Report No. 93-17 December 1993

OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Department of Budget and Finance

Summary

The office of the Auditor and the certified public accounting firm of Deloitte & Touche conducted a financial audit of the Department of Budget and Finance for the fiscal year July 1, 1992 to June 30, 1993. The audit examined the department's financial records and its system of accounting and internal controls and tested these for compliance with applicable laws and regulations.

In the opinion of Deloitte & Touche, except for keeping balances of revenues received for computer and telecommunication services provided by the Information and Communication Services Division in special revenue funds instead of transferring the balances to the general fund, the department's financial statements present fairly its financial position as of June 30, 1993, and the results of its operations for the year then ended in conformity with generally accepted accounting principles. Deloitte & Touche noted no matters involving the internal control structure and its operation that would be material weaknesses as defined in the report on the internal control structure. It also noted, with respect to items tested, that the department has complied, in all material respects, with laws and regulations applicable to the department.

We found that the department has no written procedures for evaluating the underwriting firms with which it negotiates in issuing state bonds. We also found that the department often deposited more than 60 percent of its available funds with one financial institution in violation of statutory requirements. Additionally, excess funds collected from other state agencies and departments for using the state's computer system and as reimbursements for using the state's telecommunications system should be lapsed to the general fund. We found that the department's dealings with financial institutions subject it to unnecessary risks. Specifically, deposits with paying agents are not collateralized, advances are made to agents on behalf of trustees, and unauthorized releases of securities are made by custodial banks. Lastly, we found that the department's policy for collateral requirements for state fund deposits are inconsistently enforced and may be restrictive.

Recommendations and Response

We recommend that the department continue to use the request for proposal process in selecting underwriting firms. It should develop a formal process and criteria to evaluate the performance of underwriting firms. Further, we recommend that the department seek an opinion from the Attorney General on the legality of its practice of depositing more than 60 percent of available funds with one institution. We also recommend that the department transfer the balances in the special fund accounts of the Information and Communications Services Division to the State's general fund.

We recommend that the department consider the need for collateralization of deposits with paying agents, review its trust agreements to assure that the schedule for maturing investments allows adequate time for trustees to transmit funds to paying agents, and that the department enforce its tri-party agreements with custodial banks. We also recommend that the department consistently enforce its collateral requirements and perform periodic checks for accuracy of collateral data. In addition, we recommend that the department review its collateral requirements to determine the appropriateness of the percentages used to value the collateral.

The department states that it is not industry practice to prepare formal evaluations of underwriters used for bond offerings and that it will have to look into the merits of such a process. We stand by our recommendation that services of underwriters should be formally evaluated. Evaluations should use criteria developed by the department, just as proposals for services are evaluated with criteria developed by the department.

The department agrees to seek an opinion from the Attorney General on its practice of depositing more than 60 percent of its cash with one bank. The department offered several reasons in defense of this practice. The department also agrees with our recommendation to transfer excess funds held in special revenue accounts to the general fund, and has begun doing so. It also agrees that dealings with institutions could be tightened insofar as they concern advances to agents on behalf of trustees and the unauthorized release of securities by custodial banks. The department feels, however, that it has taken all prudent steps feasible to minimize the risk of loss of deposits with paying agents. In addition, the department agrees with our recommendations to review its collateral requirements for depositing the state's cash with financial institutions and to consistently enforce those requirements.

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