OVERVIEW

Management and Financial Audit of the Hawai`i Tourism Authority's Major Contracts

Report No. 03-10, June 2003

Summary

Pursuant to Section 23-13, Hawai'i Revised Statutes, our office conducted a management and financial audit of the Hawai'i Tourism Authority's major contracts. A major contractor is one awarded a contract or agreement in excess of $15 million. Three contractors met this criteria: Hawai'i Visitors & Convention Bureau (HVCB), SMG, and the National Football League. We focused exclusively on the two marketing contracts valued at $151.7 million with the Hawai'i Visitors & Convention Bureau, by far the largest of the three contractors.

We found that inadequate oversight by the authority provided HVCB with a blank check to spend state funds for self-serving purposes. For example, we found that HVCB increased the compensation of its state-funded employees by 42 percent over the past three years—from $3.7 million in CY2000 to $5.3 million in CY2002—although the amount of state funding for those same years remained relatively unchanged. The bureau also used state contract funds to pay for exorbitant bonuses and unnecessary severance packages for its employees who were already highly compensated. For example, eight employees were paid between $90,000 and $170,000 with state funds in CY2002. Although it was not obligated to do so, HVCB paid and accrued approximately $202,000 in severance pay using state contract funds. One employee's severance pay was approximately $141,000, nearly the equivalent of that employee's annual salary.

The bureau also expended $191,000 in state contract funds for other inappropriate or questionable expenditures. Such expenditures included paying for an employee's parking and speeding tickets and reimbursing an employee for the employee's family travel expenses. These expenditures violate HVCB's own travel and entertainment policy. We also found an unusual arrangement whereby the state-funded salary of HVCB's vice president in Japan is supplemented by an airline. HVCB asserts that this arrangement does not give that airline an unfair advantage in negotiating favorable cooperative marketing partnerships. However, any arrangement that presents even the *appearance* of a conflict of interest should be avoided so that marketing activities supported by state contract funds are not tainted. Furthermore, we question the propriety of HVCB using its consultant law firm, paid with state funds, to perform legal services that sought to undermine the authority and the State.

The bureau also exercised poor management and oversight over its state-funded contractors. For example, rather than formally evaluating its subcontractors, HVCB relied on personal relationships and oral communication to evaluate its state-funded subcontractors. We also found that HVCB awarded a $242,000 state-funded subcontract to a vice president's firm on the same day she resigned as HVCB vice president for developing international markets. In addition, the bureau did not execute contracts in a timely manner, procured services that were beyond the scope of its state contracts, and maintained contract files that were incomplete and disorganized. We also found questionable arrangements between the former governor's office and HVCB that raise questions about whether the former governor's office used HVCB to circumvent the State Procurement Code.

In what is perhaps our most serious finding, our consultant CPA firm declared a qualified opinion on HVCB's financial statements for the year ending December 31, 2002. The consultant found that HVCB committed funds in one year to pay for future goods and services of another year—a direct violation of generally accepted accounting principles. For example, in November 2001, HVCB accrued approximately $1 million to an advertising company although no related services were provided by December 31, 2001. It appeared that the advertising company pre-billed HVCB for services it had yet to provide. By doing so, HVCB was able to spend exactly up to its state contract limit and circumvent the potential return of unexpended funds to the authority.

We also found that the authority's lax monitoring and enforcement of its contracts with HVCB left little assurance that $151.7 million in state funds were effectively spent. Specifically, we found that poorly constructed contracts and inadequate contract monitoring and enforcement by the authority did not adequately protect the State's interests. For example, the plethora of reports submitted by HVCB contained vague information that failed to tie results to goals and objectives.

We also assessed the actions taken by the authority in response to our previous audit, *Management Audit of the Hawai'i Tourism Authority, Report No. 02-04*. The authority has taken steps to address some of the other management deficiencies discussed in our prior audit. For example, the authority created a marketing department to oversee marketing contracts, drafted contracting policies and procedures, and clarified staff roles and responsibilities. Furthermore, the authority conducted a performance evaluation of both itself and HVCB. However, the authority continues to allow HVCB to provide services without a signed contract.

Recommendations and Response

We recommended that the authority's board of directors and its executive director improve contractor accountability, enforce contract provisions, improve contract language, and maintain and apply contracting policies and procedures. We also recommended that the State and Legislature take appropriate steps to assess the extent to which HVCB violated generally accepted accounting standards during the course of its state marketing contracts.

In written comments on a draft of our report, the authority's board chair and executive director accepted our findings and recommendations. They acknowledged our audit as a tool to improve its operations, respond to legislative questions and concerns, ensure contractor compliance, minimize the state's liability, and optimize the state's expenditures for tourism promotion. Their response also reiterated that the authority takes very seriously its responsibility to the public to be a fiscally accountable organization.

We note that the authority specifically commented on three points in our report. While we take no issue with the authority's comments, we stand by the statements in our report and our strengthened recommendations.

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