

# OVERVIEW

## *Financial Audit of the Department of Health*

Report No. 04-05, March 2004

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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 Health, State of Hawaii, for the fiscal year July 1, 2002 to June 30, 2003. 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.

In the opinion of the firm, the financial statements present fairly the department's financial position and changes in financial position and cash flows for the fiscal year ended June 30, 2003, in conformity with generally accepted accounting principles.

With respect to the department's internal control over financial reporting and operations, we found several deficiencies. Failure to comply with the procurement codes undermines the department's ability to ensure that state funds are spent in a cost effective and beneficial manner. Specifically, in 14 instances out of a sample of 60 small purchases less than \$25,000, the department did not comply with the quotation requirements of Chapter 103D and the related procurement circulars. Altogether, the 14 purchases totaled \$190,094.

In addition, Chapter 103F and the administrative rules provide procedures for the restrictive purchases of health and human services, similar to those of sole source purchases specified in Chapter 103D. We found three instances of non-compliance with the applicable statutes and rules by the Emergency Medical Services and Injury Prevention System Branch. These three contracts totaled \$7.45 million.

We also found that the department lacks formal policies and procedures for its contract management process. In three out of 30 contracts selected, contractors began work prior to the execution of a legally binding contract. These three contracts totaled approximately \$22 million. We also found one instance where a contract payment was incorrect and not made in accordance with contractual terms, resulting in an overpayment of \$128,689.

Moreover, the department failed to submit certain required federal financial reports on a timely basis. Failure to comply with federal financial reporting requirements can delay the receipt of federal funds and jeopardize the department's ability to receive future funding.



The department lacks formal policies or procedures to identify and lapse invalid encumbrances. As a result, out of a sample of 30 encumbrances, we found four instances, totaling \$54,537 between January 1999 and October 2002, where funds were encumbered for contracts that were closed, inactive, or completed.

Finally, we found that the department's controls over petty cash are inadequate. The department did not adhere to the Hawaii Administrative Rules and its own internal policies and procedures requiring periodic, unannounced petty cash counts at least twice a year.

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## Recommendations and Response

We recommend that the department adhere to the procurement codes and establish policies and procedures for the procurement of goods and services. The department should also establish formal policies and procedures over its contract management functions, provide training, formally execute contracts prior to the commencement of contracted services, and properly review contractor performance and invoices before contract payments.

We also recommend that the department ensure that all required federal financial reports are submitted within required deadlines. The appropriate-level management should monitor each federal program's reporting process. In addition, the department should adhere to the State's policy of unencumbering funds related to contracts/purchase orders that are fulfilled, closed, or become inactive. Finally, the department should have an employee independent of the petty cash process perform periodic and unannounced reviews of each petty cash account.

In its response, the department recognizes our audit as a constructive one that will benefit not only its staff but also the general public. The department acknowledges that the audit findings and recommendations provide an opportunity for the department to continue to improve efficiency and effectiveness in its financial oversight as well as in the procurement procedures. The department also provided additional comments to explain its current procedures and new actions in addressing the internal control deficiencies identified in our report.

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