

# OVERVIEW

## *Financial Audit of the Department of Business, Economic Development and Tourism*

Report No. 03-03, March 2003

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### Summary

The Office of the Auditor and the certified public accounting firm of KPMG LLP conducted a financial audit of the Department of Business, Economic Development and Tourism, State of Hawaii, for the fiscal year July 1, 2001 to June 30, 2002. The audit examined the financial records and transactions of the department; reviewed the related systems of accounting and internal controls; and tested transactions, systems, and procedures for compliance with laws and regulations.

We found deficiencies in the financial accounting and internal control practices of the department. We found that the department is deficient in the management of its loan programs. The department administers four revolving loan programs that were developed to stimulate Hawaii's economy and be responsive and beneficial to small businesses unable to obtain financing through the private sector.

However, we found that the department issued only 16 loans totaling \$2,333,500 during the five-year period ended June 30, 2002. In addition, of the 94 outstanding loans with an aggregate principal balance of \$9,449,566, 45 loans (48 percent) with an aggregate principal balance of \$5,568,059 (59 percent) were greater than 90 days past due.

Although the department has policies and procedures in place to administer its various loan programs, these policies and procedures are neither formally documented nor consistently enforced. The department does not actively monitor its delinquent loans or its delinquent participation loans.

We found that the department's loan files are incomplete. Loan files selected for review were missing adequate documentation of on-site inspections of applicants' collateral or evidence that loan proceeds were spent for authorized purposes. The department is not consistently using the informal checklist that it developed to assist in assuring that all necessary documents are obtained and maintained in the loan files.

We also found that 12 loan repayment checks out of a sample of 15 (80 percent), were not deposited by the department in a timely manner. The checks totaled \$226,171 and averaged six elapsed business days between their receipt and deposit.

The Hawaii Tourism Authority does not adequately manage its contracts. We found that contractors performed services prior to the execution of legally binding contracts; contracts were renewed prior to the authority's evaluation of the quality of the work provided; and, in one instance, final payment was remitted to the contractor prior to completion of all required tasks.

We found that the department does not properly lapse unnecessary encumbrances. Our testing found 11 instances, out of a sample of 30, where funds remained encumbered for contracts or purchase orders that were canceled, inactive, and/or expired. Of the 11 instances, eight encumbrances totaling \$517,430 should have been voided at least two fiscal years ago, with one encumbrance that should have been voided in 1994. The department's failure to identify and lapse invalid encumbrances has denied the State its opportunity to utilize these funds for other priorities.



The department must improve the administration of its petty cash funds. Petty cash functions are inadequately segregated; the petty cash custodian performs both custodial and reconciliatory functions. Also, the department's various divisions do not submit account reconciliations to the fiscal office in a timely and consistent manner. We found that seven out of a sample of 15 petty cash replenishment requests were not accompanied by reconciliations as required by department policy.

Finally, the balance of \$25,000 maintained in the department's administration petty cash fund is excessive. The average monthly disbursement out of the account during FY 2001-02 was \$356, and \$776 was the largest monthly disbursement. Once again, the State is denied the opportunity to utilize the funds for other priorities.

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## Recommendations and Response

We recommend that the department increase participation in its loan programs and implement a formal marketing strategy. Also, the department should revise its procedures for monitoring delinquent accounts and contact borrowers as soon as their accounts become ten days past due.

We also recommend that the department establish written guidelines for loan functions, properly maintain loan files and ensure that the files contain all required documentation, and deposit loan repayments on the day of receipt.

The Hawaii Tourism Authority should execute formal contracts before contractors perform services, monitor contracts and relevant agreement terms in a complete and timely manner, ensure receipt of final reports from contractors by the stipulated completion date, withhold final payments from contractors until final reports are received and approved, and perform final evaluations of each contractor prior to entering into any subsequent agreements with them.

In addition, we recommend that the department unencumber funds relating to contracts/purchase orders that are fulfilled during the year; ensure that all encumbrances correspond to active and ongoing projects or purposes; and promptly unencumber existing encumbrances related to closed, terminated, and/or completed projects or purposes.

Finally, the department should assess the segregation of duties related to the department's various petty cash funds, perform periodic and unannounced reviews of each division's petty cash account reconciliations and cash counts, require divisions to prepare and submit reconciliations of petty cash accounts in adherence to established policies, and significantly reduce the amount of funds in the administration petty cash fund.

The department agrees with some of our findings and recommendations and noted that it has already begun to implement some of our recommendations.

The Hawaii Tourism Authority, although not in complete agreement with our findings, stated that it will insist upon strict compliance with its technical contract management requirements by its contractors.

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