



KOBAYASHI, KANETOKU, DOI, LUM & YASUDA CPAs LLC

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Reports

Year Ended June 30, 2013

Submitted by
**THE AUDITOR
STATE OF HAWAII**

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Reports

Year Ended June 30, 2013

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Section I

Introduction



June 26, 2014

The Auditor
State of Hawaii:

We have completed our audit of the basic financial statements of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2013. We have also audited the Highways Division's compliance with requirements applicable to its major federal financial assistance programs. We submit herein our reports pertaining to our audit of the Highways Division's basic financial statements and federal financial assistance programs.

The audit objectives and scope of our audit were as follows.

AUDIT OBJECTIVES

1. To provide opinions on the fair presentation of the Highways Division's basic financial statements and the schedule of expenditures of federal awards as of and for the year ended June 30, 2013, in accordance with accounting principles generally accepted in the United States of America. Our independent auditors' report, which expressed unmodified opinions on the Highways Division's basic financial statements, is issued under separate cover.
2. To consider the Highways Division's internal control over financing reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the Highways Division's compliance with certain provisions, laws, regulations, contracts, and grant agreements that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the Highways Division's internal control over compliance with requirements that could have a direct and material effect on each of its major federal programs in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, and to test and report on internal control over compliance.
5. To provide an opinion on the Highways Division's compliance with applicable laws, regulations, contracts and grants that could have a direct and material effect on each of its major federal programs.

SCOPE OF AUDIT

We performed an audit of the Highways Division's basic financial statements and schedule of expenditures of federal awards as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, the standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

ORGANIZATION OF REPORT

Our report is organized into three sections as follows:

Section I, entitled "Introduction," describes the objectives and scope of our audit and the organization and contents of this report.

Section II, entitled "Internal Control Over Financial Reporting and Compliance and Other Matters," contains our report on the Highways Division's internal control over financial reporting and on compliance and other matters based upon our audit of the Highways Division's basic financial statements.

Section III, entitled "Compliance and Internal Control Over Federal Awards," contains our report on the Highways Division's compliance and internal control over federal awards in accordance with OMB Circular A-133, a schedule of expenditures of federal awards, and a schedule of findings and questioned costs.

We would like to take this opportunity to express our appreciation to the personnel of the Highways Division for the cooperation and assistance extended to us during our audit. We will be pleased to discuss any questions that you or your associates may have regarding our findings and recommendations.

Sincerely,

Kobayashi, Kentoko, Sai, Seno, Yamaoka CPAs LLC

Section II

Internal Control Over Financial Reporting and Compliance and Other Matters



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

The Auditor
State of Hawaii:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities and each major fund of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2013, and the related notes to the basic financial statements, which collectively comprise the Highways Division's basic financial statements, and have issued our report thereon dated June 26, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Highways Division's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Highways Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Highways Division's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in Appendix 1 to the accompanying schedule of findings and questioned costs as Findings 2013-01 through 2013-03 that we consider to be significant deficiencies.

Compliance and Other Matters

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

Highways Division's Responses to Findings

The Highways Division's responses to the findings identified in our audit are described in Appendix 1 to the accompanying schedule of findings and questioned costs. The Highways Division's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Kobayashi, Kentoko, Sai, Leno, Yano CPAs LLC

Honolulu, Hawaii
June 26, 2014

Section III

Compliance and Internal Control Over Federal Awards



**Independent Auditors' Report on Compliance For Each Major Federal Program;
Report on Internal Control Over Compliance; and Report on Schedule of Expenditures
of Federal Awards Required by OMB Circular A-133**

The Auditor
State of Hawaii:

Report on Compliance for Each Major Federal Program

We have audited the Highways Division, Department of Transportation, State of Hawaii's (the Highways Division), compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Highways Division's major federal programs for the year ended June 30, 2013. The Highways Division's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Highways Division's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Highways Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Highways Division's compliance.

Opinion on Each Major Federal Program

In our opinion, the Highways Division complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in Appendix 2 to the accompanying schedule of findings and questioned costs as Findings SA-2013-01 through SA-2013-06. Our opinion on each major federal program is not modified with respect to these matters.

The Highways Division's responses to the noncompliance findings identified in our audit are described in Appendix 2 to the accompanying schedule of findings and questioned costs. The Highways Division's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the Highways Division is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Highways Division's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Highways Division's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in Appendix 2 to the accompanying schedule of findings and questioned costs as Findings SA-2013-01 through SA-2013-06 that we consider to be significant deficiencies.

The Highways Division's responses to the internal control over compliance findings identified in our audit are described in Appendix 2 to the accompanying schedule of findings and questioned costs. The Highways Division's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of the governmental activities and each major fund of the Highways Division as of and for the year ended June 30, 2013, and the related notes to the basic financial statements, which collectively comprise the Highways Division's basic financial statements. We issued our report thereon dated June 26, 2014, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Kobayashi, Kaitoko, Naito, Sano & Yamada CPAs LLC

Honolulu, Hawaii
June 26, 2014

**HIGHWAYS DIVISION
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Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

<u>Federal/Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
U.S. Department of Transportation		
Highway Planning and Construction	20.205	\$ 176,449,642
ARRA - Highway Planning and Construction	20.205	23,868,125
State and Community Highway Safety Program:		
NHTSA Grant	20.600	4,082,830
Fatal Accident Reporting System Grant	20.600	38,447
Commercial Driver's License Program Improvement	20.232	221,223
Commercial Drivers License Information System Modernization	20.238	33,256
National Motor Carrier Safety Program - Assistance program grant	20.218	<u>564,103</u>
Total U.S. Department of Transportation		205,257,626
U.S. Department of Homeland Security		
Driver's License Security Grant Program	97.089	<u>441,795</u>
Total Federal Expenditures		<u><u>\$ 205,699,421</u></u>

See accompanying Independent Auditors' Report on Compliance For Each Major Federal Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133 and Notes to Schedule of Expenditures of Federal Awards.

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Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Highways Division and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

2. Relationship to Financial Statements

Federal financial assistance revenues are reported in the Highways Division's financial statements. Actual expenditures related to the major programs have been reconciled to the accounting records underlying the Highways Division's financial statements.

3. Relationship to Federal Financial Reports

The amounts reported in the accompanying schedule of expenditures of federal awards have been reconciled to the amounts reported in the related financial reports of the respective programs.

4. Subrecipients

Of the federal expenditures included in the accompanying schedule of expenditures of federal awards, the Highways Division provided federal awards to subrecipients as follows:

<u>Federal/Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Subrecipient Expenditures</u>
Highway Planning and Construction	20.205	\$ 38,373,849
ARRA - Highway Planning and Construction	20.205	8,427,162
NHTSA Grant	20.600	3,057,579
Commercial Driver's License Program Improvement	20.232	221,223
Commercial Drivers License Information System Modernization	20.238	33,256
Driver's License Security Grant Program	97.089	441,795
Total Subrecipient Expenditures		<u>\$ 50,554,864</u>

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Schedule of Findings and Questioned Costs

Year Ended June 30, 2013

(1) Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unmodified

Internal control over financial reporting:

Material weaknesses identified? yes no

Significant deficiencies identified yes no

Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major programs:

Material weaknesses identified? yes no

Significant deficiencies identified yes no

Type of auditors' report issued on compliance for major programs: Unmodified

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

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
20.205	Highway Planning and Construction
20.600	State and Community Highway Safety Program – NHTSA and Fatal Accident Reporting System Grants

Dollar threshold used to distinguish between type A and type B programs? \$3,000,000

Auditee qualified as low-risk auditee? yes no

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Schedule of Findings and Questioned Costs

Year Ended June 30, 2013

(2) Financial Statement Findings

Refer to Appendix 1.

(3) Federal Award Findings and Questioned Costs

Refer to Appendix 2.

(4) Summary Schedule of Prior Audit Findings

No findings were reported.

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Significant Deficiencies

June 30, 2013

Finding 2013-01 Timely Reconciliation of HWYAC Accounts

Condition

FAMIS is the accounting system used by the State of Hawaii (the State) to accumulate and report financial fund data to reflect total sources and expenditures of the State, which includes the Highways Division. HWYAC is the Highways Division's proprietary accounting system used to capture financial and project cost information, and serves as the Highways Division's general ledger for financial reporting purposes.

Cash receipts and cash disbursements transactions are processed and recorded in FAMIS. This information is then manually reentered into HWYAC by Highways Division personnel to provide more detailed information for each of its federal and state projects, which is used by management of the Highways Division for financial reporting, project costing, and federal reimbursement purposes.

During our audit, we noted that the Highways Division does not reconcile amounts recorded in FAMIS to amounts recorded in HWYAC on a timely basis to ensure the integrity of Highways Division's financial reporting process. Instead, the Highways Division reconciles cash in State Treasury, revenues, expenditures, and transfers recorded in FAMIS to those amounts recorded in HWYAC as part of the annual year-end closing process. This is an extremely time consuming exercise requiring extensive reconciliations and analysis to be prepared, resulting in a significant number of adjusting journal entries, and ultimately prolonging the year-end closing process.

We noted that cash in State Treasury, revenues, expenditures, and transfers as of and for the year ended June 30, 2013 were not properly reconciled until June 2014.

Criteria

Financial information related to cash in State Treasury, revenues, expenditures, and transfers reported in the HWYAC system should be complete and accurate to ensure the integrity of financial information used by management and those outside the Highways Division, including the State and the Federal government.

Cause

The Highways Division did not adhere to its policy requiring the performance of monthly reconciliations of its cash in State Treasury. This was due in part to the fact that the Highways Division did not have an individual in the Fiscal Officer position for over a year. This position was filled in January 2014. Additionally, several individuals left the fiscal office during the year and their positions remained vacant for the remainder of the year. As a result, the fiscal office's efforts were redirected toward the

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Significant Deficiencies

June 30, 2013

maintenance of daily operations and the periodic reconciliations were not done during the year in accordance with the Highways Division's established policy.

Effect

We noted that the Highways Division recorded numerous journal entries to adjust cash in State Treasury, revenues, expenditures, and transfers to the proper balances as of and for the year ended June 30, 2013. In addition, we proposed several audit adjustments, including audit adjustments aggregating \$1.2 million for the State Highways Fund and \$2.1 million for the Capital Projects Fund to properly adjust cash in State Treasury balance at June 30, 2013. The effect of these transfers resulted in an overall decrease in the cash in State Treasury balance.

The failure to perform reconciliations in a timely manner could result in erroneous cash transactions going undetected. These undetected errors could lead to inaccurate financial information provided to management, the State, and the Federal government.

As further discussed in Finding 2013-03 on pages 17 to 19, the Highways Division was not able to meet its financial reporting deadlines, which was in part due to the Highways Division practice of not reconciling amounts recorded in FAMIS to amounts recorded in HWYAC on a timely basis.

Recommendation

We recommend that the Highways Division reconcile amounts recorded in FAMIS to amounts recorded in HWYAC on a monthly basis. This should improve the accuracy and completeness of the financial information used by management and those outside the Highways Division, including the State and the Federal government. This should also allow the Highways Division to identify, investigate, and correct potential cash receipts and cash disbursement errors in a timely manner.

View of Responsible Officials and Planned Corrective Action

Management concurs with this finding. Subsequent to year end, a Fiscal Officer was hired and the Highways Division is currently working to fill vacant staff positions. The adjustments to properly record the transfers and the State Treasury account at June 30, 2013 were recorded in June 2014. Currently, the fiscal office is doing its best to reconcile HWYAC to FAMIS on a regular basis. Fiscal policies and procedures are expected to be updated and implemented by the end of fiscal year 2015.

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Significant Deficiencies

June 30, 2013

Finding 2013-02 Reconciliation of Payroll Costs

Condition

Payroll for all State personnel, including the Highways Division, is centrally calculated and processed by the Department of Accounting and General Services (DAGS) payroll system, which maintains basic personnel data required to compute an employee's net pay in order to produce employee payroll checks and to summarize payroll costs for reporting in FAMIS.

The Highways Division accumulates payroll costs for each of its federal and state projects in the HWYAC system, which is used by the Highways Division for financial reporting, project costing, and federal reimbursement purposes. All employees are required to input their labor hours into the AS400 system each pay period. These employee hours are entered into the HWYAC system, which then calculates the direct labor, indirect costs, and fringe benefit costs by project based upon stored salary rate tables, certain personnel information, charge codes, and function codes.

During our audit, we noted payroll costs reported in FAMIS exceeded the payroll costs recorded in HWYAC by \$3.8 million for the year ended June 30, 2013. This difference is primarily due to (1) employees not inputting their labor hours in the AS400 for hours worked during the pay period on a timely basis or not at all, (2) system limitations which do not allow employees to input premium pay items, such as differential pay (e.g., hazard and temporary assignment pay), meals, and travel costs, and (3) the timing difference in recording payroll costs in HWYAC, which is based on the labor hours worked in the pay period, and in FAMIS, which is based on the amount paid during the pay period considering the State's payroll lag policy. The net effect of these unrecorded time and expense charges and the payroll lag resulted in a \$3.8 million understatement of payroll costs in HWYAC.

The Highways Division does not reconcile payroll costs processed through the DAGS payroll system and reported in FAMIS to payroll costs reported in HWYAC on a timely basis. Instead, the Highways Division merely adjusted payroll costs recorded in HWYAC to equal the payroll costs recorded in FAMIS as part of the year-end closing process. The \$3.8 million payroll cost variance was allocated proportionately amongst the largest non-federal appropriations. Although this methodology is conservative for federal reimbursement purposes (since the payroll cost variance is only allocated to non-federal appropriations), it is clear that the classification of payroll costs to federal and state projects are inaccurate and may limit the Highways Division's ability to identify and claim reimbursement for allowable payroll costs incurred on federal projects.

As the Highways Division's payroll costs are adjusted to amounts recorded in FAMIS at year-end, payroll costs in the aggregate are properly reported in the Highways Division's financial statements.

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Significant Deficiencies

June 30, 2013

Criteria

Payroll costs reported in the HWYAC system should be complete and accurate to ensure the integrity of financial information used by management and those outside the Highways Division, including the Federal government.

Cause

The Highways Division did not adhere to established policies and procedures, which require that payroll costs reported in HWYAC be reconciled to payroll costs processed through the DAGS payroll system in a timely manner. We were informed that the process to reconcile payroll costs between these two systems would be time consuming and require additional staff resources.

Effect

Failure to properly reconcile payroll costs reported in HWYAC to payroll costs processed through the DAGS payroll system, combined with the Highways Division's practice of merely adjusting payroll costs recorded in HWYAC to equal the payroll costs recorded in FAMIS as part of the year-end closing process, results in the inaccurate classification of payroll costs to federal and state projects, and may limit the Highways Division's ability to identify and claim reimbursement for allowable payroll costs incurred on federal projects.

In addition, the failure to properly reconcile payroll costs reported in HWYAC to payroll costs processed through the DAGS payroll system could lead to significant errors going undetected for significant periods of time since the nature of payroll cost variances are not investigated and corrected in a timely manner.

Recommendation

We recommend that the Highways Division reconcile payroll costs reported in HWYAC to payroll costs processed through the DAGS payroll system each pay period, or at least on a monthly basis. This should improve the accuracy and completeness of payroll cost information used by management and those outside the Highways Division, including the Federal government. This should also allow the Highways Division to identify, investigate, and correct payroll errors in a timely manner.

Additionally, we recommend that the Highways Division (1) implement stricter policies and procedures requiring all employees to input their timesheet information on a timely basis, and (2) explore alternate methods of tracking and accumulating premium pay items, to ensure that Federal and State projects in the HWYAC system include all payroll costs.

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Significant Deficiencies

June 30, 2013

View of Responsible Officials and Planned Corrective Action

Management concurs with the finding. The fiscal office is in the process of implementing policies to ensure that monthly reconciliations of payroll costs between HWYAC and FAMIS are performed. The Highways Division is also in the process of implementing a new accounting system to replace HWYAC, which will allow premium pay items to be tracked by project and simplify the reconciliation process between the systems. Additionally, Highways Division management has communicated the importance of meeting timesheet reporting deadlines to the various districts and branch offices in an effort to reduce the amount of missing timesheets each pay period. Fiscal policies and procedures are expected to be updated and implemented by the end of the fiscal year ending June 30, 2015.

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Significant Deficiencies

June 30, 2013

Finding 2013-03 Timely Reporting of Financial Information

Condition

During our audit, we noted that the Highways Division was not able to meet the financial reporting deadlines established by the State, the Federal government, and the revenue bond certificate. The Highways Division issued its financial statements as of and for the year ended June 30, 2013 in June 2014.

Criteria

The Highways Division should have a financial reporting process capable of providing complete and accurate financial information on a timely basis to meet its financial reporting requirements, including:

State comprehensive annual financial report (CAFR) – The financial information of the Highways Division is included in the State CAFR. The audited financial statement amounts should be provided to DAGS for inclusion in the State CAFR.

Single audit – The Office of Management and Budget (OMB) Circular A-133 Section 320(b) states that the reporting package (which includes the audited financial statements and single audit reports) and the data collection form are required to be submitted to the Federal Audit Clearinghouse the earlier of 30 days after the receipt of the auditors' reports or nine months after the end of the audit period, unless a longer period of time was agreed to in advance by the cognizant or oversight agency for the audit. The U.S. Federal Highways Administration (FHWA) granted the Highways Division an extension until April 30, 2014.

Revenue bond certificates - In accordance with the *Certificate of Director of Transportation Providing for the Issuance of State of Hawaii Revenue Bonds* dated August 1, 1993 and all supplemental certificates applicable to the 1998, 2003, 2005, 2008, and 2011 outstanding revenue bond issuances, the Highways Division is required to have the annual audited financial statements completed within 270 days after the close of the fiscal year. Additionally, in accordance with the *Continuing Disclosure Certificate* for each of the outstanding issuances, the Highways Division shall provide audited financial statements no later than April 1st following the end of each Fiscal Year to the Municipal Securities Rulemaking Board (MSRB).

Cause

The Highways Division experienced a high degree of management and staff turnover during the past year. The Highways Division did not have an individual in the Fiscal Officer position for over a year and the Chief Accountant, who typically plays a key role in preparing reconciliations and audit schedules, left the Highways Division during the year-end closing process. Although personnel from the Highways

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Significant Deficiencies

June 30, 2013

Division worked diligently to accomplish the many tasks necessary to account for and report on the Highways Division's activities, they encountered difficulties and delays in reconciling account balances and transactions; completing the required fund and government wide closing entries; and preparing audit schedules, analyses, and reports necessary for the timely completion of the financial statement audit.

The aforementioned staff turnover was further complicated by the fact that there were insufficient formalized procedures for the year-end closing and reporting process for the fiscal office to follow prior to hiring the Fiscal Officer in 2014. In addition, the fiscal office experienced difficulty in finding readily available work papers and templates to support certain financial statement amounts and disclosures.

Additionally, a technical issue with the Highways Division's HWYAC accounting system was identified during year-end closing, which temporarily halted closing procedures as key accounting personnel diverted their efforts to addressing this problem.

The culmination of these events negatively impacted the Highways Division's ability to complete closing procedures and prepare audit schedules on a timely basis.

Effect

The Highways Division was unable to meet the financial reporting deadlines established by the State, the Federal government, and the revenue bond certificate as follows:

State CAFR – As the Highways Division's final audited financial statement amounts were not available for inclusion in the State CAFR, unaudited balances and accrual estimates were provided to DAGS. There were numerous adjusting journal entries and audit adjustments proposed during the year-end closing and audit process. The impact of the Highways Division's adjusting journal entries and audit adjustments on the State CAFR has not been determined.

Single audit – As further described in Finding SA-2013-04 on pages 26 and 27, the Highways Division failed to meet the April 30, 2014 extended filing deadline for the single audit reporting package and data collection form. Failure to meet the reporting deadline resulted in noncompliance with the reporting requirements of OMB Circular A-133. Continued noncompliance may negatively affect the level of federal financial assistance from the federal granting agencies.

Revenue bond certificates – The Highways Division's failure to deliver the 2013 audited financial statements within 270 days after year-end was a violation of its bond covenants and continuing disclosure certificates. However, this violation did not constitute an event of default under the master bond certificate and all applicable supplements since the audited financial statements were provided to the MSRB prior to any written notice of default received from bondholders.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Significant Deficiencies

June 30, 2013

Recommendation

We recommend that the Highways Division continue its efforts to establish formal, written policies and procedures to ensure that it meets the financial reporting deadlines established by the State, the Federal government, and the revenue bond certificate, including (1) procedures for the year-end closing and reporting process, (2) identification of work papers and templates required to support certain financial statement amounts and disclosures, (3) related time lines and staff assignments. In doing so, the loss of knowledge due to staff turnovers will be minimized and allow the Highways Division to continue operations uninterrupted.

As further described in Finding 2013-01 on pages 12 and 13, we recommend that the Highways Division reconcile amounts recorded in FAMIS to amounts recorded in HWYAC on a monthly basis to expedite the year-end closing process and to allow the Highways Division to identify, investigate, and correct potential cash receipts and cash disbursement errors in a timely manner.

We also recommend that the Highways Division consider providing cross-training opportunities to fiscal office staff and consider filling vacant positions as deemed necessary to enhance the Highways Division's ability to meet its daily and year-end financial reporting requirements.

View of Responsible Officials and Planned Corrective Action

Management concurs with the finding. In January 2014, the Highways Division hired a Fiscal Officer with the qualifications and experience to oversee the financial closing process and preparation of audit schedules. Additionally, the Highways Division is currently working to fill the Chief Accountant position, as well as other vacant positions in the fiscal office. Further, the Fiscal Officer has begun implementing new procedures to expedite the year-end closing process. Fiscal policies and procedures are expected to be updated and implemented by the end of fiscal year 2015.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

**Finding SA-2013-01
Cash Management**

U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205

Condition

During our audit, we noted that the Highways Division requested federal reimbursements from FHWA for subrecipient expenditures prior to remitting payments to subrecipients.

We noted that for 12 of the 15 requests for reimbursement during the year ended June 30, 2013, payments to subrecipients were made more than 7 days after reimbursements were received from the FHWA (ranging from 8 days to 22 days). These payments to subrecipients aggregated to \$43.7 million, out of a total of \$46.8 million paid during the year ended June 30, 2013.

Criteria

In accordance with the *Cash Management Improvement Act Agreement between The State of Hawaii and The Secretary of the Treasury, United States Department of the Treasury* (the Treasury State Agreement), the time period from the date federal funds are received and credited to the State's account and the date those funds are expended from the State's account shall be no more than 7 days.

Cause

Upon receipt of federal reimbursement from FHWA for subrecipient expenditures, the Federal Aid Accountant will compare and reconcile the reimbursement amounts approved by FHWA to the reimbursement requests submitted by the subrecipients. Upon completion of this reconciliation process, she will advise the Pre-Audit Clerk to make the appropriate payments to the subrecipients. Following the departure of the Federal Aid Accountant during the fiscal year, another individual was temporarily assigned to fill the position until a permanent replacement could be found. As a result of this staff turnover, the payments to subrecipients were not made on a timely basis.

Effect

The Highways Division did not comply with the cash management requirements to minimize the time elapsing between the receipt of funds from the FHWA and their disbursement to subrecipients. Repeated failure to request funds in accordance with the Treasury State Agreement could result in the denial of requested federal reimbursements from the FHWA prior to remitting payments to subrecipients.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Recommendation

We recommend that the Highways Division adhere to established formal procedures to ensure compliance with FHWA's cash management requirements pertaining to reimbursements for subrecipient expenditures. Specifically, the time period from the date federal funds are received and credited to the Highways Division's account and the date those funds are expended from the Highways Division's account should not exceed 7 days as stipulated in the Treasury State Agreement.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. Subsequent to year-end, a full-time accountant was assigned to assume the duties and responsibilities of the Federal Aid Accountant position. The Highways Division understands the importance of complying with the terms of the Treasury State Agreement and is in the process of implementing stricter policies to ensure that subrecipients are paid in a more timely manner.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

**Finding SA-2013-02
Davis-Bacon Act**

U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205

Condition

Certain Highways Division construction projects are subject to the provisions of the Davis-Bacon Act (the Act). In order to monitor compliance with these provisions, the Highways Division has developed policies and procedures requiring contractors and subcontractors to submit weekly certified payroll reports within 7 calendar days after the pay checks are disbursed. Upon receipt of the certified payroll reports, the Highways Division would then date and time stamp the reports, and forward the reports to the respective project engineer for his or her review to determine compliance with the Act.

During our audit, we selected and tested a sample of 25 certified payroll reports. We noted that 6 of the certified payroll reports were not stamped with the date and time that the reports were received, and that 4 of the certified payroll reports were received after the 7-day deadline. Additionally, we identified 6 instances where the certified payroll reports did not contain any evidence (e.g., signature, initial, check marks, etc.) documenting the review by the Highways Division project engineer. During our compliance work, we noted that all employees tested were paid the required prevailing wage rate.

Criteria

The Highways Division must ensure that contractors and subcontractors working on construction projects funded with Federal financial assistance comply with the provisions of the Act and the Department of Labor regulations (29 CFR part 5). Specifically, contractors and subcontractors must submit weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payroll reports), evidencing that their employees were paid wages not less than those established for locality of the project (i.e., prevailing wage rates).

Cause

The Highways Division did not adhere to its internal policies and procedures requiring project engineers to obtain and review certified payroll reports on a timely basis to determine that the contractor or subcontractor is complying with the prevailing wage rates. We also noted that each district office has different procedures in place to document compliance with provisions of the Act.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Effect

The Highways Division was not in compliance with the provisions of the Act requiring the timely receipt and review of certified payroll reports submitted by contractors and subcontractors to determine that their employees are paid prevailing wage rates.

Recommendation

We recommend that the Highways Division adhere to its internal policy requiring project engineers to obtain and review certified payroll reports on a timely basis (i.e., within 7 days after the pay checks are disbursed) to determine that the contractor or subcontractor is complying with the prevailing wage rate requirement. We also recommend that the Highways Division develop standardized procedures to document the date and time of receipt of the certified payroll reports, as well as the review and approval of those certified payroll reports by the project engineers.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. The Highways Division has reiterated to the Construction Engineers in district offices the importance of adhering to the internal policy for the timely submittal of certified payroll reports. Since each district office is not staffed identically, procedures to improve receipt dating and the review and approval of certified payroll reports have been recommended and discussed with the Construction Engineers.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Finding SA-2013-03

Allowable Costs

U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205

Condition

During our audit, we noted that the July 2013 reimbursement request (i.e., federal billing) contained \$111,284 of erroneous payroll costs related to the pay period ended May 31, 2013. This error was corrected in the April 2014 reimbursement request. The Highways Division also made corrections to its financial statements and schedule of expenditures of federal awards for the year ended June 30, 2013.

Criteria

The Office of Management and Budget (OMB) Circular A-87, Appendix A, paragraph C.1, states that allowable costs must be necessary and reasonable for proper and efficient performance and administration of Federal awards, be in accordance with generally accepted accounting principles, and be adequately documented.

Questioned Costs

Total questioned cost amounted to \$111,284, which represents erroneous payroll costs claimed for reimbursement.

Cause

In September 2013, the Highways Division discovered that the payroll costs for the pay period ended May 31, 2013, incorrectly included \$381,634 or three times the amount of certain labor charges for that pay period due to inadvertent uploads of payroll data into the Highways Division's financial reporting system. This payroll processing error included \$111,284 of payroll costs charged to the FHWA federal grant.

This error went undetected for a significant period of time since the Highways Division does not reconcile payroll costs processed through the DAGS payroll system to payroll costs recorded in the HWYAC system on a regular basis, as further described in Finding 2013-02 on pages 14 to 16.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Effect

The Highways Division requested and received reimbursement for costs unallowable by the FHWA grant, which went undetected until September 2013, and subsequently corrected in April 2014. The failure to properly reconcile payroll costs lead to errors going undetected for a significant period of time.

Recommendation

We recommend that the Highways Division adhere to establish policies and procedures requiring that only allowable payroll costs be charged to the FHWA grant. We also recommend that the Highways Division improve its internal controls over payroll costs by reconciling payroll costs between the DAGS payroll system and the HWYAC system on a monthly basis.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. The Highways Division has implemented internal control measures to make sure that the correct payroll costs are charged against FHWA grants. The Highways Division has also enforced policies and procedures to ensure that HWYAC is reconciled to FAMIS on a more regular basis.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

**Finding SA-2013-04
Reporting**

U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205

National Highway Traffic Safety Administration
NHTSA Grant and
Fatal Accident Reporting System Grant
CFDA No. 20.600

Condition

The Highways Division did not submit its single audit reporting package and data collection form (Form SF-SAC) for the fiscal year ended June 30, 2013 to the Federal Audit Clearinghouse by the required due date.

Criteria

OMB Circular A-133 Section 320(b) states that the single audit reporting package and the data collection form are required to be submitted to the Federal Audit Clearinghouse the earlier of 30 days after the receipt of the auditors' single audit reports or nine months after the end of the audit period, unless a longer period of time was agreed to in advance by the cognizant or oversight agency for the audit. The FHWA granted the Highways Division an extension until April 2014 for the submission of the single audit reporting package and data collection form for the year ended June 30, 2013.

Cause

A number of factors negatively impacted the Highways Division's ability to complete its year-end closing procedures and to prepare necessary audit schedules and reports on a timely basis. The Highways Division did not have an individual in the Fiscal Officer position for over a year, which was ultimately filled in January 2014. In addition, the Chief Accountant, who typically plays a key role in preparing reconciliations and audit schedules, left the Highways Division during the year-end closing process. The Highways Division also experienced significant turnover in various accounting positions in the fiscal office. Additionally, a technical issue with the HWYAC system was identified during the year-end closing process, which temporarily halted closing procedures as key accounting personnel diverted their efforts to addressing this technical problem.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

As further described in Finding 2013-03 on pages 17 to 19, the Highways Division also needs to improve its financial reporting process to ensure that complete and accurate financial information is captured, and that required financial reports be prepared and submitted to users of these reports in a timely fashion.

Effect

The Highways Division did not comply with the reporting requirements of OMB Circular A-133.

Recommendation

We recommend that the Highways Division improve its financial reporting process to ensure compliance with the reporting requirements of OMB Circular A-133, which requires that the single audit reporting package and data collection form be submitted to the Federal Audit Clearinghouse the earlier of 30 days after the receipt of the auditors' single audit reports or nine months after the end of the audit period, unless a longer period of time is agreed to in advance by the cognizant or oversight agency for the audit.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. In January 2014, the Highways Division hired a Fiscal Officer with the qualifications and experience to oversee the financial closing process and preparation of audit schedules. Additionally, the Highways Division is working to fill all the vacant positions in the fiscal office. Training sessions are also being conducted for the fiscal staff on the audit schedules and financial statements. Further, the Fiscal Officer has begun implementing new procedures to expedite the year-end closing process. Fiscal policies and procedures are expected to be updated and implemented by the end of fiscal year 2015.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

**Finding SA-2013-05
Subrecipient Monitoring**

U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205

Condition

During the year ended June 30, 2013, the Highways Division passed on \$46.8 million of FHWA Highway Planning and Construction grant monies to subrecipients, which included the City & County of Honolulu, the County of Maui, the County of Hawaii, and the County of Kauai.

Although the Highways Division reviewed the respective single audit reports for all of the subrecipients and did perform a review of documentation submitted with the billings from those subrecipients, the Highways Division did not perform any site visits during the year ended June 30, 2013.

Criteria

In accordance with the Office of Management and Budget (OMB) Circular A-133 and 31 USC 7502(f)(2)(B), each pass-through entity should monitor the subrecipient's use of federal awards. Subrecipient monitoring includes the following:

- Identifying to the subrecipient the federal award information and applicable compliance requirements.
- Review reporting, conduct site visits, maintain regular contact with subrecipient offices, and perform other procedures to assess whether subrecipients are complying with program requirements.
- Review subrecipient single audit reports to determine whether prompt and corrective action has been taken on audit findings pertaining to the respective program.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Cause

In prior years, the Highways Division regularly conducted site visits at the City & County of Honolulu, the County of Maui, the County of Hawaii, and the County of Kauai. The Highways Division experienced turnover in the Federal Aid Accountant position during the current year, which was filled by a temporary replacement hire for most of the year. We were informed that the Federal Aid Accountant typically has a key role in conducting subrecipient site visits; however, since the Federal Aid Accountant's efforts were focused on learning and performing the daily tasks of the new position, site visits were not conducted in the current year.

Effect

Conducting actual onsite visits will improve the Highways Division's monitoring of its subrecipient's compliance with program requirements. In particular, the Highways Division will be able to better assess whether each subrecipient has sufficient internal controls to properly manage federal awards in compliance with all applicable laws, regulations, and program requirements.

Recommendation

We recommend that the Highways Division improve its subrecipient monitoring procedures by conducting periodic site visits of its subrecipients.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. The Highways Division continues to review each county's annual single audit reports as part of the subrecipient monitoring requirements. Also, the designated Federal Aid Accountant visited the County of Kauai and performed reviews of pass-through federal project documentation procedures during fiscal year 2014. During fiscal year 2015, the Highways Division plans to perform reviews at all four city and county subrecipient offices. The Highways Division also plans to perform periodic site visits every year.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

**Finding SA-2013-06
Cash Management**

National Highway Traffic Safety Administration
NHTSA Grant and
Fatal Accident Reporting System Grant
CFDA No. 20.600

Condition

During our audit, we noted that the Highways Division requested federal reimbursements from the National Highway Traffic Safety Administration (NHTSA) for subrecipient expenditures prior to remitting payments to subrecipients.

We noted that for all 23 requests for reimbursement of subrecipient expenditures during the year ended June 30, 2013, payments to subrecipients were made more than 7 days after reimbursements were received from NHTSA (ranging from 8 days to 45 days). These payments to subrecipients aggregated \$3.1 million during the year ended June 30, 2013.

Criteria

In accordance with the *Cash Management Improvement Act Agreement between The State of Hawaii and The Secretary of the Treasury, United States Department of the Treasury* (the Treasury State Agreement), the time period from the date Federal funds are received and credited to the State's account and the date those funds are expended from the State's account shall be no more than 7 days as stipulated in the Treasury State Agreement.

Cause

Upon receipt of federal reimbursement from NHTSA for subrecipient expenditures, the fiscal office prepares a TDR to transfer funds to the Highways Division cash in State Treasury account in FAMIS. This process usually takes two to three days to post. Once the funds are posted in FAMIS, the Pre-Audit Clerk is notified to begin processing subrecipient payments. This process is sometimes further delayed due to the lack of adequate support or documentation, including original invoices and signatures authorizing payment.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2013

Effect

The Highways Division did not comply with the cash management requirements to minimize the time elapsing between the receipt of funds from NHTSA and their disbursement to subrecipients. Repeated failure to request funds in accordance with the Treasury State Agreement could result in the denial of requested federal reimbursements from NHTSA prior to remitting payments to subrecipients.

Recommendation

We recommend that the Highways Division adhere to established formal procedures to ensure compliance with NHTSA's cash management requirements pertaining to reimbursements for subrecipient expenditures. Specifically, the time period from the date federal funds are received and credited to the Highways Division's account and the date those funds are expended from the Highways Division's account should not exceed 7 days as stipulated in the Treasury State Agreement.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. The Highways Division understands the importance of complying with the terms of the Treasury State Agreement and is in the process of implementing stricter policies to ensure that subrecipients are paid in a more timely manner.