

OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Highways Division of the Department of Transportation

Summary

The Office of the Auditor and the certified public accounting firm of Deloitte & Touche LLP conducted a financial audit of the Highways Division of the Department of Transportation for the fiscal year July 1, 1996 to June 30, 1997. The audit examined the financial records and systems of accounting and internal controls and tested these for compliance with applicable laws and regulations. Because of the serious problems noted, Deloitte & Touche LLP was unable to express an opinion on the division's financial statements.

The division manages 2,300 lane miles of highways, employs 850 people, and generates volumes of \$325 to \$400 million annually.

We found that the financial records of the division were too incomplete to be audited in a timely manner. The division failed to 1) determine the proper amounts for all accounts, 2) reconcile the division's accounting records with the State's accounting records, and 3) prepare its financial statements in accordance with generally accepted accounting principles. Deloitte & Touche LLP considered the division's failure to perform these accounting procedures to be a reportable condition and a material weakness in the internal control system.

Specifically, we found that the fiscal staff failed to maintain its accounting records in a proper manner and to prepare its financial statements on a timely basis, resulting in a material weakness in internal controls. Many of the internal financial reports are not being used, as they are considered to be irrelevant or untimely. Projects have to be monitored using non-financial information and the annual fixed asset inventory was not performed by a district office as required by law.

We also found that cash management activities require improvement. The division is not maximizing its investment income because no formal analysis is prepared to determine the availability and need for cash by month. Furthermore, a significant portion of moneys collected from the public for highway purposes is being transferred to the State's general fund for general operating purposes.

Finally, we found that the division failed to comply fully with the Hawaii Public Procurement Code and the administrative rules relating to a sole source contract.

Recommendations and Response

We recommend that the division take steps necessary to ensure that the division's accounting records are properly maintained and financial statements are prepared on a timely basis. We also recommend that the fiscal staff generate more relevant and useful financial reports, ensure the accuracy of those reports and render them on a more timely basis. Further, we recommend that the division implement procedures to monitor its projects more effectively and ensure that all district offices complete their annual inventory of fixed assets within the time period required.

We also recommend that the division improve its cash management activities by preparing necessary analyses and that the Legislature, governor, Department of Transportation and Highways Division consider the negative long-term effect of transferring highway fund revenues to the general fund. We also recommend that the director of the department ensure compliance with the provisions of the Hawaii Public Procurement Code.

The department generally concurs with our findings and recommendations. It states that the division is currently working on a new performance accounting system to maintain accounting records in an accurate manner, prepare financial statements on a timely basis and improve internal financial reporting. Further, the department recognizes that monitoring of projects is a key factor to complete projects in a timely manner and within budget. The department also acknowledges its failure to complete the annual fixed asset inventory, stating that the Oahu District Office is currently trying to complete the \$300,000 fixed asset inventory by March 31, 1998. Although the department concurred with our finding that earmarked funds are being used for general operating purposes, it contends that this was mandated by Act 270, Session Laws of Hawaii 1997.

The department does not agree with our finding that the Highways Division failed to comply fully with the Hawaii Public Procurement Code and the administrative rules relating to a sole source contract. It contends that since the original sole source contract fell under the old procurement law, the amendment to the sole source contract was "grandfathered" in and therefore, did not require the division to follow the sole source procedures of the new procurement law. We generally disagree. The current procurement code and administrative rules are unclear on the treatment of amendments to contracts "grandfathered" in under the old procurement law. In addition, the scope requirements of phase II do not qualify the contract as a sole source contract under the new procurement law. And since the contract amount increased significantly with this amendment (\$1.5 million or over 150 percent), the department should have considered awarding phase II through a bidding process under the new procurement code. The spirit of open competition was violated and the State has no assurance it received the best value for the price.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830