that the department does not utilize performance-based budgeting, which is the basis for recommendation No. 19. In addition, its director stated that the State utilizes the Performance, Planning, and Budgeting System in name only and not in practice, and that the way the state budget is actually developed does not align with the State's budgeting system. Therefore, we deem recommendation No. 19 **Open and likely not to be pursued**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(17) The Budget Division should document operational and administrative policies and procedures to reflect current activities and procedures.	A lack of documented policies made it difficult to assess the department's compliance with budget protocols and policies.	Open	The department could not provide documentation that formal policies and procedures have been completed.
(18) The department should use cost-effective strategies to retain qualified staff and cultivate employees' skills.	The Budget Division lacked of a formalized succession plan. Ultimately, this could affect the department's ability to deliver effective and timely services.	Closed	The department has taken action to addressing staffing concerns by accepting interns from legislative staff and the university.
(19) The Budget Division should utilize elements of performance-based budgeting to ensure accountability.	The Budget Division administrator provided best-guess estimates instead of actual achievement rates, which produced highly inaccurate success rates.	Open and not likely to be pursued	

The report also included five recommendations to improve management and controls over its information technology system and one recommendation to the department's Treasury Management Branch to undergo technical training. Our review found the department has taken actions to enhance operational and physical security of its IT systems and we therefore deem recommendation Nos. 20 through 24 **Closed**. And, although the department appears to have taken steps towards providing technical training, as recommended in the report, we could not verify when any training sessions took place or who attended. Therefore, we deem recommendation No. 25 **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Budget and Finance			
(20) Improve management and controls over its IT system by establishing a periodic review of user access to electronic applications and mainframe applications.	The department does not conduct regular reviews of user access to its sensitive applications.	Closed	Annual reviews by the department's IT staff are performed regarding network users and permission settings.
(21) Implement controls to secure and monitor direct access to the Microsoft Dynamics database.	The department does not conduct regular reviews of user access to its sensitive applications.	Closed	Access to the Microsoft Dynamics application is provided after authorization by the FAD administrator.
(22) Enable additional password setting for the Microsoft Dynamics application.	Password controls for the Microsoft Dynamics application are inadequate compared to industry standards.	Closed	Password controls have been built into the department's system.
(23) Move the server room to a more secure location or implement additional physical security controls.	There are inadequate physical security controls and environmental controls in the department's server room.	Closed	The treasury system server was moved to the Information and Communication Services Division computer room.
(24) Establish an off-site rotation of backup media for the Microsoft Dynamics application.	There is no off-site rotation of backup media. If there is a disaster, the department could potentially lose all financial data for the Microsoft Dynamics system.	Closed	The treasury system and database backup is performed and monitored daily, copied to tape, and physically sent to the State Archives for storage.
(25) Treasury Management Branch staff should undergo Microsoft Dynamics training.	Lack of training created inefficiencies in the cash and investment process, as well as increasing the risk of manual errors.	Open but in progress	The FAD administrator said consultants were brought in to provide training as needed, but he could not provide sufficient documentation to support the claim.

Chapter 4

Aloha Tower Development Corporation: New Agency but Familiar Concerns

Report No. 10-04, *Management Audit of the Aloha Tower Development Corporation*, found the Aloha Tower Development Corporation (ATDC) board has had little success redeveloping the Aloha Tower Project Area since the corporation was established in 1981. Our audit added that nearly every development the corporation has undertaken resulted in litigation, with millions of dollars in legal costs and delays. Our audit also found the corporation knowingly operated with an outdated master plan and administrative rules, which affected its ability to accomplish its mission. We concluded that the corporation should be abolished and the Hawai'i Community Development Authority (HCDA) should assume the corporation's redevelopment responsibilities, including the assumption of more than \$7 million in debt owed to the Department of Transportation (DOT) for lost revenues.

Since our audit report was issued, ATDC was moved from the Department of Business, Economic Development & Tourism (DBEDT) to the DOT, and the ATDC board composition changed. However, our review found that some issues raised in our 2010 audit remain. The ATDC board continues to operate without an updated master plan and strategic plan, even though the Aloha Tower Project Area has changed. In addition, the board surrendered its development responsibilities when it allowed the market to dictate long-term plans for the site. Our review also found progress has been made in areas identified in the report with regards to paying down the multi-million dollar debt to DOT and a possible new development project for the area.

Background

The Aloha Tower Development Corporation was established by the Legislature in 1981 as a public body corporate and instrumentality of the State to undertake the redevelopment of the Aloha Tower complex in Honolulu. At the time of our 2010 audit report, the ATDC was administratively attached to the Department of Business, Economic Development & Tourism. Report No. 10-04, *Management Audit of the Aloha Tower Development Corporation*, described the area encompassing Piers 5 through 23 as the Aloha Tower complex. The area between Piers 5 and 14, which is to be used for any redevelopment plans, is known as the Aloha Tower Project Area. The project area is located on land owned by the State of Hawai'i and controlled by the Department of Transportation–Harbors Division. In 1993, DOT–Harbors leased the project area to ATDC for redevelopment.

The purpose of ATDC is to undertake redevelopment of the complex to strengthen the community's international economic base in trade activities; enhance beautification of the waterfront; better serve modern maritime uses; and provide for public access and uses of the waterfront property. The ATDC is administered by a board of directors, which at the time of our report consisted of seven voting members including the director of business, economic development and tourism; the director of transportation; the chair of the Board of Land and Natural Resources; and the mayor of the City and County of Honolulu. The remaining members were appointed by the governor for staggered terms. In 2008, a subgroup of ATDC was created, called the Harbors Modernization Group. Its purpose was to undertake projects for the Harbors Modernization Plan, which consists of seven statewide harbor projects.

The ATDC's primary source of revenue is lease rent from the Aloha Tower Marketplace. The corporation's revenues and expenses flow through the Aloha Tower Fund, a special fund for the development, redevelopment, or improvement of the Honolulu waterfront. The ATDC was required to annually reimburse DOT for any losses in revenue caused by any action of the corporation or a developer. As of June 30, 2008, the corporation owed DOT roughly \$7.7 million for lost revenue.

Since issuance of our 2010 report, the Legislature amended the law in 2011 and administratively attached ATDC to the DOT. While the mission and powers of ATDC have not changed, its board of directors was reduced to three, with a membership that includes the DBEDT director, the transportation director, and the deputy director of DOT-Harbors. Lawmakers also reduced the boundaries of the complex area, which now stretch from Piers 5 to 11.

ATDC board has failed to update its master plan and strategic plan, but recognizes their importance

In Report No. 10-04, *Management Audit of the Aloha Tower Development Corporation*, we found ATDC was operating with an obsolete master plan and outdated administrative rules, and without an approved strategic plan. As a result, our audit concluded that the corporation may be unaware of and unable to overcome development constraints and that development of certain commercial, residential, and hotel uses in the project area may no longer be viable.

Our follow-up review included interviews with current ATDC board members, who acknowledged the value and importance of a master plan and strategic plan and agreed it is the board's responsibility to update both. They also admitted the board has not yet discussed updating the master plan or strategic plan. Yet, the board entered into an agreement in 2011 with a developer who planned to create a mixed-use complex that reportedly includes retail and academic facilities. According to one ATDC board member, this developer has its own strategic plan based

on a long-term vision for its own interests, and that the Aloha Tower Marketplace fits into the plan. The board member pointed out that past efforts by ATDC to develop the marketplace area as a retail complex have not worked over the past 30 years.

Our 2010 audit report supported the board member’s contention that little development progress has been made over the past three decades. However, the report attributes ATDC’s struggles to costly litigation; inherent conflict between redevelopment of the project area and maritime uses; and the ATDC’s pursuit of unrealistic financing strategies, as opposed to pursuit of a flawed development concept. By moving forward on a project based on the long-term plans of a developer and not those established by ATDC, the board is foregoing its responsibilities to develop an updated master plan and a strategic plan. These are responsibilities that would help ensure ATDC meets its statutory duties.

Lack of funds is no longer an issue

When the ATDC was placed under DOT for administrative purposes in 2011, the Legislature did not appropriate any operating funds for the corporation for FY2012. Department of Transportation documents show that in its proposal to the Department of Budget and Finance to transfer ATDC, there is no position organization chart because the corporation’s operating budget was eliminated in 2010—which, in turn, eliminated ATDC’s executive officer and staff. The ATDC board chairman commented at the time of ATDC’s transfer from DBEDT to DOT that the board did not have the financial ability to update the master and strategic plans. However, the corporation did receive a legislative appropriation for FY2013 and submitted a budget proposal that includes funding for a temporary position and related expenses for FY2014 and FY2015. The ATDC board chairman added that the recent restoration of operating funds allows ATDC to consider updating its master and strategic plans in the future.

Administrative rules are being updated, but lack of a strategy continues to be problematic

In order to reflect the administrative transfer of ATDC from DBEDT to DOT, the DBEDT administrative rules that were repealed when the law was amended removing ATDC from DBEDT must be adopted by DOT. The DOT took such action in 2012, but also used the opportunity to update the rules, which had not been updated since 1992. The proposed rules would re-classify the existing zoning system “to accommodate the sort of development strategies that will be able to survive and grow in the project area.” The proposed zoning changes would allow multipurpose venue, entertainment, and commercial and retail development at Pier 10. It would also allow hotel, office, and residential development at Piers 5 and 6 and maritime and office development at Pier 11. However, the rules do not make clear whether concerns raised more than a decade ago regarding new project-area development have been fully considered.

A consultant hired by the corporation in 2000 to conduct a planning and feasibility study of the Project Area raised concerns about any new future development. For example, the consultant concluded that office use would require financially strong anchor tenants willing to lease enough space at a high enough rent to make the development financially stable; a weak merchant mix would discourage consideration for additional retail use; the small property areas at Piers 10 and 11 would limit the size of a potential hotel; and residential use would hinge upon the State's ability or willingness to sell its fee simple interest in the land within the complex boundaries. In addition, the terrorist events of September 11, 2001, resulted in a new federal measure regarding the security of vessels, ports, and waterways.

Our 2010 audit noted that, according to the DOT–Harbors administrator, these restrictions could have effects on the Aloha Tower Project Area, such as requiring additional screening of passengers and vehicles entering parking areas near cruise and charter vessels or that hotel development at Piers 10 and 11 could require a rewrite of the Facility Security Plan. An ATDC board member said the new rules would provide a blueprint for a master plan. The purposes of administrative rule-making are to implement legislation and to establish operating procedures for state agencies. Although the current board has taken steps towards updating its administrative rules, the rules neither represent a master plan nor diminish the need for an updated master plan and a strategic plan as stated in the audit.

\$7.7 million ATDC debt to the Department of Transportation expected to take more than ten years to pay off

In 2005, ATDC and DOT entered into a memorandum of understanding that provided two types of payment from ATDC to pay off a multi-million-dollar debt. One payment is a fixed amount of \$225,000 per year, or a “minimum annual base payment.” The second, called an “equity participation payment,” is 50 percent of ATDC's annual net revenues plus a possible supplemental payment based on a formula agreed by the two parties. In addition, the 2011 Legislature allowed for moneys from the Aloha Tower Fund to be used for lease payments to DOT.

In accordance with that amendment, more than \$2.8 million remaining in the Aloha Tower Fund was transferred in July 2011 to the DOT–Harbors Special Fund. According to the department's Business Management Office, that money was used to pay down the debt to DOT. An additional equity payment of more than \$387,000 was made in FY2013, which reduced the debt owed to \$4.5 million as of December 31, 2012. The department estimates that at the current rate of payment, it will take more than ten years to pay off the debt.

Litigation appears to be over

Since its inception in 1981, the Aloha Tower Development Corporation's efforts to develop the project area have been hampered by a string of litigation. Our 2010 audit report noted that legal expenses for the corporation could approach \$2.5 million. We identified three ongoing legal cases at the time: a dispute over parking restrictions at Irwin Memorial Park; a case involving developer Kenneth H. Hughes, Incorporated; and a case involving AHI Aloha Associates, LLC, in yet another disagreement involving parking at the project area. Documents show a payment of \$1.55 million from the ATDC Special Fund in 2010 to settle the Hughes case. Also in 2010, the corporation and AHI Aloha Associates, LLC, mutually agreed to a cashless settlement, although ATDC paid its own legal fees. The third case initially resulted in a ruling against ATDC in 2010, when it was ordered to pay more than \$135,000 in attorneys' fees and costs. However, an appeals court reversed that order in 2012. Still, it is possible this ruling may again be appealed. With this exception, ATDC reported no outstanding legal obligations for the first time in decades.

Status of Recommendations

Report No. 10-04, *Management Audit of the Aloha Tower Development Corporation*, included multi-part recommendations to the state Legislature and the Hawai'i Community Development Authority.

Recommendations to the Legislature

We made a three-part recommendation to the Legislature to take action to abolish the Aloha Tower Development Corporation; transfer the rights, powers, duties, and functions of ATDC to the Hawai'i Community Development Authority (HCDA); and direct ATDC and DOT to develop a transition plan for the orderly transfer of the Harbors Modernization Group to DOT–Harbors Division. The Legislature did not abolish the ATDC, nor did it place the corporation's rights, powers, duties, and functions within the HCDA. Instead, the Legislature administratively attached ATDC to DOT while maintaining ATDC board's powers and duties. Therefore, given that the Legislature took action to amend the laws regarding ATDC, recommendation No. 1a is deemed **Closed**. However, as the powers and duties of ATDC were not transferred to HCDA as the audit suggested, recommendation No. 1b is deemed **Not applicable**. The 2011 Legislature also repealed the law that established the Harbors Modernization Group. Documents show the Harbors Modernization Program was transferred from ATDC to the Engineering Branch of the DOT–Harbors Division. The DOT established a Special Projects Office, which provides overall administration and management of all planning and engineering functions and activities related to the Harbors Modernization Plan. Therefore, recommendation No. 1c is deemed **Closed**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Legislature			
(1a) Repeal Chapter 206J, Hawai'i Revised Statutes, on June 30, 2011, to abolish the Aloha Tower Development Corporation (ATDC).	The ATDC has mismanaged its redevelopment of the Aloha Tower Project Area in its 30 years of effort and should be repealed.	Closed	The 2011 Legislature placed the ATDC within the Department of Transportation (DOT) for administrative purposes.
(1b) Direct the ATDC, the Hawai'i Community Development Authority (HCDA), and the DOT to develop and submit a plan to the 2011 Legislature to provide for the transfer of the rights, powers, functions, and duties of the ATDC to the HCDA.	The HCDA may be the best fit for ATDC's development responsibilities, as its jurisdiction already includes development of the waterfront area.	Not applicable	The 2011 ultimately placed the ATDC within the DOT for administrative purposes, thereby making this recommendation not applicable.
(1c) Direct the ATDC and the DOT to develop and submit a plan to the 2011 Legislature to provide for the transfer of rights, powers, functions, and duties of the Harbors Modernization Group to DOT-Harbors.	The ATDC has no expertise in harbors modernization, and DOT-Harbors already has responsibility for Hawai'i's harbors and controls the resources for harbors improvements.	Closed	In 2011, the Harbors Modernization Plan was formally transferred from ATDC to DOT-Harbors, Engineering Branch.

Recommendations to the Hawai'i Community Development Authority

We made a two-part recommendation to the Hawai'i Community Development Authority on the premise that our recommendation to transfer the powers and functions of the ATDC to HCDA would be implemented. However, given that the ATDC was retained by the Legislature, we applied our 2010 recommendations to the ATDC board. The recommendations focused on updating the ATDC's master plan and administrative rules and developing a strategic plan to carry out the master plan. The ATDC board members said the board has not discussed updating the master plan or strategic plan and, even though the board has taken action to update its administrative rules, rule-making adoption was not completed at the time of this report. Therefore, recommendation No. 2a is deemed **Open**. Our report also recommended ATDC and DOT engage in discussions to resolve ATDC's \$7.7 million debt to DOT. We found both parties have agreed to a payment formula that ATDC will follow to reduce the amount owed in lost revenue. Therefore, recommendation No. 2b is deemed **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Hawai'i Community Development Authority			
(2a) Update the master plan and rules for the Aloha Tower Project Area and develop a strategic plan to carry out the plan, given the current constraints to development.	The ATDC board failed in its leadership responsibility to develop and update a workable master plan.	Open	The ATDC board has taken no action to update its master plan or develop a strategic plan.
(2b) Enter into discussions with the DOT–Harbors to resolve the ATDC’s \$7.7 million debt to DOT–Harbors for lost revenues.	From FY1996 to FY2001, the Aloha Tower Marketplace paid the ATDC only 22 percent of the forecasted revenue, about \$17 million less than was originally projected during this timeframe.	Open but in progress	Through an agreement between ATDC and DOT, the ATDC will reduce its debt in addition to making an annual base payment. As of December 2012, the debt is roughly \$4.5 million.

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Chapter 5

Issues Regarding State Procurement Office's Administration of pCard Program Remain Murky

Our program and management audit of the State Procurement Office's (SPO) Purchasing Card (pCard) Program assessed the adequacy of SPO's management oversight and internal control system of the State's pCard Program. Our audit also examined whether executive branch agencies' pCard practices were in compliance with laws, rules, policies, and procedures. The pCard Program is intended to simplify the State's small-purchase operations and reduce the administrative burden associated with issuing purchase orders and processing invoices for payment without sacrificing controls. We found SPO failed to adequately establish and evaluate goals and objectives and meaningful performance goals for the program. We also found the executive-branch agencies' pCard Programs lacked streamlined procedures that could save time and money. Despite numerous attempts to meet with SPO for this follow-up review, the agency elected not to meet with our office and referred to its written response dated May 20, 2010. We notified SPO that the requested meetings were necessary to conduct a proper assessment of the implementation of our report recommendations and that, in their absence, our assessments would be based on our interpretation of SPO's 2010 written responses. As a result, we were unable to validate or clarify agency claims regarding the implementation of our report recommendations, which impacted our assessments and left issues raised in our 2010 audit report somewhat muddled.

Background

In 2001, the State Procurement Office established its Purchasing Card (pCard) Program. The pCard is a limited credit card to be used by government agencies in place of cash or purchase orders for the acquisition of goods, services, or construction. The purpose of the program was to simplify the State's small-purchase operations and reduce the administrative burden associated with issuing purchase orders and processing invoices for payment, without sacrificing controls. In 2002, the State contracted with First Hawaiian Bank (FHB) to provide, implement, and support a pCard Program. By April 2005, executive-branch agencies were required by the comptroller to use pCards instead of purchase orders to pay for goods and services under \$2,500. Agencies also had the option to use the pCard for purchases in excess of \$2,500.

Statewide procurement is governed by the Hawai'i Public Procurement Code and SPO. The administrator of the office is designated the chief procurement officer for all executive-branch agencies. The SPO

administers the pCard contract with FHB and manages the overall state program by providing guidance and training to relevant employees. Further, SPO has the authority to direct executive-branch agencies in using the pCard but not to other jurisdictions such as the Judiciary or the counties, which are responsible for their own pCard Programs. The purchasing card administrator of each executive-branch agency serves as that agency's primary administrator of the pCard Program. Each administrator's duties include developing pCard procedures for the respective agency, approving cardholder agreements, and coordinating training for pCard users.

In Report No. 10-05, *Program and Management Audit of the State's Purchasing Card Program*, we found the pCard Program provides a number of benefits: vendors are paid sooner, cardholders receive their goods and services faster, and the State receives a rebate. However, we also found that other benefits, such as a more efficient and streamlined government-procurement system, have not been achieved. We noted that although SPO is ultimately responsible for the program, it has taken a hands-off approach to administering the program by delegating significant responsibilities to executive offices. The report concluded that, until SPO becomes more proactive, it will not recognize and address the problems and concerns facing executive departments and cannot make program improvements to realize the full potential of the pCard Program.

Office's ability to measure effectiveness of the pCard Program is still questionable

The SPO disagreed with our findings that formal written goals regarding the pCard Program are "nonexistent" and referred to its annual report on goals, objectives, and policies. The annual report is required under Act 100, Session Laws of Hawai'i 1999. Our review of SPO's 2012 Act 100 report found it included goals that apply to SPO in general, but are not specific to the pCard Program. In addition, the language used to describe the program's objectives and policies in the 2012 Act 100 report is the same as that in previous such reports from 2006 through 2009. Our 2010 audit report found this language to be "vague," and noted that SPO did not conform to state law, which requires that objectives are determined by identifying how each goal is to be accomplished. According to best practices, establishing goals is required in order to measure the performance of a program. Measuring program performance is a critical element of accountability for public resources. Therefore, without clear goals for the pCard Program, accountability for public resources cannot be ensured. Further, SPO's decision not to meet with our office for this project prevented any follow-up work to clarify whether SPO has specific program goals for the pCard Program or other issues associated with this recommendation.

The SPO's action plan is missing key elements to measure program performance

Our 2010 audit report found the SPO's 2009 Act 100 report, which describes the agency's action plan, lacks vital information as required by state law and recommended by best practices. Specifically, the action plan neither indicates how objectives will be implemented nor who will be responsible for their implementation. The action plan also lacked detailed action steps, identification of resources to be used, and anticipated savings. The SPO contends its reporting on the progress and achievements of the pCard Program is detailed in its Act 100 report. However, our review of SPO's most current Act 100 report for 2012 found the same omissions described in our 2010 audit report.

We also questioned the five-year timetable provided in SPO's action plan for the implementation of an audit program that would allow departments to perform audits. In 2010, we raised the uncertainty because we noted that not all departments had yet converted to the new system. The SPO claimed the system was in place for all executive-branch departments in 2009. The SPO noted that the pCard audit function permits departments to access data regarding pCard usage for internal review and analysis.

The SPO said that it is not designed to provide a third-party examination of transactions as would be performed by an auditing firm. The SPO remarked that it is not an audit agency and does not have the personnel capable of carrying out an audit as suggested in our report. However, our review of the SPO's 2012 Act 100 report found that the pCard Program's action plan calls for SPO to audit departments for compliance regarding pCard usage. Due to the agency's decision not to meet with our office, we were unable to verify its claims that the transition of software systems to provide the pCard audit function was completed in 2009 or to clarify SPO's remarks about its inability to perform an audit even as its action plan calls for it to conduct a compliance audit of departments with pCard usage.

The office's method of measuring program performance remains questionable

Our 2010 report found the pCard Program's performance measures were not developed as part of an action plan and did not identify what outcome was expected; the source of data to be measured; methodology for calculation; or timeframe, as recommended by best practices. We also found the pCard Program performance measures failed to outline the process by which performance—in meeting stated goals—would be measured, as there were no program-specific goals. The SPO contended the performance measures were more than sufficient for the pCard Program's requirements and needs. Further, SPO asserted it continuously monitored and evaluated the progress of its program through various expenditure reports provided by FHB.

Our current review found the performance measures described in SPO's 2012 Act 100 report includes the dollar value of pCard purchases annually as well as the ratio of pCard transactions to purchase-order transactions. It also uses data of rebates received to measure cost effectiveness of the program. However, according to best practices designed to help ensure accountability and effective results, management reviews should be performed at the functional or activity level. Such reviews involve comparing actual performance with planned or expected results. We also raised this point in the audit report. However, we found the performance measures described in SPO's 2010 Act 100 report do not meet any expected results. The SPO's response fails to address this shortcoming and its decision not to meet with our office prevented any follow-up work to assess how SPO measures performance using only actual performance numbers without comparing them to any expected results.

SPO's claims that promote operational efficiencies in the pCard Program could not be verified

Our 2010 audit report questioned the SPO's claims of program cost savings and also found lacking operational efficiencies. The report added that the SPO's decentralized environment evolved into various, rather than uniform, processes and methods to accommodate program and department needs. We also found SPO focused more on ensuring that executive-branch agencies had adequate internal controls over the pCard Program instead of providing guidance on operational efficiency, which is one of the program's original intentions. The SPO concurred that departments have created their own procedures based on their need to balance efficiency and risk. The SPO reiterated that it is not appropriate for SPO to impede operational decisions or to usurp departments' responsibilities by dictating their operations and allocations of their resources. In response to our report recommendation to streamline or unify various steps within the pCard Program, SPO claimed it developed standardized forms to facilitate changes and deletions as well as standardized forms for new-card submissions.

Our follow-up review found policies and procedures that enforce management's directives and help achieve effective results that can be tailored by agencies to fit their special needs according to best practices. However, SPO's decision not to meet with our office prevented any follow-up work to assess how SPO measures the effectiveness of each department's specific pCard Program procedure with regard to achieving one of the pCard Program's primary purposes—operational efficiency.

Finally, SPO's claimed that it had used pCard administrator workshops and meetings, and cardholder training to help identify areas to improve departmental program performance and efficiencies.

Status of Recommendations

Report No. 10-05, *Program and Management Audit of the State's Purchasing Card Program*, made seven recommendations to the State Procurement Office. Three recommendations directed SPO to ensure the intent of the pCard Program—to streamline the State and County governments' small-purchase payment process—is being met. The remaining four recommendations called for SPO to formulate and adopt clear guidance to help executive-branch agencies achieve consistency and efficiency in operating and administering the pCard Program. Due to SPO's unwillingness to engage with our office, we were unable to conduct the necessary follow-up work to verify SPO's claims that it has addressed the recommendations or to clarify its reasons for choosing not to implement the recommendations. As a result, all seven recommendations are deemed **Open**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the State Procurement Office			
(1)The State Procurement Office (SPO) should ensure that the intent of the pCard Program—to streamline the State and County governments' small-purchase payment process—is being met. To address this, the procurement office should:			
(1a) Set meaningful goals and objectives for the program and identify how they will be accomplished.	The 2009 report to the Legislature contained no goals specific to the pCard Program. Objectives and policies are stated, but SPO did not identify how they were to be accomplished. The SPO did not identify specific results for its objectives.	Open	The SPO's decision not to meet with analysts for this project prevented any follow-up work to clarify whether SPO has specific program goals for the pCard Program or other issues associated with this recommendation.
(1b) Devise an action plan to include a timetable indicating how its objectives and policies will be implemented.	The SPO action plan was ineffective, as there was no indication of how the plans would be implemented, or who would be responsible for their implementation.	Open	A review of SPO's FY2012 annual report on goals, objectives, and policies shows the action plan for the pCard Program is still missing key elements.
(1c) Develop performance measures that are part of the action plan and compare actual performance with expected results.	The SPO did not establish meaningful performance measures to indicate whether objectives had been met, and did not properly evaluate the pCard Program's performance.	Open	The SPO's decision not to meet with analysts prevented follow-up work to assess how SPO measures performance using only actual performance numbers.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
<p>(2) The SPO should re-engineer the pCard Program by formulating and adopting clear guidance that will help executive-branch agencies achieve consistency and efficiency in operating and administering the pCard Program. Specifically, it should:</p>			
<p>(2a) Streamline, unify, or codify the various steps within the pCard Program with a focus on simplification, standardization, and efficiency.</p>	<p>Operational efficiencies of the pCard Program were lacking and SPO leaves it up to each department to determine efficiencies.</p>	<p>Open</p>	<p>The SPO's decision not to meet with analysts prevented follow-up work to assess how SPO measures the effectiveness departments' pCard Program procedures in achieving operational efficiency.</p>
<p>(2b) Identify and develop data and report requirements to assist in streamlining and monitoring the program.</p>	<p>The SPO could not identify where, or quantify how much, savings had been achieved by the program through the use of pCards instead of purchase orders.</p>	<p>Open</p>	<p>The SPO's decision not to meet with analysts prevented follow-up work to verify its claims that it uses FHB and CentreSuite reports to measure the program's progress.</p>
<p>(2c) Issue minimum core standards and policies for pCard users to simplify and expedite the pCard transaction process.</p>	<p>Lack of concrete guidance by SPO resulted in departments creating their own pCard Programs that are equally, or more, labor intensive than the old purchase-order process.</p>	<p>Open</p>	<p>The SPO's decision not to meet with the analysts prevented follow-up work to assess whether SPO issued minimum core standards and policies to simplify and expedite the pCard transaction process.</p>
<p>(2d) Assist and be more responsible for program implementation and improve its training to executive agencies.</p>	<p>Instead of offering to assist agencies enhance and achieve operational efficiencies, SPO left it up to each department to determine efficiencies.</p>	<p>Open</p>	<p>The SPO's decision not to meet with analysts prevented follow-up work to verify that it uses workshops, meetings, and training to improve program performance.</p>

Chapter 6

Public Safety Department Begins Process to Ensure Effective Sheriff Division

Our *Audit of the Department of Public Safety, Sheriff Division*, Report No. 10-06, found a Sheriff Division with an ill-defined role and a lack of mission clarity struggling to uphold its law-enforcement duties and responsibilities as those duties and responsibilities expanded. In addition, ineffective leadership resulted in a division that lacked guidance and direction, and failed to produce a strategic plan or state law-enforcement program, which defined the division's mission and set boundaries based on its capabilities. Inadequate training and an absence of procedures related to staffing and providing service to the courts also raised questions regarding the safety of the public, the courts, and the sheriffs.

Since the release of our audit report, the division has made progress on a number of fronts. The department is in the process of developing a strategic operating plan and creating a distinct plan for law enforcement, with strategic goals and objectives of both plans aligned. The department also took initial steps to follow up this action with a formal risk assessment to help the department better identify the division's objectives and identify the actions needed to achieve those objectives. However, ongoing personnel issues and unresolved disputes with other agencies have left the division struggling to meet security needs at courts and airports, one of its primary goals.

Background

The mission of the Department of Public Safety is to provide for the safety of the public and state facilities through law-enforcement and correctional management. The department is organized into three main divisions, including the Law Enforcement Division, which is headed by a deputy director. The Law Enforcement Division, which protects the public in designated areas, including all state property and facilities, is made up of Narcotics Enforcement Division and Sheriff Division.

The mission of Sheriff Division is to provide general law-enforcement services to preserve the public peace, protect the rights of persons and property, prevent crime, and detect and arrest law offenders.

Engaging in a disciplined planning process was a vital first step to refocus a confused Sheriff Division

Our 2010 audit found that the department interpreted the role of Sheriff Division as the State's primary law-enforcement agency, and in doing so, took on additional public-safety responsibilities that may have been beyond its capabilities. We found that statutory changes contributed to the expansion of law-enforcement duties for the division, but that the division also broadened its scope of responsibilities through its own initiative. As the state's law-enforcement needs have expanded, confusion over the extent of Sheriff Division's responsibilities has grown. We found that vague constitutional language, coupled with a broad interpretation by the department of its statutory authority and Sheriff Division's responsibilities, contributed to this confusion and uncertainty. We recommended a number of avenues, which the division has failed to fully pursue, that would better define its scope of responsibilities and set boundaries based upon its capabilities to fulfill those responsibilities: develop a strategic plan, conduct a risk assessment, and create administrative rules.

Strategic-planning process has begun

We pointed out a strategic plan is a disciplined effort to produce fundamental decisions and actions that shape and guide what an organization is, what it does, and why it does it. Identifying goals and objectives is only one phase of the strategic-planning process, which, when done properly, will increase effectiveness and efficiency, lead to better decision-making, and enhance organizational capabilities. We found the department relied on an annual report it submitted to the Legislature as its strategic plan. However, key elements of the report, such as the division's stated objectives, were presented broadly and lacked specifics as to how they would help the division accomplish its goal—to provide for the protection and safety of the people of Hawai'i.

Our follow-up review found that in 2012, the department embarked on a two-phase process to develop a strategic operating plan. Phase One of the plan included redefining the department's mission statement, prioritizing its core values, and identifying initiatives to address its core issues. Among the three core issues identified by the department is to provide full-service law enforcement. To accomplish this, the plan identified three action initiatives for Law Enforcement Division: 1) ensure all law-enforcement officers are fully certified; 2) provide law enforcement in-service training; and 3) manage the service of warrants.

In August 2012, the department took action to solicit a contractor to implement Phase Two of the process, which was to work with department teams from various divisions—including law enforcement—to enact their identified initiatives. The contractor helps each team develop clear objectives related to its initiatives; facilitates the development of specific actions needed to achieve each division's objectives; and identifies and

sets realistic target dates to achieve each initiative. The department's deputy administrative director projects the strategic plan will be completed by the end of 2013.

Sheriff showed initiative toward addressing risk management

The state sheriff admitted to not initially understanding what was involved in conducting a risk-assessment. However, the sheriff researched then began the process of establishing a risk-management program for Sheriff Division. In response to our audit report recommendations, the sheriff crafted a report in 2011 that provided the conceptual framework for a risk-management program that will eventually involve an assessment of current risk management practices at Sheriff Division and provide recommendations to improve those practices. In addition, the division plans to create a risk management unit to eventually formalize all its policies and procedures designed to mitigate risk into a more comprehensive policy. The sheriff's report acknowledged that, in accordance with our 2010 audit report, a risk-assessment process will help clarify the responsibilities and accountabilities of Sheriff Division. According to the sheriff, the risk assessment could be completed by the end of 2013.

Administrative rules on hold

Our audit report found the department lacked administrative rules pertaining to Sheriff Division. Administrative rules are used as agency statements of general or particular applicability to implement or interpret a law or policy. The department's broad interpretation of state laws regarding public safety, combined with its lack of administrative rules, may have contributed to the expansion of the division's duties which were assumed by a relatively modest number of deputy sheriffs. Although the deputy director of law enforcement believes administrative rules or statutory changes would help clarify Sheriff Division's responsibilities, the deputy director does not consider it the division's most pressing priority. According to the deputy director, a higher priority for the division is developing policies and procedures in order to obtain accreditation from the Commission on Accreditation for Law Enforcement Agencies (CALEA), as also recommended in our audit report. The department included CALEA accreditation as one of the objectives identified in its strategic-planning process critical to guiding the future of the Sheriff Division. The state sheriff says he is optimistic the accreditation process will be completed within three to five years.

Limited progress has been made to address facilities' security issues

Our audit report noted the department director's acknowledgment that Sheriff Division had not been given sufficient personnel to fulfill its duties, particularly at many of the courts. We found that inadequate staffing was a concern raised by every neighbor island section, and cited

the Kona Unit on the island of Hawai‘i as an example. The Kona Unit included six deputy sheriffs who were responsible for the security of five courts in West Hawai‘i.

Our audit analyzed personnel data from the Sheriff Division roster as of August 2009. Based on our follow-up review of a 2012 division roster, we found the number of deputy sheriffs assigned to provide security at the O‘ahu district court and courts on Maui and Kaua‘i had decreased. However, the number of deputies assigned to the Kona section on the Big Island had increased, by three. It should also be noted that, as of December 2012, there were 13 deputy sheriffs assigned to Kapolei court on O‘ahu, which is a significant improvement from 2010, when we found the division could not provide any staff at the Kapolei court.

The state sheriff told us that manpower will be an ongoing issue for Sheriff Division. The sheriff added that discussions with the Judiciary resulted in a study performed by the National Center for State Courts to assess court security in Hawai‘i. The study concluded that, in order to conform to best practices, Sheriff Division would need an additional 104 deputy sheriffs to provide security to the courts. Prompted by the study’s conclusions, the department has submitted a budget request for fiscal biennium 2013–2015 for an additional 16 deputy sheriffs for various courts on O‘ahu, Maui, and the island of Hawai‘i. Although this is a positive step, the division’s staffing still falls far short of the commissioned report’s recommendation.

Lack of new agency agreements with Judiciary and transportation department continue to cloud security-responsibility issues

Our audit report found that in accordance with law enforcement standards, effective security of courts is dependent upon the use of agreed-upon written directives and operational plans. When multiple agencies are involved in the security of a court, a memorandum of agreement (MOA) is needed to identify and specify the requirements and responsibilities of each. Our 2010 audit also found that determining responsibility for ensuring the security of courts between the Sheriff Division and Judiciary was based on an expired MOA. Our report concluded that, with no formal, documented agreement, there was no guidance for Sheriff Division’s relationship with the courts. In addition, we found two MOAs between Sheriff Division and the Department of Transportation (DOT) created separate issues. One MOA essentially gave operational control of the Department of Public Safety’s deputy sheriffs to the DOT at Honolulu International Airport. A second MOA to provide security at neighbor island airports was not honored by the Public Safety Department due to funding issues with DOT. As a result, private security companies were hired to provide security at those airports.

Our follow-up review found that there is still no formal written agreement between the department and the Judiciary, although a draft MOA is under review. There is also no new formal agreement between the department and DOT to resolve whether operational control at Honolulu International Airport should remain with DOT or be with the Department of Public Safety. According to the deputy director of the Law Enforcement Division, the department’s position is that it cannot expand to cover airport security on the neighbor islands at this time. The deputy director added that the department currently does not have adequate staffing to provide neighbor island airport security.

Status of Recommendations

Report No. 10-06, *Audit of the Department of Public Safety, Sheriff Division*, included five multi-part recommendations to the Department of Public Safety. Recommendation Nos.1 and 2 involved actions related to the development of a comprehensive strategic plan and a risk assessment for Sheriff Division. The charts below include our assessments of the individual recommendations.

Our review found that the department and Sheriff Division have taken steps to engage in a strategic planning process and develop a risk-management program. However, those actions are not expected to be completed until later in 2013. Therefore, we deem recommendation Nos. 1a, 1b, 1c, 1d, 1e, 1f, 1g, 2a, 2b, 2c, and 2d **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Public Safety			
(1) Perform a risk assessment of each section of Sheriff Division.	Inadequate training and an absence of procedures related to staffing raised questions regarding the safety of the public, the courts, and the sheriffs.	Open but in progress	The state sheriff intends to complete a risk assessment by the end of 2013.
(2) Develop a strategic plan for Sheriff Division that meets the requirements of Act 100, Session Laws of Hawaii 1999.	Division lacked guidance and direction and failed to produce a strategic plan that defined the division's mission and set boundaries based on its capabilities.	Open but in progress	A department-wide strategic operating plan is being developed with a contracted consultant. The department anticipates completing the plan by the end of 2013.

Recommendation Nos. 3 and 4 called for the consideration of reorganizing the statutes pertaining to Sheriff Division and drafting administrative rules for the division to help clarify its duties, functions, responsibilities, and jurisdictions. The deputy director of law enforcement stated the department has not taken action regarding those recommendations. Therefore, we deem recommendation Nos. 3, 4a, 4b, 4c, and 4d **Open**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Public Safety			
(3) Collaborate with the administration and potentially the Legislature to consider reorganizing the statutes pertaining to the duties and functions of Sheriff Division.	The department's broad interpretation of state laws pertaining to public safety expanded the responsibilities of Sheriff Division.	Open	The deputy director of law enforcement stated the department has not begun revising the statutes or developing administrative rules.
(4) Draft administrative rules that clearly determine and define the responsibilities and jurisdiction of Sheriff Division.	The department lacked administrative rules related to the Sheriff Division, which may have contributed to the expansion of the division's duties.	Open	The department intends to address the rules but provided no timeframe for adoption.

Recommendation No. 5 called for Sheriff Division to seek accreditation from CALEA to ensure proper law-enforcement policies and procedures are enacted and followed. The Sheriff Division has taken actions in preparation to meet CALEA standards by identifying policies that will require revision or those that must be developed. However, the accreditation process could take years to complete. Therefore, we deem recommendation No. 5 **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendation to the Department of Public Safety			
(5) Seek accreditation for the Sheriff Division from the CALEA to help ensure that proper law-enforcement policies and procedures are enacted and followed.	The intent of the recommendation was to require the department to seek accreditation to ensure proper law-enforcement standards were being met.	Open but in progress	The accreditation process, which involves evaluating policies and procedures and consulting with the union and the division's customers could take up to five years to complete.

Chapter 7

Mixed Results for Public Safety Department's Efforts to Improve Oversight and Data Quality

Report No. 10-10, *Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services*, found that the Department of Public Safety (PSD) did not provide detailed and accurate financial information to policymakers and the public, a key component in solving the State's chronic prison overcrowding problem. For instance, PSD reported that it cost twice as much to maintain an inmate in an in-state facility as it did in an out-of-state one; however, we found these estimates were the result of a flawed methodology driven by data that were easiest for the department to report.

We also found that the department circumvented the State's procurement process when it established an inter-governmental agreement with the City of Eloy, Arizona, and Corrections Corporation of America (CCA) for prison beds and services at Florence Correctional Center, Red Rock Correctional Center, and Saguro Correctional Center. In addition, we found no evidence that Eloy sub-contracted inmate services to CCA, nor was the city compensated for its role in the agreement. Moreover, the department had no written policies or procedures for contract administration, and the administrator and staff readily accepted CCA's representations and conclusions of its performance without verifying statements against documented evidence. At the time of our 2010 fieldwork, the department had no plans for contracting for private prison beds beyond June 30, 2011, when its contract with Eloy and CCA was to expire.

In our follow-up review, we found the department has improved the accuracy of its incarceration data, employing a more systematic process that utilizes comparable costs and cost-accounting methodology. Additionally, the current department director told us that compliance with the State procurement rules, policies, and procedures is a top priority for him. Indeed, we found that the department properly secured a new contract with CCA for the confinement, care and custody of Hawai'i inmates.

However, the department and division still have not documented any formal policies or procedures related to the administration of contracts, the systematic and formal evaluation of its contractors, or the retention of contract-monitoring records. In addition, we found that department staff are participating in procurement activity without having appropriate training—in violation of procurement rules, policies, and procedures—and the director has yet to attend any procurement training.

These significant deficiencies call into question the current director's commitment to proper compliance and introduce the risk that the violations cited in our previous report can and will occur again.

Finally, since our audit report was issued in December 2010, new leadership has taken over management of PSD. During our initial audit, we were repeatedly denied full access to requested information. However, in our follow-up review, we found both management and staff to be responsive and helpful.

Background

The Department of Public Safety is responsible for formulating and implementing state policies and objectives for correctional, security, law enforcement, and public safety programs and functions. The department's Corrections Division is responsible for managing both jails and prisons. The Office of the Deputy Director for Corrections provides for the custody, care, and assistance of all persons incarcerated by the courts or otherwise subject to confinement based on an alleged commitment of a criminal offense.

In December 1995, in an effort to address the prison overcrowding crisis, the department initiated a transfer of prison inmates to out-of-state facilities. From 1995 to 1998, the department housed 600 inmates in Texas with the Bobby Ross Group. The first transfer of Hawai'i inmates was viewed as a "short-term solution to chronic overcrowding"—an attempt to give prison officials "breathing room" until new prison cells could be built to accommodate bed space needs and future demands in-state. In 1998, a downturn in the economy derailed funding for major prison expansion, causing both state legislators and prison officials to reexamine the use of out-of-state facilities as a longer-term solution. What started as a temporary solution to relieve prison overcrowding is today a matter of state policy.

In 2006, the former department director signed an inter-governmental agreement (IGA) with the City of Eloy, Arizona, to consolidate housing for Hawai'i inmates to three prisons owned and operated by Corrections Corporation of America, a for-profit provider of correctional facilities. At the time, the corporation was building a \$95 million prison in Saguaro, Arizona, specifically for Hawai'i inmates. As the name indicates, inter-governmental agreements are agreements that involve government-to-government transactions. Such agreements are exempt from competitive procurement methods that state agencies must generally employ when soliciting proposals, a requirement of the Hawai'i Public Procurement Code.

Department's incarceration costs are more accurate, but updated information is not provided to the Legislature

In our follow-up review, we found that Department of Public Safety management now emphasizes the need for accurate incarceration-cost data and has revised its methodology for calculating per capita incarceration costs for both in-state and out-of-state facilities. Today, in its calculation for in-state facilities' cost per day, the department uses the average end-of-month population reported for each facility rather than operating bed capacity. This new calculation results in an average daily cost for all in-state facilities of \$88 per day. Indirect per capita costs, such as costs for correction programs services, food services, health care, and administrative services, are calculated using the same methodology and then added to the average daily cost, resulting in a total cost of \$127 per day to maintain inmates in-state.

The PSD administrative costs for the department are now also included as part of in-state incarceration costs. However, these costs are not included in the out-of-state contracted facilities and the Federal Detention Center costs because, according to the department, only a small percentage of the department's administrative time and resources are dedicated to these areas, although more than one-third of all Hawai'i inmates are housed in such facilities. In addition, the department has not included any cost for litigation as part of its calculation for per capita incarceration costs. According to the department, these costs, if included, would have the biggest impact on per capita costs for housing inmates in out-of-state facilities, since the biggest lawsuits involve these facilities. Although the department is equipped with tools to effectively track inmate data through Offendertrak, a computer-based, inmate-tracking system installed in 1999, the department is not effectively utilizing the capabilities of Offendertrak for this data. As a result, the department's calculation on per capita incarceration costs for the various inmate populations is still inaccurate and skews overall inmate costs.

Although the department has updated its methodology, it has not provided these updated (and more accurate) cost data to the Legislature. When asked why the department no longer reports these numbers to the Legislature, the acting business-management officer replied there used to be a proviso in the budget that required the department to submit incarceration costs as part of its budget request. The proviso last appeared in the department's 2010 budget documents, the last time it reported this information to the Legislature. In addition, the Legislature has not made any subsequent requests for such information. As a result, policymakers are still not provided sufficient or accurate information on incarceration costs for inmates in out-of-state and in-state facilities.

Department addressed its procurement violation involving inappropriate use of an inter-governmental agreement

Our follow-up effort also found that the department worked with the State Procurement Office (SPO) and used the competitive purchase process to procure a new contract with CCA for the confinement, care, and custody of male Hawai'i inmates, replacing the previous contract which expired on June 30, 2011. We verified that the department issued a request for information and a request for proposal (RFP). The department also requested a review of its draft RFP from the SPO and modified its RFP to incorporate SPO comments. The department then issued a contract for health and human services for a competitive purchase of services for the confinement, care, and custody of male Hawai'i inmates. However, the department was unable to provide documentation that the SPO had reviewed and approved the contract per our recommendation.

Department has addressed some of the control-environment issues involving contract oversight

The department has also addressed some of the control-environment issues involving contract oversight. For instance, the Federal Detention Center (FDC) Branch developed and implemented an enhanced audit tool for staff to use regularly to test compliance with contract requirements. The new tool includes a description of what to test and how to validate compliance. In addition, the branch has addressed fiscal-monitoring deficiencies identified in our audit report. In our review, we found each invoice included a contract date stamp, all of the required information was filled in, and the stamp was signed by the accounting clerk certifying satisfactory receipt of goods and services and evidence of payment approval. In addition, the information contained in each invoice had been reviewed and reconciled against branch records and validation of a review was recorded. Moreover, the department is planning to restore the position of onsite prison contract compliance monitor for the Saguaro Correctional Center and the Red Rock Correctional Center to improve the contract-oversight function.

However, the department and branch still have not documented any formal policies or procedures related to the administration of contracts, the systematic and formal evaluation of contractors, or the retention of contract-monitoring records. In addition, the department and branch have not documented or implemented formal processes and procedures for the review, approval, and processing of invoices to ensure payments to external entities are accurate, appropriately supported, properly recorded, and the goods and services have been received.

No evidence supports director's stated priority of compliance with procurement rules

The current director stated that compliance with procurement rules, policies, and procedures is a top priority; however, the department has not fulfilled the requirement to ensure that FDC Branch staff and management dealing with the procurement of competitive purchase of service for health and human services under Section 103F-402, Hawai'i

Revised Statutes (HRS), and Small Purchases under Section 103D-305, HRS, meet the training requirements for the level of procurement authority delegated. For instance, the department has not conducted any training for procurement policies and procedures under Chapter 103F, HRS, or for contract administration and contract management since our audit. In addition, the FDC Branch administrator and the FDC Branch supervisor still have not attended all applicable mandatory procurement training workshops required for competitive purchase of service for health and human services under Section 103F-402, HRS. We also found that the Mainland/FDC Branch administrator and supervisor have not attended all of the applicable mandatory procurement training workshops required for small purchases under Section 103D-305, HRS. As a result, both the administrator and supervisor are conducting and participating in procurement activity without having completed all of the required procurement training workshops in violation of the procurement rules.

State Procurement Office did not take action on department and branch procurement violations

The SPO did not address our recommendation to suspend procurement authority for key Mainland/FDC Branch staff procuring prison beds and services until they had completed procurement training workshops, and the department failed to ensure that these key staff completed the required procurement training. We also recommended that the State chief procurement officer suspend procurement authority delegated to the department for out-of-state prison contracts with private vendors until the department's practices are reviewed and policies and procedures are in place to ensure compliance with Chapter 103F, HRS. Contrary to our recommendation and reports by SPO that this had been addressed, PSD's contracting officer informed us that SPO never contacted him regarding the deficiencies noted in the department's competitive procurement process, never suspended procurement authority for branch staff who procure prison beds and services for failing to meet procurement training requirements, and never notified PSD of the need for FDC Branch key staff to attend required training. Neither the department nor SPO has made any changes to procurement delegation for branch employees since 2009.

Although the department's response to this recommendation was that its procurement policies and procedures had been updated and were awaiting departmental review and approval by the director, the department was unable to provide us with a draft copy of the new procurement policies and procedures for Chapter 103F, HRS. In addition, the department's procurement policies and procedures have never been provided to SPO for review.

Status of Recommendations

Report No. 10-10, *Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services*, included ten recommendations, eight of which were directed to the Department of Public Safety and the remaining two to the State chief procurement officer.

Recommendations to the Department of Public Safety

Our follow-up effort found that the department has improved its incarceration-cost methodology, resulting in more accurate cost estimates. Therefore we deem recommendation No. 1a **Closed**. However, because the department has yet to include litigation and administrative costs into its calculation, we have deemed recommendation No. 1b **Open but in progress**. Although the department now has more accurate incarceration-cost data, it has not shared this information with the Legislature. As such, we deem recommendation No. 1c **Open and likely not to be pursued**. We also found that the department is still not utilizing the capabilities of Offendertrak, its inmate-tracking management system. According to the deputy director for administration, reports generated by Offendertrak are still not reliable. Since the department has arranged for a content audit review of the system, we deem recommendation No. 1d **Open but in progress**.

With regard to monitoring the operations of private prisons, we found that the branch had developed and implemented an enhanced audit tool, which staff use to regularly test contractor compliance with contract requirements. Therefore, we deem recommendation No. 2a **Closed**. However, we found that the audit tool does not include, and neither the department or the branch has documented, any formal policies and procedures related to the documentation of contract compliance issues, how to obtain adequate evidence to support contractor testimony/ performance, and what is required for the retention of monitoring records. As a result, recommendation No. 2b remains **Open but in progress**. In addition, the department and the branch still have not documented any formal policies or procedures related to the administration of contracts, the systematic and formal evaluation of contractors, and the retention of contract-monitoring records. Therefore we deem recommendation No. 2c **Open but in progress**. Moreover, the department still has not documented and implemented any formal policies or procedures for the review, approval, and processing of invoices to ensure payments to external entities are accurate, appropriately supported, or properly recorded, and that goods and/or services have been received. Therefore, we deem recommendation No. 2d **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Public Safety			
(1a) Consider developing a cost calculation that follows the principles of performance accounting.	The department's methodology to determine cost was flawed.	Closed	The department now uses a cost-accounting methodology.
(1b) Utilize a more systematic process for cost comparisons.	The department used inconsistent inmates counts in its various cost calculations.	Open but in progress	The department now uses the average end-of-month population reported for each facility. However, it does not include any costs for litigation.
(1c) Communicate with the Legislature in order to provide pertinent information in return.	Because funding is virtually guaranteed, management was indifferent to the needs of policymakers and the public for accurate and reliable cost information.	Open and likely not to be pursued	The last time the department reported this information to the Legislature was in 2010.
(1d) Compile useful, reliable, and complete data, utilizing available tools such as Offendertrak.	The department was underutilizing Offendertrak, its inmate-tracking management system.	Open but in progress	Offendertrak's data is considered unreliable and is not used in cost calculations.
(2a) Use standardized tools to measure compliance with all areas of the contract on a regular basis.	The department's lack of contract-monitoring policies and procedures created numerous contracting issues and allowed errors to go uncorrected.	Closed	The branch developed and implemented an enhanced audit tool for staff use to regularly test compliance with contract requirements.
(2b) Develop a quality review program to ensure the monitoring of records and reports and documentation of inspection results.	The department's lack of contract monitoring policies and procedures created numerous contracting issues and allowed errors to go uncorrected.	Open but in progress	The audit tool does not include any policies or procedures regarding contractor performance testing.
(2c) Establish policies and procedures related to documenting contract compliance issues and the retention of records.	The Mainland/FDC Branch had no written policies and procedures for the administration of contracts related to the care, custody, and confinement of Hawai'i inmates in non-state facilities.	Open but in progress	The department and the branch still have not documented any formal policies or procedures related to contract administration.
(2d) Update its policies and procedures for fiscal monitoring and the approval and processing of invoices.	Some invoices had no documentation to validate reviews or evidence of payment approval.	Open but in progress	The department and the branch have not implemented formal processes and procedures for the review, approval, and processing of invoices.

Recommendations to the State chief procurement officer

Report No. 10-10 recommended that the State chief procurement officer suspend procurement authority delegated to the department for out-of-state prison contracts with private vendors until department practices are reviewed, policies and procedures are in place, and key staff have completed procurement training. Because SPO did not suspend procurement authority for the branch staff and neither it nor the department made any changes to procurement delegation, we deem recommendation Nos. 3a1 and 3a2 **Open**. However, SPO worked with the department to properly procure a new contract with Corrections Corporation of America; therefore, we deem recommendation No. 3b **Closed**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the State chief procurement officer			
(3) To improve contracting for private prison beds in out-of-state facilities, SPO should suspend procurement authority delegated to the department for out-of-state prison contracts with private vendors until:			
(3a1) The department's practices are reviewed and policies and procedures are in place to ensure compliance with Chapter 103F, HRS; and	During our audit, we noted violations of procurement procedures, poor procurement practices, and missing procurement policies.	Open	Neither the department nor SPO has made any changes to procurement delegation since 2009.
(3a2) The Mainland/FDC Branch administrator and key staff have completed contract administration training related to health and human services under Chapter 103F, HRS.	See comments above.	Open	See comments above.
(3b) The State chief procurement officer should provide guidance and oversee the procurement process for the next prison beds contract.	The department improperly signed an inter-governmental agreement with Corrections Corporation of America (CCA).	Closed	The department worked with SPO and used the competitive procurement process to procure a new contract with CCA.

Chapter 8

New Leadership at Tax Department Corrects Course on Planning and IT Management

Report No. 10-11, *Management and Financial Audit of the Department of Taxation Contracts*, released in December 2010, found that after ten years and \$87 million, the Department of Taxation's (DoTAX) effort to replace its aging computer system was still on-going and had yet to be finalized. Our audit found that long-term planning for these projects was minimal to non-existent and oversight was left to managers with no formal project-management or information-technology (IT) backgrounds. We also found that the department took on too many projects with insufficient staffing, resulting in the department allowing its IT vendor to become an essential component of its IT infrastructure. Our audit questioned the department's ability to sustain the current rate of system enhancements without continued support from its vendor, which was scheduled to terminate services in June 2011. We concluded that without a transition plan, DoTAX and its IT infrastructure were facing precarious futures.

Since our 2010 audit report was issued, new leadership has taken over management of DoTAX. Our review found that leadership has initiated corrective actions to address our audit recommendations. The tone at the top regarding corporate culture and values has changed significantly since our audit. For example, the current director stresses—through words and actions—the importance of long-range planning and working together to achieve department goals. Corrective actions include the creation of a department-wide strategic plan, an IT strategic plan, and an IT transition plan. The department is working with the State's Office of Information Management and Technology (OIMT) to modernize its tax processes and systems. The department has assumed all technical functions and responsibilities previously performed by its IT vendor and has attended to practices and problems that previously created a dysfunctional work environment.

Background

The Department of Taxation's mission is to administer the tax laws of the State of Hawai'i in a consistent, uniform, and fair manner by educating taxpayers on tax laws, developing a professional staff, and using technology to increase efficiency and effectiveness. The department is responsible for administering and enforcing tax revenue laws of the state and collecting all taxes and other payments payable thereunder. The

department is the State's primary revenue-generating entity. Therefore, the success of its tax collection functions is of critical importance to the well-being of Hawai'i's residents.

In 1999, DoTAX began a five-year, \$51 million effort to replace its aging computer systems. The department contracted with an IT vendor to develop and install a new Integrated Tax Information Management system (ITIM). By October 2004, the department and its vendor completed six major system implementations. Then, over the next four years, the effort continued with an additional 13 projects and enhancements to the system. In January 2008, yet another system enhancement followed: a \$25 million delinquent tax-collections project, which called for 22 new collection initiatives. This last enhancement resulted in a contingency fee contract with the department's IT vendor at a compensation rate of one-third of all new tax collections realized. However, our audit found that a lack of planning and insufficient resources to support a growing IT infrastructure threatened to cripple these important systems.

Since the current director took office in 2011, he has assigned an almost entirely new management team, including a change in deputy director.

Department takes steps to provide long-term guidance

Our 2010 report found the department's ability to accomplish its mission was affected by its failure to develop and implement an effective strategic plan. The audit concluded that a lack of planning threatened the sustainability of the department's IT infrastructure.

Our review found that the department has engaged in long-term planning, developing a four-year strategic plan covering values, vision, mission statement, goals, and objectives in March 2011. A component of the plan includes effective management and modernization of the department's IT processes and technology. The department also developed and implemented an IT strategic plan to guide the department's efforts to sustain and extend department-wide strategies and goals. Based on this information, the department decided it must modernize its IT infrastructure and streamline and modernize tax processing away from the current ITIM system. The department is coordinating this work with OIMT and the Department of Accounting and General Services (DAGS).

Department addresses its dysfunctional work environment

The audit report found the department's work load had increased due to operational and statutory changes that affected the ITIM system. However, from 2005 to 2010, the staffing level at the DoTAX Information Technology Services Office (ITSO) had steadily decreased by a total of 20 percent. To compensate, DoTAX allowed its vendor to become an essential component in its IT infrastructure. In addition,

the report found the department's inability to deal with dissent among its employees led to management conflicts and a dysfunctional work environment so corrosive the governor's office intervened.

Our review found that DoTAX leadership has taken steps to address these issues through better planning, reorganizing and managing various intra-agency factions, and transforming the departmental culture. According to the director, management has become more inclusive—involving the group manager, branch chief, division administrator, director, and deputy director in decision making. Prior to 2011, the System Administration Office (SysAd) and the Tax Law Change (TLC) group were overseen by operational divisions with limited technology expertise. As a result of changes instituted in 2011, these two groups, which had been unable to work together, now work under ITSO and are overseen by the Director's Office. The leaders for these two groups have been replaced. The three parties now work more closely together to establish and set project priorities and schedules.

Transition plan enabled the department to operate its IT systems after the departure of its long-time vendor

Our 2010 audit found the department was not only unable to sustain the current rate of system enhancements, it struggled to maintain its current levels of activity without assistance. With an IT infrastructure in near continuous project-development mode for more than a decade, internal staff were stretched thin and frustrated, spending the majority of their time doing system testing at the expense of other responsibilities. In spite of these problems, the department had not adequately planned for the end of the contract with its vendor in 2011, when it would lose vendor support and operate independently.

Our follow-up review found the department had developed and implemented an IT transition plan to ensure it could successfully assume all technical functions and responsibilities previously performed by the IT vendor related to ITIM system information technology functions. The department had also developed and implemented a formalized process to limit and control ITIM system enhancement and change requests to those required by law. Critical system fixes are performed as needed, and implemented based on available resources and priorities. Since its IT vendor left on June 30, 2011, the department has successfully supported and maintained the ITIM system without vendor support, with little to no detrimental impact upon operations, and has continued delinquent tax collections.

Status of Recommendations

Report No. 10-11, *Management and Financial Audit of the Department of Taxation Contracts*, included multi-part recommendations to DoTAX and the Legislature.

Recommendations to the Department of Taxation

In our 2010 audit report, we issued a four-part recommendation to DoTAX that applied to the development and implementation of an effective IT strategic plan and a transition plan.

Documents show the department developed and implemented an IT strategic plan to guide the department's efforts to sustain and extend department-wide strategies and goals. Therefore, recommendation No. 1a is deemed **Closed**. The department developed and implemented a formalized process to limit and control ITIM system enhancement and change requests to those required by law or deemed necessary; therefore recommendation No. 1b is deemed **Closed**. The department developed and implemented an IT transition plan that allowed it to successfully support and maintain the ITIM system without vendor support with little to no detrimental impact upon operations; therefore recommendation No. 1c is deemed **Closed**. According to the department, it is assembling a team that will work with OIMT on the department's tax modernization project and OIMT's ERP project and will use OIMT's formal project/contract-management processes and procedures to effectively plan and manage this work. Therefore, recommendation No. 1d is deemed **Open but in progress**.

Our second recommendation to the department addressed work-environment issues. Our review found that department leadership has engaged in better planning and reorganized various intra-agency factions to help transform the department culture. Therefore, recommendation No. 2a is deemed **Closed**. As part of the department's planning process, it assembled the top-ten values suggested by employees in their dealings with each other. In order to build commitment and accountability, the director established a process by which program management units defined objectives that support the department's goals and performance measures used to assess progress and provide feedback on their efforts. Therefore, recommendation No. 2b is deemed **Open but in progress**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendations to the Department of Taxation			
(1a) Develop and implement an effective IT strategic plan to guide the department's efforts to sustain and extend department-wide strategies and goals.	Our audit found that long-term planning for the department's IT projects was minimal to non-existent. The department's failure to develop and implement an effective IT strategic plan threatened the sustainability of its IT infrastructure.	Closed	The department developed and implemented an IT strategic plan to guide its efforts.
(1b) Discontinue any further enhancements to the IT system unless required by law until its needs and priorities are addressed through IT strategic planning.	We found the department was unable to sustain the current rate of system enhancements and struggled to maintain current levels of activity without assistance.	Closed	The department developed and implemented a formalized process to limit and control ITIM system enhancement and change requests to those required by law or deemed necessary.
(1c) Ensure the transition upon completion of the 2009 modification is completed and results in a sustainable and ongoing support and maintenance of its IT systems.	Without an appropriate transition plan to fill the void left by the departure of its long-time IT vendor, the department would struggle to fulfill the tax collection needs of the State.	Closed	The department developed and implemented an IT Transition Plan to ensure that it can successfully assume all technical functions and responsibilities performed by its IT vendor related to its ITIM system.
(1d) Better manage its future IT systems by establishing an adequate project- and contract-management methodology and ensuring project management is competent to hold vendors accountable.	We found that ill-equipped project managers contributed to poor contract oversight and weak vendor accountability.	Open but in progress	The department is planning to adopt and use the Office of Information Management and Technology formal project/contract-management processes and procedures to plan, manage and deliver its IT system projects.
(2a) Tackle the root cause of problems impeding the department's performance. A cultural transformation will be the key to the department's success.	Many conflicts existed among taxation managers resulting from contrasting personalities, parochial interests, and perceptions that some tax department managers favored the IT vendor at the expense of department IT staff.	Closed	The two groups that were unable to work together have been reassigned to report to the director.
2b) Improve its performance by altering the way department leaders and managers treat each other and manage their people, as well as building commitment and accountability through involvement and trust.	Many conflicts existed among taxation managers resulting from contrasting personalities, parochial interests, and perceptions that some tax department managers favored the IT vendor at the expense of department IT staff.	Open but in progress	To build commitment and accountability, the director established a process by which program-management units define objectives and performance measures that support the department's goals and receive feedback on their efforts.

Recommendation to the Legislature

Our third recommendation was for the Legislature to consider amending the department’s statutes to coincide with the federal Internal Revenue Code to allow state audit agencies authorized under the laws of the State to audit state revenues and programs. The Legislature did not amend the department’s statutes. Given that the Legislature took no action on this issue, recommendation No. 3 is deemed **Open and likely not to be pursued**.

RECOMMENDATION	PURPOSE	STATUS	COMMENTS
Recommendation to the Legislature			
(3) Consider amending the department’s statutes to coincide with the Internal Revenue Code to allow state audit agencies authorized under State law to audit state revenues and programs.	During our audit we were told all requested documents must first be collected, screened, and culled by the department, with a final review by the director. These requirements hampered our review of documents.	Open and likely not to be pursued	The Legislature has not amended the department’s statutes to allow state audit agencies authorized under the State laws to audit state revenues and programs.