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State of Hawaii Department of Transportation— Highways Division

Single Audit Report
for the Fiscal Year Ended June 30, 2005

Submitted by
The Auditor
State of Hawaii

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

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STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2005

Grant/CFDA Grantor's Program Title	Federal CFDA Number	Federal Expenditures
U.S. DEPARTMENT OF TRANSPORTATION:		
Highway planning and construction	20.205	$162,807,571
State and community highway safety program:		
NHTSA grant		1,582,335
Fatal accident reporting system grant		46,168
Total state and community highway safety program	20.600	1,628,503
National motor carrier safety program—		
Assistance program grant	20.218	854,158
TOTAL EXPENDITURES		$165,290,232

Notes:

1. The Schedule of Expenditures of Federal Awards includes the federal grant activity of the State of Hawaii, Department of Transportation, Highways Division (the "Highways Division") and is presented on the basis of cash disbursements made by the Highways Division. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the financial statements.

2. The Schedule of Expenditures of Federal Awards does not include the amount of the Highways Division's matching funds that were expended during the year ended June 30, 2005.

3. Of the total federal expenditures, $26,528,719 was provided to subrecipients.

Deloitte.

Deloitte & Touche LLP
Suite 1200
1132 Bishop St.
Honolulu, HI 96813-2870
USA

Tel: +1 808 543 0700
Fax: +1 808 526 0225
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Auditor
State of Hawaii:

We have audited the financial statements of the Highways Division, Department of Transportation, State of Hawaii (the "Highways Division") as of and for the year ended June 30, 2005, and have issued our report thereon dated March 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Highways Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the Highways Division's internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the Highways Division's internal control over financial reporting that, in our judgment, could adversely affect the Highways Division's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 05-1 and 05-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider 05-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Highways Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards, and which is described in the accompanying Schedule of Findings and Questioned Costs as item 05-3.

This report is intended solely for the information and use of the Highways Division's management, U.S. Department of Transportation, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

March 17, 2006

Deloitte

Deloitte & Touche LLP
Suite 1200
1132 Bishop St.
Honolulu, HI 96813-2870
USA

Tel: +1 808 543 0700
Fax: +1 808 526 0225
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND COMPLIANCE AND OTHER MATTERS AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

The Auditor
State of Hawaii:

Internal Control over Compliance

The management of the Highways Division, Department of Transportation, State of Hawaii (the "Highways Division") is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Highways Division's internal control over compliance with requirements that could have a direct and material effect on its major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Highways Division's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 05-1 and 05-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider 05-1 to be a material weakness.

Compliance and Other Matters

We have audited the compliance of the Highways Division with the types of compliance requirements described in the *U.S. Office of Management and Budget ("OMB") Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2005. The Highways Division's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Highways Division's management. Our responsibility is to express an opinion on the Highways Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Highways Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Highways Division's compliance with those requirements.

In our opinion, the Highways Division complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 05-3 and 05-4.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Highways Division as of and for the year ended June 30, 2005, and have issued our report thereon dated March 17, 2006. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards for the year ended June 30, 2005 is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of management of the Highways Division. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, when considered in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Highways Division's management, U.S. Department of Transportation, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

March 17, 2006

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
AS OF JUNE 30, 2005

Part I—Summary of Auditors' Results

1. The independent auditors' report on the financial statements expressed an unqualified opinion.

2. Reportable conditions in internal control over financial reporting were identified, one of which was considered to be a material weakness.

3. An instance of noncompliance considered material to the financial statements was disclosed by the audit.

4. Reportable conditions in internal control over compliance with requirements applicable to its major federal awards program were identified, one of which was considered to be a material weakness.

5. The independent auditors' report on compliance with requirements applicable to its major federal awards program expressed an unqualified opinion.

6. The audit disclosed findings required to be reported by OMB Circular A-133.

7. The Highways Division's major program was Highway Planning and Construction, CFDA Number 20.205.

8. A threshold of $3,000,000 was used to distinguish between Type A and Type B programs as those terms are defined by OMB Circular A-133.

9. The Highways Division did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II—Financial Statement Findings Section

Material Weakness

05-1 CAPITAL ASSETS

Observation: Reconciliation of capital asset (non-infrastructure) activity was not performed accurately or timely. This condition was also noted in previous years.

Background: The Highways Division utilizes the State's fixed asset reporting system maintained by the Department of Accounting and General Services ("DAGS") to account for its capital assets. The district offices initiate forms to update the inventory and submit them to the fiscal office, which then forwards the forms to DAGS for processing. The fiscal office performs, on a quarterly basis, an analysis of capital asset (non-infrastructure) additions. Such analysis notes capital expenditures recorded in its accounting system (called "HWYAC"), and identifies the page and line of the DAGS fixed asset edit report in which the asset is entered into the DAGS fixed asset system.

The reconciliation for fiscal year 2005 was revised to include all payments made in the fiscal year, but did not include all amounts that were paid subsequent to June 30, 2005, but for which the goods were received prior to June 30, 2005.

Recommendation: Improve the capital asset reconciliation procedure to include all appropriate reconciling items.

Observation: The accounting policies and procedures for infrastructure assets should be improved. This condition was also noted in previous years.

Background: Effective from fiscal year 2002, the Highways Division has been required to capitalize and depreciate all capital assets, including infrastructure assets. In this endeavor, the Highways Division contracted with a consulting firm to perform a valuation of the infrastructure assets as of June 30, 2002. During fiscal year 2003, the consulting firm was again contracted to capitalize all of that year's transactions. However, during the fiscal year 2003 audit, we noted several errors in computations performed by the consulting firm.

During fiscal year 2004, the Highways Division performed the work internally to capitalize that year's capital asset transactions. During that year's audit, we noted the following:

- The Highways Division did not sufficiently review the contractor's work. Accordingly, the June 30, 2003 balance of infrastructure assets per the audited financial statements did not agree to the final 2003 report issued by the consultant by $552 million. The Highways Division tried to have the consultant reconcile the amounts, but was unsuccessful.

- The Highways Division still had not formalized plans as to how or when it would assume full responsibility for accounting for infrastructure assets. The procedures manual developed by the consultant to implement an asset management system proved to be insufficient for the Highways Division's needs and no training was provided by the consultant.

- The Highways Division did not have a comprehensive detail of all infrastructure assets at June 30, 2004. The Highways Division had attempted to utilize the DAGS fixed asset system to track infrastructure assets; however, the amounts in the DAGS fixed asset system did not reconcile to the June 30, 2004 audited balance by $228 million (which was corrected by an audit journal entry.)

During fiscal year 2005, the Highways Division again performed the work internally to capitalize the year's capital asset transactions. During this year's audit, we noted the following:

- The Highways Division addressed only the current year's activity, and did not attempt to reconcile the differences noted in the previous years.

- The Highways Division has started to develop policies and procedures regarding the implementation of an asset management system. However, the recommendation to modify the existing financial system to automate the infrastructure assets valuation work was not implemented in fiscal year 2005.

- The information in the DAGS fixed asset system still does not reconcile to the information in the Highways Division's accounting records. At June 30, 2005, the unreconciled difference approximated $700 million.

Recommendation: Develop policies and procedures to properly account for the infrastructure assets.

<u>Reportable Condition</u>

05-2 ACCOUNTING AND INTERNAL REPORTING PROCEDURES

Observation: The Highways Division did not reconcile its accounting records with those of the State of Hawaii on a timely basis. This condition was also noted in prior years.

Background: The Highways Division maintains its own accounting system, which is independent of the State of Hawaii's accounting system, called "FAMIS." Since FAMIS is the official accounting system of the State, the Highways Division's accounting records must be reconciled to the State's records. State law requires that this reconciliation take place at least on an annual basis.

Failure to reconcile the accounting records accurately and on a timely basis may result in undetected errors or irregularities.

Recommendation: Develop procedures to ensure that the Highways Division's accounting records are reconciled with those of the State of Hawaii on a timely basis. We understand that the Highways Division's request for the funding for the development and implementation of a new accounting system was not approved by the State Comptroller.

<u>Other Matters</u>

05-3 APPLICATION OF INDIRECT COST RATE

Program: U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205

Observation: The indirect cost rate was applied to the wrong base. This condition was also noted in the prior year.

Background: The grant with the Federal Highway Administration ("FHWA") allows the Highways Division to charge indirect costs, as well as direct costs. The indirect costs are based on an indirect cost rate proposal ("ICRP") that was approved by the FHWA in fiscal year 2002. The ICRP calculated the indirect cost rate using direct payroll as the base.

In fiscal years 2003 and 2004, the Highways Division inadvertently applied the indirect cost rate to both direct payroll and fringe benefits, instead of direct payroll only. The use of a larger base had the effect of overcharging the FHWA for indirect costs by $1,333,723 in fiscal year 2003 and by $1,407,414 in fiscal year 2004.

In fiscal year 2005, the Highways Division had made a decision to stop the charging of indirect costs to the federal grants; however, the HWYAC accounting system was not programmed to stop the charges. Thus, during fiscal year 2005, indirect costs of $1,830,898 were charged to the grants. At year-end, an accounting entry was made to record a payable to the FHWA for this amount.

Recommendation: Reimburse the FHWA for the over-allocated indirect costs for the fiscal years 2003, 2004, and 2005, and make an adjustment to the HWYAC accounting system to stop the charging of indirect costs.

Part III—Federal Award Findings and Questioned Cost Section

Material Weakness

05-1 CAPITAL ASSETS

The material weakness in internal control over proper accounting of capital assets, both infrastructure and non-infrastructure, also applies to the Highways Division's major federal awards program.

Questioned Costs: None

Reportable Condition

05-2 ACCOUNTING AND INTERNAL REPORTING PROCEDURES

The reportable condition in internal control over financial reporting relating to the Highways Division's failure to reconcile its accounting records with those of the State of Hawaii on a timely basis also applies to the Highways Division's major federal awards program.

Questioned Costs: None

Other Matters

05-3 APPLICATION OF INDIRECT COST RATE

The finding relating to the application of the indirect cost rate also applies to the Highways Division's major federal awards program.

Questioned Costs: $1,830,898

05-4 SUBRECIPIENT MONITORING

Program: U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205

Observation: The Highways Division did not adequately monitor its subrecipients. This comment was also noted in previous years.

Questioned Costs: None

Background: The counties of the City and County of Honolulu, Hawaii, Maui, and Kauai are the primary subrecipients of federal awards received by the Highways Division. As a pass-through entity, the Highways Division's responsibilities include:

- Identifying to the subrecipient the federal award information and applicable compliance requirements,
- Monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements,
- Ensuring required audits are performed and proper corrective action is taken on audit findings, and

- Evaluating the impact of subrecipient activities on the Highways Division’s ability to comply with applicable federal regulations.

The Highways Division’s monitoring activities of subrecipients take place at a high level, primarily through the review of single audit reports that are filed with the Highways Division. However, the Highways Division does not always follow up on any findings reported in the single audit reports or always ensure that the appropriate corrective action is implemented.

Failure to adequately monitor the activities of subrecipients may result in a delay in discovering that federal funds that the Highways Division is responsible for are not being expended in accordance with their intended purposes. (However, this potential problem is somewhat mitigated, in that the Highways Division’s district engineers do monitor the progress of the projects, including the approval of reimbursement requests from the counties.)

Recommendation: Take a more active role in monitoring the subrecipients’ compliance with federal requirements and perform such monitoring activities on a timely basis. Such activities may include regularly scheduled discussions with subrecipients, regular site visits to review financial or programmatic records and observe operations, review of subrecipient budgets for federal expenditures, and the review of single audit reports and corrective action plans in a timely manner. We were informed that the Highways Division will conduct site visits to various county projects in fiscal year 2006.

Part IV—Summary Schedule of Prior Audit Findings

Financial Statement Findings Section

<u>Material Weakness</u>

04-1 CAPITAL ASSETS

Observation: Reconciliation of capital asset (non-infrastructure) activity was not performed accurately or timely. This condition was also noted in the prior year.

Background: The Highways Division utilizes the State's fixed asset reporting system maintained by the Department of Accounting and General Services ("DAGS") to account for its capital assets. The district offices initiate forms to update the inventory and submit them to the fiscal office, which then forwards the forms to DAGS for processing. The fiscal office performs, on a quarterly basis, an analysis of capital asset (non-infrastructure) additions. Such analysis notes capital expenditures recorded in its accounting system called "HWYAC," and identifies the page and line of the DAGS fixed asset edit report in which the asset is entered into the DAGS fixed asset system.

The reconciliation for fiscal year 2004 included only amounts paid through May 2004, as there was a one-month reporting lag in the HWYAC report (i.e., the June report details May transactions). The report with the June 2004 transactions initially could not be located, and was not reconciled to the DAGS records until after we requested that it be performed.

In addition, certain errors noted in the capital asset detail in the prior year remain uncorrected, or were corrected erroneously, in fiscal year 2004.

Recommendation: Reconcile capital asset activity recorded in the HWYAC system to the DAGS system on a timely basis.

Status: The recommendation was not implemented. See current year's comment.

Observation: The accounting policies and procedures for infrastructure assets should be improved. This condition was also noted in the prior year.

Background: Effective fiscal year 2002, the Highways Division was required to capitalize and depreciate all capital assets, including infrastructure assets. In this endeavor, the Highways Division contracted with a consulting firm to perform a valuation of the infrastructure assets. During fiscal year 2003, the consulting firm was again contracted to capitalize the fiscal year 2003 transactions. During the 2003 audit, we noted several errors in the computations performed by the consulting firm, resulting in audit adjustments. The adjustments were given to the contractor to incorporate into the final report for fiscal year 2003.

For fiscal year 2004, the Highways Division internally performed the work to capitalize the infrastructure asset additions. During our audit, we noted the following:

- The Highways Division did not sufficiently review the contractor's work. Accordingly, the June 30, 2003 balance of infrastructure assets per the audited financial statements did not agree to the final 2003 report issued by the consultant. The consultant's report was overstated by approximately $552 million. The Highways Division could not adequately account for the differences, and tried to have the consultant reconcile the amounts without success.

- The Highways Division still has not formalized plans as to how or when it will assume full responsibility for accounting for infrastructure assets. It contracted with the consultant in prior years to develop a procedures manual and provide training for the Highways Division to implement an asset management system. However, upon delivery of the report in fiscal year 2004, it was noted that the manual was not in sufficient detail to be used as a procedures manual, and no training was provided by the consultant. The contract has since ended and no additional funds are available.

- The Highways Division does not have a comprehensive detail of all infrastructure assets at June 30, 2004. The Highways Division has attempted to utilize the DAGS fixed asset system to track infrastructure assets, and during fiscal year 2004 added approximately 1,500 asset items totaling $7.4 billion to the DAGS system. However, amounts in the DAGS system did not reconcile to the June 30, 2004 audited balance by $228 million. An audit adjustment was required to correct the balance.

Recommendation: Develop policies and procedures to properly account for the infrastructure assets.

Status: The recommendation was not implemented. See current year's comment.

<u>Reportable Condition</u>

04-2 ACCOUNTING AND INTERNAL REPORTING PROCEDURES

Observation: The Highways Division did not reconcile its accounting records with those of the State of Hawaii on a timely basis. This condition was also noted in the prior year.

Background: The Highways Division maintains its own accounting system, which is independent of the State of Hawaii's accounting system, called "FAMIS." Since FAMIS is the official accounting system of the State, the Highways Division's accounting records must be reconciled to the State's records. State law requires that this reconciliation take place at least on an annual basis.

Failure to reconcile the accounting records accurately and on a timely basis may result in undetected errors or irregularities.

Recommendation: Develop procedures to ensure that the Highways Division's accounting records are reconciled with those of the State of Hawaii on a timely basis.

Status: The recommendation was not implemented. See current year's comment.

Other Matters

04-3 APPLICATION OF INDIRECT COST RATE

Program: U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205

Observation: The indirect cost rate was applied to the wrong base.

Background: The grant with the Federal Highway Administration ("FHWA") allows the Highways Division to charge indirect costs, as well as direct costs. The indirect costs are based on an indirect cost rate proposal ("ICRP") that was approved by the FHWA in fiscal year 2002. The ICRP calculated the indirect cost rate using direct payroll as the base.

In fiscal years 2003 and 2004, the Highways Division inadvertently applied the indirect cost rate to both direct payroll and fringe benefits, instead of direct payroll only. The use of a larger base had the effect of overcharging the FHWA for indirect costs by $1,333,723 in fiscal year 2003 and by $1,407,414 in fiscal year 2004.

The error was made because the Highways Division had historically allocated indirect costs to projects based on a percentage of direct payroll plus fringe benefits prior to the approval of the indirect cost rate in fiscal year 2002, and did not focus on the fact that the new indirect cost rate was based only on direct payroll. (The Highways Division had contracted an outside consultant to prepare the ICRP, instead of preparing the proposal internally.)

An audit adjustment was recorded in fiscal year 2004 to reflect the correct amount of the indirect cost allocation.

Recommendation: Reimburse the FHWA for the over-allocated indirect costs, and apply the indirect cost rate to only direct payroll in all future billings.

Status: The recommendation was not implemented. See current year's comment.

Federal Award Findings and Questioned Cost

Material Weakness

04-1 CAPITAL ASSETS

The material weakness in internal control over proper accounting of capital assets, both infrastructure and non-infrastructure, also applies to the Highways Division's major federal awards program.

Questioned Costs: None.

Status: The recommendation was not implemented. See current year's comment.

Reportable Condition

04-2 ACCOUNTING AND INTERNAL REPORTING PROCEDURES

The reportable condition in internal control over financial reporting relating to the Highways Division's failure to reconcile its accounting records with those of the State of Hawaii on a timely basis also applies to the Highways Division's major federal awards program.

Questioned Costs: None.

Status: The recommendation was not implemented. See current year's comment.

Other Matters

04-3 APPLICATION OF INDIRECT COST RATE

The finding relating to the application of the indirect cost rate also applies to the Highways Division's major federal awards program.

Questioned Costs: $1,333,723 in fiscal year 2003 (not previously reported) and $1,407,414 in fiscal year 2004.

Status: The recommendation was not implemented. See current year's comment.

04-4 SUBRECIPIENT MONITORING

Program: U.S. Department of Transportation, Highway Planning and Construction, CFDA No. 20.205

Observation: The Highways Division did not adequately monitor its subrecipients. This comment was noted in the prior year.

Questioned Costs: None

Background: The counties of the City and County of Honolulu, Hawaii, Maui, and Kauai are the primary subrecipients of federal awards received by the Highways Division. As a pass-through entity, the Highways Division's responsibilities include:

- Identifying to the subrecipient the federal award information and applicable compliance requirements,
- Monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements,
- Ensuring required audits are performed and proper corrective action is taken on audit findings, and
- Evaluating the impact of subrecipient activities on the Highways Division's ability to comply with applicable federal regulations.

The Highways Division's monitoring activities of subrecipients take place at a high level, primarily through the review of single audit reports that are filed with the Highways Division. In fiscal year

2004, the Highways Division reviewed the fiscal year 2003 single audit report for each of the four counties. Two of the counties' single audit reports disclosed material weaknesses and reportable conditions in the counties' internal control system. As a pass-through entity, the Highways Division is required to ensure that the proper corrective action is taken on all single audit findings. According to OMB Circular A-133, pass-through entities shall "issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action." As of the date of this report, March 17, 2006, the Highways Division had not yet issued a decision on the single audit findings.

Failure to adequately monitor the activities of subrecipients may result in a delay in discovering that federal funds that the Highways Division is responsible for are not being expended in accordance with their intended purposes.

Recommendation: Take a more active role in monitoring the subrecipients' compliance with federal requirements. Such activities may include regularly scheduled discussions with subrecipients, regular site visits to review financial or programmatic records and observe operations, review of subrecipient budgets for federal expenditures, and the review of single audit reports and corrective action plans in a timely manner. In addition, comply with the provisions of OMB Circular A-133 and issue a management decision on all audit findings within six months after receipt of the single audit reports.

Status: The recommendation was not implemented. See current year's comment.

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