

OVERVIEW

Financial Audit of the Department of Human Resources Development

Report No. 07-09, December 2007

Summary

The Office of the Auditor and the certified public accounting firm of Accuity LLP conducted a financial audit of the Department of Human Resources Development, State of Hawai'i, for the fiscal year July 1, 2005 to June 30, 2006. 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, in all material respects, the department's financial position of its general fund and human resources development special fund as of June 30, 2006, and the respective changes in financial position and the respective budgetary comparison for the general and major special revenue funds for the year then ended in conformity with accounting principles generally accepted in the United States of America. However, the firm was not able to apply auditing procedures to satisfy themselves regarding the amounts reported as workers' compensation liability and the related workers' compensation expense in the statement of net assets and statement of activities. Additionally, the firm disclaimed opining on the workers' compensation and unemployment insurance interdepartmental accounts in the governmental funds.

With respect to the department's internal control over financial reporting and operations, we found two material weaknesses. First, we found that accounting personnel and accurate financial reporting are not a priority of the department. While the department is proficient with day-to-day tasks, it lacks a formal internal financial reporting process. The department also does not produce financial statements and is not subject to annual financial audits. Collectively, these factors contributed to certain account balances being misstated as of June 30, 2006. Further, external stakeholders, including the public, are left with no means to evaluate the financial performance of the department.

The second material weakness is that the department has not taken functional ownership of the Workers' Compensation Program. The department is responsible for planning and administering the Workers' Compensation Program for a majority of state agencies and the Legislature; however, it does not systematically calculate, track, and report the approximately \$29 million in related liabilities. Additionally, the department has not established formal policies over processing related claims to avoid potential exposure to related litigation. As a result, we found that workers' compensation expenditure and liability balances were significantly misstated as of June 30, 2006.



Recommendations and Response

We recommend that the department train current accounting staff and enable them to, or hire personnel with the experience necessary to, perform advanced financial accounting functions that include preparing financial statements, designing systems of internal controls and financial reporting, providing training to other staff, and reviewing financial reports to identify discrepancies.

We also recommend that the department establish formal, written policies and procedures governing workers' compensation claims that include, among other things, guidelines for initial estimates, updates, and reviews of reserves.

The department expressed its appreciation of the value of audits but disagreed with many of our findings and conclusions. The department provided detailed explanations supporting its disagreement with our findings. However, the department's responses either do not specifically address, or demonstrate a lack of understanding of, the actual findings. We stand by our conclusions presented in the final report and believe our audit report presents a balanced and accurate analysis of the department's financial operations.

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