STATE OF HAWAI‘I

Office of the Auditor

2011 ANNUAL REPORT

MARION M. HIGA

State Auditor

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STATE OF HAWAIʻI
Office of the Auditor

Mission of the Office of the Auditor

The Office strives to ensure government accountability for policies, programs, and use of public funds through postaudits of accounts, programs, and performance. The office reports its findings and recommendations to policy makers to provide timely, accurate, and objective information for decisionmaking.

The Honorable Members of the Legislature
The Honorable Neil Abercrombie, Governor

June 18, 2012

Ladies and Gentlemen:

I am pleased to present this Annual Report, which highlights the efforts of the Office of the Auditor in 2011. This report, and the audits and special studies that it summarizes, address many of the major issues facing state government.

As we like to say in the office, "We tell it like it is, not how we would like it to be." Facts are facts, and we carefully corroborate and objectively analyze them. They can't be manipulated or, of course, fabricated. These concepts may seem self-evident, but in the age of the Internet, with it abundance of raw information, the ability to discern fact from fiction is more valuable than ever. As this report makes clear, we have become pretty good at uncovering the truth and getting to the bottom of a story.

Sincerely,

Marion M. Higa
State Auditor

"Based on a True Story"

Marion M. Higa, State Auditor

Mike Daisey is a monologist, which is a fancy way of saying he is a storyteller. He is also a talented writer and actor, so he is a very good storyteller. His detailed, first-person tales, which he usually tells from behind a desk onstage, have won him both critical acclaim and a loyal following.

In September 2010, Daisey began performing "The Agony and the Ecstasy of Steve Jobs," a monologue that recounts his visit to Shenzhen, China earlier that year to investigate reports of abusive labor practices at factories that assemble iPhones and iPads. In the monologue, Daisey, an admitted "worshipper in the cult of Mac," tells of his struggle to balance his desire to own the latest Apple innovations with the knowledge that these high-tech wonders come with a high human cost.

During his visit to Shenzhen, Daisey, with the help of a translator, interviewed underage workers outside the gates of a gigantic electronics plant. He also posed as an American industrialist so he could tour the busy factory floor and workers' overcrowded dorms. In addition, Daisey met with underground union organizers over lunch in which they discussed their long hours, low pay, and unsafe working conditions. At the meeting, he also met people who suffered extensive nerve damage after being exposed to toxic chemicals at an iPhone factory. Some of them had hands that were shaking so badly they couldn't pick up a glass of water. In the monologue's dramatic high point, Daisey describes how he handed over his iPad to a disabled Chinese worker, who cradled it with a hand that had been mangled by a metal press at one of the Apple factories. According to Daisey, it was the first time the worker had ever seen the technological wonder he had helped create. "It's a kind of magic," Daisey quotes the worker saying as the iPad's screen flickered on.

It's a powerful moment; it also isn't true.

Last March, a few months after "The Agony and the Ecstasy of Steve Jobs" was featured on a public radio program, a skeptical journalist tracked down the woman who had served as Daisey's translator during his China trip. According to the translator, Daisey fabricated and embellished many of the facts and anecdotes that he recounts in his monologue. For example, she and Daisey did not speak with underage workers outside their factory or anywhere else. She did confirm that Daisey had pretended to be an American businessman and toured a factory and dormitory; however, she disputed many of the details in Daisey's descriptions. Finally, they did meet a few union workers for lunch, but none of them had nerve damage, nor did they speak of chemical poisoning. And the man with the mangled hand who marveled at the booted-up iPad? He was there, but he never claimed to have worked at a factory of one of Apple's suppliers' factories and never handled Daisey's iPad.

When Daisey was confronted with his many inaccuracies and embellishments, he was apologetic but admitted to only one error: misrepresenting his story as a piece of journalism to public radio staffers. It was theater, not journalism. Daisey explained that toxic poisonings and grueling working conditions at Chinese electronics plants had been reported (and forgotten) by the media before he made his trip to Shenzhen. Daisey argued it was his monologue that made people care about the problems and advocate for something to be done about them. That was his goal. Therefore, even though he may have taken a few dramatic "shortcuts," his monologue was still true, since it spoke to a higher truth, and one that had already been established—the plight of Chinese workers.

"And everything I have done in making this monologue for the theater has been toward that end, to make people care. I'm not going to say that I didn't take a few shortcuts in my passion to be heard."
— Mike Daisey

Mike Daisey may be a talented monologist, but he would make a terrible auditor. In our world, facts are facts. As we like to say in the office, "We tell it like it is, not how we would like it to be." Facts do not serve a higher truth, so they cannot be manipulated nor, of course, fabricated. Our audit findings and conclusions are the result of the careful, objective analysis of information that we systematically collect. Therefore, facts are what determine the truth, not the other way around.

In our work, we encounter our fair share of Mike Daiseys—people who disregard the "facts," policies and procedures, rules and regulations and sometimes ethics and laws in the belief that the end always justifies the means.

Last year, in our *Performance Audit of the Hawai'i Public Charter School System*, Report No. 11-03, we audited the records of ten of the State's 31 charter schools for the school year 2009–2010. We reviewed charter documents, policies, procedures, and other relevant reports to assess whether the schools were not only meeting Hawai'i Department of Education performance standards but also whether they were spending public funds properly.

Charter schools are public schools that are granted greater autonomy in exchange for greater accountability. By removing some of the rules, regulations, and red tape designed to manage an entire educational system, charter school administrators are free to quickly implement innovative policies and programs. To our surprise, many people in the charter school system did not fully understand the nature of this compact between charter school and community. Most understood the concept of greater autonomy; but the part about accountability? Not so much.

For example, we found a school that spent $18,000 in public money on school excursions to an amusement park, ice skating rink, and pizza restaurant. When questioned about the propriety of these expenditures, a school administrator explained that these activities were "student incentives," claiming that some charter schools on the mainland use incentives to motivate their students. But who was eligible for incentives? How is that determined? How do you measure the effectiveness of the program? The school did not have any policies or procedures guiding its incentive program, which was discontinued when a new executive director asked questions like the above and received no answers.

At another school, we found staff were excessively increasing each others' salaries, sometimes more than doubling their pay. In one case, an office administrator sought out a retired staff member to sign the purchase order and the check for one of these salary increases. We were told the staff members were fully deserving of their salary increases; we were also assured their raises were fully vetted and approved by the appropriate people. However, when questioned why someone no longer on staff was allowed to sign a school check, the office administrator, who was the recipient of the check, responded that the retiree was still authorized by the bank to do so.

That response was so off the wall it caught some of our auditors by surprise! (It was OK because of bank policy?) But we are pretty good at discerning fact from fiction; and in the end, it was a story we weren't buying.

Staff of the Office of the Auditor

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Reports Published in 2011

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2010 Annual Report

Management Audit of the Hawai'i Public Housing Authority, Report No. 11-01

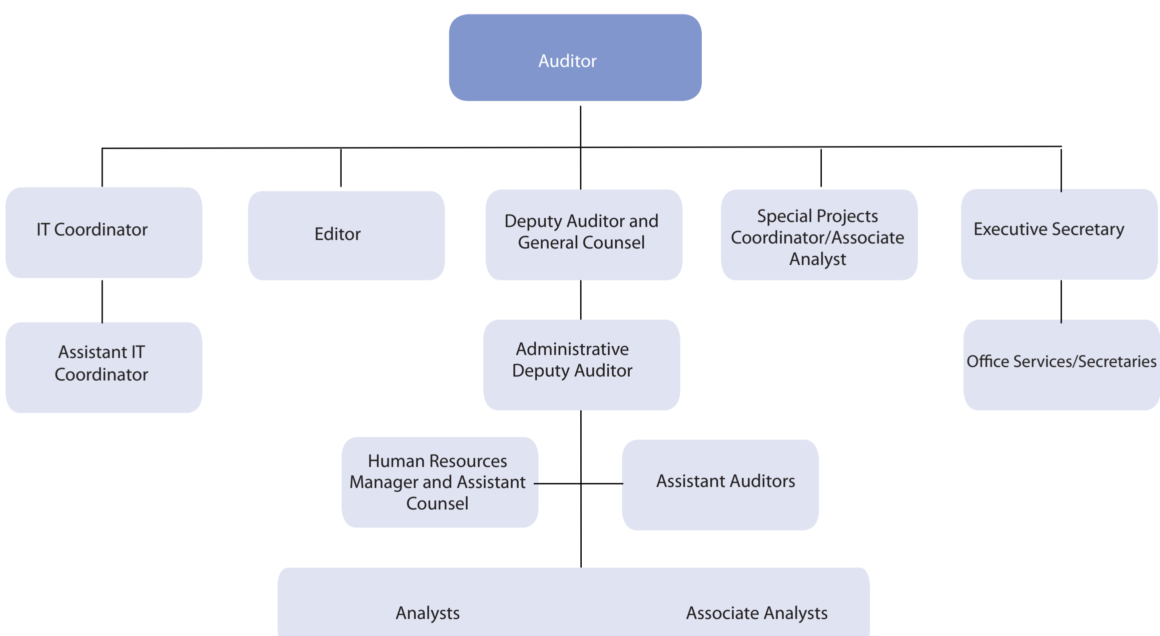
Sunrise Analysis: Regulation of Large-Scale Dog Breeders and Facilities, Report No. 11-02

Performance Audit of the Hawai'i Public Charter School System, Report No. 11-03

Review of Revolving Funds, Trust Funds, and Trust Accounts of the Office of the Governor, Office of the Lieutenant Governor, Department of Education and Hawai'i State Public Library System, and Office of Hawaiian Affairs, Report No. 11-04

The office also performed 67 quick reviews of proposed special and revolving funds, and administered 24 financial statement audits, including the State's Comprehensive Annual Financial Report.

Organization of the Office of the Auditor



2011 Summary of Reports

Management Audit of the Hawai'i Public Housing Authority

Report No. 11-01, January 2011

The Hawai'i Public Housing Authority administers 5,331 public housing units in 67 federally funded buildings and 864 units in 14 state-funded buildings. During FY2007-2010, the authority lacked staff with the resources and time to sufficiently monitor project managers' performance. Oversight for rent collection, federal reporting, and issues affecting tenants' daily lives—such as building conditions, property upkeep, and timely addressing of repair and maintenance problems—was erratic.

In addition, both state- and privately run housing projects reported backlogs in repair and maintenance. Turnaround on vacant units was slow, adversely impacting families on the waiting list as well as rent collections. As of February 15, 2011, the authority had a total of 233 vacant units that either had pending maintenance work or were available for rent; overall, these units had been vacant an average of six months. With approximately 9,000 families on the waiting list and an average wait time of two to five years, delays in turning around vacant units negatively impacts families waiting for public housing, rent revenues, and overall funding available to the authority.

The authority was severely behind schedule in implementing the U.S. Department of Housing and Urban Development-mandated "asset management" system. Despite the directive's issuance in 2005, the authority had yet to reach a first-year implementation level. *Asset management* is a method of managing public housing projects intended to improve operational efficiency and effectiveness by shifting accountability from the central housing authority to individual housing project managers. The method encourages managers to operate their properties as businesses, monitoring rent revenues and managing related expenditures to accrue capital for long term asset preservation and growth.

The deadline for meeting two of the five components of this model was in 2007; full implementation of all components was required by June 30, 2011. While the authority's executive director at the time was aware the authority could not realistically meet this deadline, she had begun to determine what was reasonable to implement, assign responsible parties, and develop a plan of action. We could not comment on the results of her planning effort, but noted her contrast with the efforts under the previous executive director, whose tenure ended in March 2010. The new action represented a concerted effort to rectify the substantial lag in implementing the asset management model.

The authority has many challenges ahead. It must improve its monitoring of project managers to ensure tenants' needs are addressed and the State's assets are protected for future users. It must also implement the federally mandated asset management system model of operation. Any further delays in implementation may put federal funds at risk; for an agency already suffering from backlogs of deferred maintenance and staffing constraints, such a loss would be devastating.

The authority did not take issue with our findings. According to the then-executive director, our findings were compatible with her "to do" list and her action plans would address some of our recommendations. These included a comprehensive operations manual to ensure consistent enforcement of policies. The authority is converting to asset management by improving its budgeting and accounting processes and utilizing the technical assistance plan provided by Econometrica, Inc.

Sunrise Analysis: Regulation of Large-Scale Dog Breeders and Facilities

Report No. 11-02, October 2011

In early 2011, the problem of large-scale commercial dog breeders in Hawai'i came to light when a "puppy mill" was shut down for its allegedly cruel treatment of 153 dogs. Hawai'i is one of 22 states that lacks any regulation of dog breeders.

Our analysis of Senate Bill No. 1522, Senate Draft 2, House Draft 1 was not a typical sunrise review, because the main purpose of the bill was to ensure that dogs are treated humanely, rather than to protect consumers from risks posed by an unregulated profession or vocation. Nevertheless, we to addressed the Legislature's request under the sunrise criteria of the Hawai'i Regulatory Licensing Reform Act, Chapter 26H, Hawai'i Revised Statutes.

As proposed, the bill required the Department of Commerce and Consumer Affairs (DCCA) to issue licenses to large-scale dog breeders based on a qualifying inspection and to enforce the requirements for humane dog breeding. We found the bill problematic for several reasons. First, there was no reliable information on the magnitude of the problem of unscrupulous breeders in Hawai'i. Both the Better Business Bureau and the DCCA reported only a handful of complaints in the past few years. Proponents of the bill could not provide information that satisfied the sunrise criteria and our own research showed the harm to the public by dog breeders was at best anecdotal.

Secondly, without reliable data on the numbers and size of large-scale dog breeders, the cost of enforcement was unknown. Assuming 30 breeders (one to 20 on O'ahu and ten on the Big Island) and DCCA's lowest cost estimate of $40,000 to $50,000 per year to administer a licensure program, a breeder license would need to be at least $1,300 for the program to be self-sufficient. Of the 28 states that regulate dog breeders, or kennels and dealers, Wisconsin charges the highest fee in the nation ($1,000). Also, flaws in the proposed regulation would not provide for breeder accountability and consumer protection. By focusing on large-scale breeders in-state, the bill failed to address hobby breeders and puppies imported from overseas.

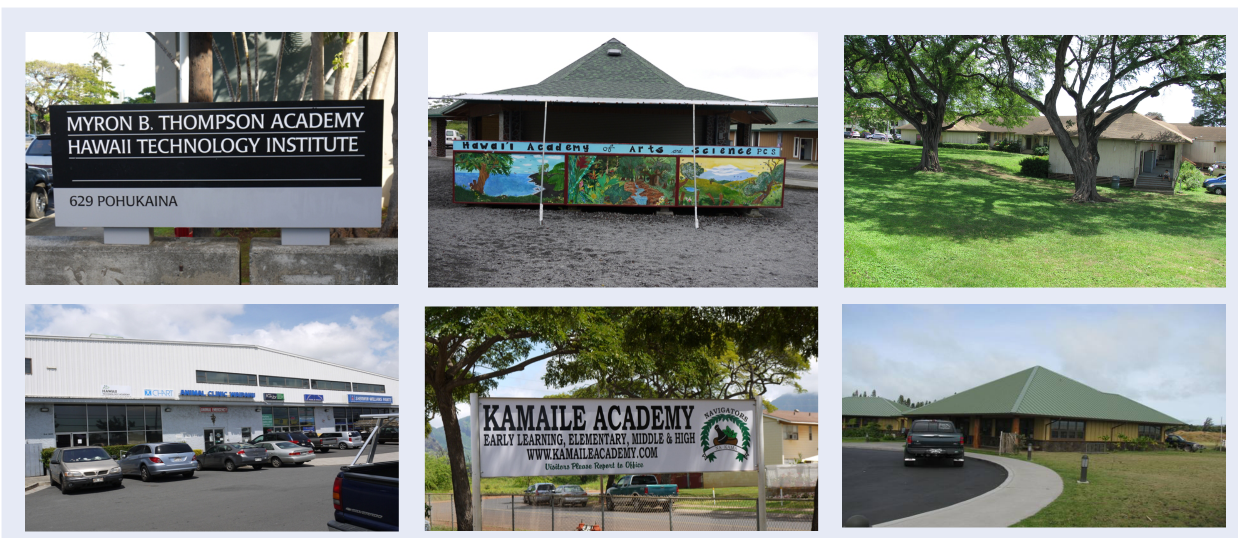
The Legislature asked us to assess a county-based regulatory program akin to the liquor commission model for enforcement. County officials familiar with animal control doubted that costs could be covered with licensing fees due to the low number of large-scale dog breeders. We could not fully assess the merits of other laws used by states to protect dogs from breeder abuse without reliable data, and given the uncertainties of costs. However, we did identify alternative models available for the Legislature to consider that could address the loopholes and hard-to-enforce provisions in the proposed regulation. For example, the American Veterinary Medical Association (AVMA) has crafted a science-based model law. The AVMA's model allows breeders the flexibility to create appropriate housing for the particular breed of dog they raise. The Hawai'i Veterinary Medical Association favors the model of Oklahoma's independent Board of Commercial Dog Breeders, which has authority to adopt rules and discipline licensees. Another alternative, adopted by 18 states, is popularly known as a "puppy lemon law" and protects purchasers of puppies by requiring sellers to reimburse buyers for the purchase price and cost of veterinary services within a specified period of time.

The department agreed with our findings and our recommendation that the Legislature address flaws in the proposed regulation and consider alternatives to licensing to achieve the goal of protecting dogs.

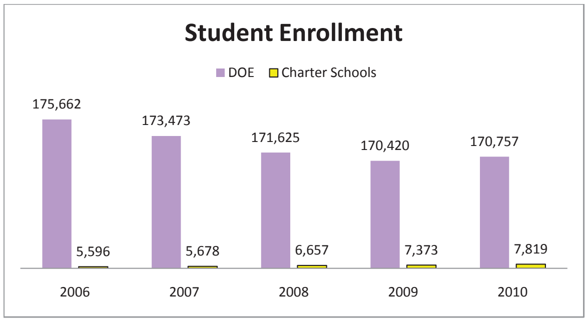
Performance Audit of the Hawai‘i Public Charter School System

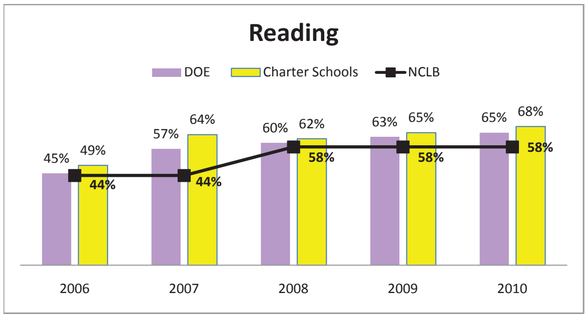
Report No. 11-03, December 2011

Since 1995, Hawai‘i's public charter schools have provided parents and their children with alternative choices in types of schools, educational programs, opportunities, and settings. To provide such choices, teachers and administrators operate independently of the statewide public school system, enjoying flexibility to shape working and learning environments for students. In exchange for this autonomy, school officials should be expected to achieve clear, objective, and measurable performance outcomes. In SY2009-10, nearly 8,000 students attended 31 charter schools throughout the state and the charter school system had a general fund budget of $49.7 million.

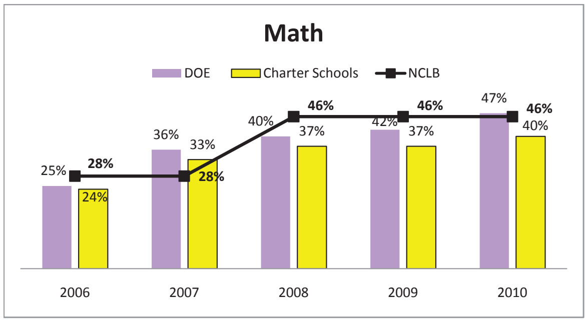


In our audit of the Hawai‘i public charter school system, we found that the Charter School Review Panel, which holds charter schools accountable for their performance, had misinterpreted state law and minimized its role in the system's accountability structure. Focusing on its duties as authorizer and re-authorizer, the panel delegated core monitoring and reporting responsibilities to local school boards, removing itself—and outside oversight—from the charter school system. The panel did not verify and analyze the data it received from the schools for accuracy and completeness, nor collect its own data to measure student performance. Student performance reports from ten schools showed numerous instances in which critical data, such as the Hawai‘i State Assessment scores for reading, mathematics, and science, were omitted or presented in misleading ways. We found that four schools failed to meet federal No Child Left Behind testing standards, and test scores from several of those schools were substantially lower than other public schools in their districts. Moreover, four schools misreported enrollment numbers. For one school, we could not verify 28 students' enrollment. With funding based on the SY2009-10 per-pupil allocation of $5,753, could not verify 28 students' enrollment. With funding based on the SY2009-10 per-pupil allocation of $5,753, that amounts to more than $160,000.





To meet federal No Child Left Behind standards, 58 percent of students must be proficient in reading. In 2006 and 2007, reading proficiency at the charter schools we examined was 44 percent.



To meet federal No Child Left Behind standards, 46 percent of students must be proficient in math. In 2006 and 2007, math proficiency at the charter schools we examined was 28 percent.

Although charter schools are exempt from the Hawai'i Public Procurement Code, they must comply with the State Code of Ethics. However, only two public charter schools of the ten we reviewed had a school ethics policy and only three followed the ethics code. Moreover, Hawai'i Technology Academy's (HTA) head of school, who is responsible for school spending, was not a public employee but an employee of the for-profit company that is providing the school's curriculum. As a private-sector employee, he was not subject to the ethics code and is ultimately accountable to his company, not the State or his school. In FY2010, HTA received $3.04 million in state funds.

We also found that the lack of oversight by the review panel, the Charter School Administrative Office, which is responsible for management of the charter school system, and local school boards had resulted in school spending and employment practices that were unethical and illegal. At the Myron B. Thompson Academy, we found $133,000 in overpayments to staff. For example, the school's part-time registrar received an "administrative differential" that boosted his annual pay to $55,200, a 212 percent increase. At other charter schools, we found instances of unrestrained spending, including one school that spent nearly $18,000 in public money on school excursions to an amusement park, ice skating rink, and pizza restaurant. We found that unless the review panel and the administrative office take active roles in a robust accountability system for charter schools, student outcomes will remain unproven and the financial viability of individual schools and the charter school system itself will be unknown.

While generally agreeing with our recommendations, both the panel and the office took issue with certain details. However, these attempts to refute and parse our documented findings were illogical and unsupported, and did not merit changing our report.

Review of Revolving Funds, Trust Funds, and Trust Accounts of the Office of the Governor, Office of the Lieutenant Governor, Department of Education and Hawai'i State Public Library System, and Office of Hawaiian Affairs

Report No. 11-04, December 2011

Section 23-12, Hawai'i Revised Statutes, requires the State Auditor to review all existing revolving and trust funds every five years.

Revolving funds are often established with an appropriation of seed money from the State's general fund. Revolving funds must demonstrate a capacity to be self-sustaining. Activities financed by revolving funds include loan programs that are initially established by general fund seed moneys and replenished through the repayment of loans. Trust funds invoke a fiduciary responsibility of state government to care for and use the assets held for the benefit of those with a vested interest in them. A pension fund is an example of a trust fund. Trust accounts are typically separate holding or clearing accounts for state agencies. A trust account is often used as an accounting device to credit or charge agencies or projects for payroll or other costs.

Of the 31 funds and accounts we reviewed this year, 10 were revolving funds, 12 were trust funds, and nine were trust accounts. We used criteria developed by the Legislature as well as by our office from a review of public finance and accounting literature. Specifically, funds must continue to serve the purpose for which they were created. A revolving fund must also reflect a clear nexus between the benefits sought and charges made upon users or beneficiaries of the related program and be an appropriate financial mechanism for the program or operation, as well as demonstrate a capacity to be self-sustaining. A trust fund must also meet the statutory definition of a trust fund. For each fund, we presented a five-year financial summary, the purpose of the fund, and conclusions about its use. We did not present any conclusions about the effectiveness of the program or its management, or whether the program should be continued. However, we did find that three of the 31 funds and accounts reviewed did not meet applicable criteria and/or may not be properly classified.

We transmitted a draft of this review to the Office of the Governor, Office of the Lieutenant Governor, Department of Education and Hawai'i State Public Library System, and the Office of Hawaiian Affairs. The Office of the Governor, Office of the Lieutenant Governor, and Hawai'i State Public Library System did not submit written responses. The Office of Hawaiian Affairs agreed with our review of its funds.

The Department of Education agreed with most of our conclusions but disagreed with our finding that the Federal Revenue Maximization Program Revolving Fund lacked clear linkage between the benefits sought and the charges made upon the users or beneficiaries of the program. However, we stood by our conclusion, as linkage cannot exist between benefits sought and charges made upon users or beneficiaries of program if a fund does not impose any charges upon such users or beneficiaries. The department also disagreed with our finding that the Food Distribution Program Revolving Fund lacked clear linkage between the benefits sought and the charges made upon the users or beneficiaries of the program. We altered our analysis of this fund based on additional information provided by the department; however, we were ultimately unable to provide a conclusion, as the fund has yet to be implemented.

Affected Agency Responses to Previous Recommendations

Investigation of Specific Issues of the Department of Business, Economic Development and Tourism

Report No. 10-01

Recommendations	Affected Agency's Response
1. We recommend that the Department of Business, Economic Development and Tourism:	
a. Cease expending or transferring any of its remaining federal reimbursement Marketing Development Cooperator Program funds until it consults with the State Legislature and the Department of Budget and Finance to determine whether the funds should remain in the possession of the department or be deposited in the state treasury;	DBEDT ceased transferring or expending Market Development Cooperator Program (MDCP) funds for program and operating funds as of February 2010. Twenty-five thousand ($25,000) was utilized in FY2011 for a financial audit, as provisoed in the FY11 budget bill. Remaining funds of $148,718 under this account held in DBEDT will be deposited into the state treasury. We are also closing the MDCP account held at HSBC Bank (China) with remaining funds of $3,679, pending compliance with Chinese government regulations and permission.
b. Ensure personnel engaged in both submitting and reviewing expenditures by overseas offices are proficient in reading and writing both English and Chinese;	Personnel at the overseas offices submitting expenditures are proficient in reading and writing both English and Chinese. Personnel in Honolulu proficient in reading and writing both English and Chinese have been assigned to review the expenditure reports, verify receipts, identify inconsistencies, and certify that reports have been reviewed.
c. Update its Overseas Offices Procedures Manual to include specific reporting and enforcement criteria regarding the purpose for expenditures made by overseas offices and ensure the policies are diligently enforced;	The Overseas Offices Procedures Manual is updated regularly based upon administrative policy and reporting changes. Most recent addendum to the procedures manual is dated December 2, 2011.
d. Conduct a financial audit (as opposed to a financial review) of the overseas offices' accounting systems every two years;	A financial audit was conducted by PKF Pacific Hawaii LLP covering the fiscal years ending June 30, 2008, 2009 and 2010 and will

Recommendations	Affected Agency's Response
	be available at http://hawaii.gov/dbedt/main/about/annual/2011-reports/2008-10-overseas-offices-audit.pdf.
e. Use the trade mission policy of the U.S. Department of Commerce as a guide to ensure future trade missions provide sufficient written criteria and transparency, and to restrict the government's influence in the use of private funds to a minimum; and	DBEDT has not organized a trade mission in 2010 or 2011. Any future trade missions will utilize the U.S. Department of Commerce trade mission policy as a guide.
f. Provide additional ethics training to departmental employees.	DBEDT Director and Deputy Director have taken the Ethics for State Employees class in March and July 2011, respectively. The Business Development and Support Division (formerly Strategic Marketing and Support Division) is also on the list for notification of future classes as they are scheduled by the Ethics Commission.
2. We recommend that the State Procurement Office (SPO) ask the Pacific and Asian Affairs Council (PAAC) to review all its fiscal material related to the 2005 trade mission. The SPO should also contact the Hawai'i Pacific Export Council and PAAC representatives to determine whether the department directly influenced or engaged in the expenditure of the mission funds and was subject to procurement laws.	The SPO does not have jurisdiction to follow up on this recommendation because the review of external accounts created for the purpose of receiving solicited funds is not within the purview of the procurement code.
3. We recommend that the governor, given the numerous and egregious acts carried out by the department administration under the direction of the director of business, economic development and tourism, and the director's lack of veracity in his interactions with the Legislature over time, consider removal of the director. Based on the findings from this report as well as previous work conducted by our office on the department's operations, we observed an environment where compliance with laws, rules, and regulations has been compromised over a considerable period of time. As it is the director who sets the "tone at the top" for	

Recommendations

Affected Agency's Response

the entire department, a change in leadership would be appropriate. The Hawai'i State Constitution provides that the governor may remove the director ahead of the end of the term for which the governor was elected; hence, the governor is responsible for the actions of her director and should consider his removal.

4. We recommend that the Legislature:

   a. Engage in discussions with the department to determine the course of action regarding the overseas offices and whether any changes need to be made to the reporting requirements to ensure it maintains legislative oversight of the overseas offices' expenditures;

   b. Review whether to preserve, amend, or rescind the department's Market Development Cooperator Program (MDCP) spending ceiling and engage in discussions with the department and the Department of Budget and Finance to determine whether the MDCP reimbursement funds should be deposited into the state treasury or remain under department control; and

   c. Engage in discussions with the department to ensure there is a clear understanding regarding information provided by the department for any future federal award it may receive to ensure that the Legislature is well-informed before it takes any action that enables the department to spend these funds.

Study of Proposed Mandatory Health Insurance Coverage for Colorectal Cancer Screening

Report No. 10-02

Recommendations

We recommended the enactment of an amended House Bill No. 823, which required health insurers to provide coverage for colorectal cancer screening for asymptomatic adults aged 50 and above. In addition, we suggested that the standard of care for colorectal screening should include the procedures and test recommended by the U.S. Preventive Services Task Force 2008 guideline.

Affected Agency's Response

On June 1, 2010, Governor Linda Lingle signed Act 157, which mandated health insurance coverage for colorectal screening as recommended by the United States Preventive Services Task Force.

Financial Examination of the Department of Budget and Finance

Report No. 10-03

Recommendations

1. We recommend that the Department of Budget and Finance:

   a. Formally review and update the State of Hawai'i Treasury Investment Policy on an annual basis, as currently required, or consider whether it is necessary for the department to update the policy related to the frequency of review.

   b. Consider best practices identified by the Government Finance Officers Association (GFOA) related to managing market risk, benchmarking, and measuring total performance in a portfolio while reviewing the

Affected Agency's Response

Treasury Investment Policy was reviewed and updated as of March 28, 2011 and will be reviewed annually in subsequent fiscal years.

Recommendations	Affected Agency's Response
investment policy, including the article, "Innovation in Managing Public Funds: Benchmarking and Total Return" from the August 2007 Government Finance Review and the GFOA Recommended Practice white paper, "Managing Market Risk in a Portfolio (2007) (CASH)." In particular, the following points should be considered:	
i. The maturity structure of a security should be fully understood. Prior to purchase, the government should confirm compliance with its investment constraints and overall investment strategy. If a security has options associated with it such as call options, the structure of the option should be analyzed to determine its potential impact on market risk through an analysis. The stated maturity date should always be used to determine compliance with maximum maturity constraints, not any potential call dates unless an official announcement of a call has been released.	Staff is following the policies set forth in the Treasury Investment Policy and reviewing the maturity structure of investments to ensure compliance with the Treasury Investment Policy and State statutes. Investment policy amended to restrict or curtail future investments in instruments (allowable by HRS) due to maturity constraints.
ii. Although the department's investment policy currently sets a maximum maturity restriction for individual securities to not exceed five years, consistent with the statutory limitation, the GFOA does not consider this the most effective way to manage market risk and to obtain an understanding of the potential price volatility of either an individual security or an entire portfolio. The GFOA recommends adopting weighted average maturity limitations and/or weighted average duration targets, which often range from 90 days to three years, consistent with the government's investment objectives, constraints, cash flow needs, and risk tolerances. The weighted average maturity limitations can be used to limit market risk in a portfolio consistent with the five-year maturity limit in the statute. The weighted average duration targets can be used to manage market risk in a portfolio.	The Treasury Investment Policy states that each investment be made with the intention of holding to maturity. Therefore, while the fair market value of the investment portfolio may fluctuate in changing market conditions, the buy and hold strategy results in the Department realizing a positive payment of principal and interest on its investments. In addition, the Treasury Investment Policy minimizes market risk primarily by structuring the portfolio to meet cash requirements. Therefore, avoiding the need to sell securities on the open market. Thus far, following this policy guidance, the Department has avoided selling securities prior to maturity at a loss. The Department is continuing its evaluation of utilizing weighted average maturity limitations, taking into consideration the current market environment as part of the annual review process.

Recommendations	Affected Agency's Response
iii. Although the investment policy states that the yield on the State's investment portfolio is of secondary importance compared to the safety and liquidity objectives, the department also has a fiduciary duty to taxpayers to ensure that it is obtaining a competitive rate of return on those funds as long as safety and liquidity are satisfied. While the investment policy states that investments are limited to relatively low-risk securities in anticipation of earning a market rate of return commensurate with the risk assumed, no formal benchmarks are specified in the investment policy. Benchmarks are points of reference, or targets, that an agency can use to evaluate its investment performance. For budgeting performance measurement goals, an agency will generally start with the one-year U.S. Treasury note as a base, consider trends in the market and the direction of interest rates, and determine an estimated return rate as its performance measurement goal. As part of the investment policy review, the department should determine an appropriate total return index as a benchmark that reflects the State's investment objectives and tolerances for risk.	The department has established, by policy, evaluating yield performance against durations on the U.S. Treasury yield curve. The Department periodically evaluates its investments against the one-month, three-month, six-month, one-year, two-year, three-year and five-year daily treasury yield curve to monitor investment performance.
c. Consider reviewing investment practices of other states (e.g., through review of websites, telephone discussions, networking at conferences, etc.) for best practices and innovations that can lead to improvements in the State's investment policy and practices.	The department updated its Treasury Investment Policy in March, 2011 utilizing the best practices format recommended by the Government Financial Officers Association (GFOA), which was developed by incorporating best practice innovations. In revising the policy, the Department also consulted with other State Treasury offices and financial institutions for best practices.
d. Update and document operational procedures for performing daily cash projections to determine excess cash in the state treasury available for investment. The Treasury Management Branch may consider investigating the use of an automated system to perform the projection, including investigating if such functionality exists in the Microsoft Dynam-	The department has increased its automation in the production of reports to assist staff, ensuring that daily investments are made in compliance with the diversification requirements of the Department.

Recommendations

ics accounting system it already uses. Alternatively, if manual spreadsheets are determined to be most cost effective, the Treasury Management Branch should use automated formulas and streamline the calculation on a single worksheet, or link cells within a workbook, to ensure that accurate amounts are translated throughout the spreadsheets in calculating projected amounts available for investment. An automated process or formulas will assist in providing a more reliable projection of excess cash, enable the consistent performance of procedures, and aid in the transition of tasks to new or other employees (including management) during an employee's absence or position vacancy.

e. Perform and document an appropriate level of review of investment decisions as required.

f. Review the investment policy to determine whether any revisions are necessary to the current internal reporting requirements. In addition, investment reports should be prepared in a timely manner and with adequate information to allow the director of finance and FAD administrator to determine whether the State's investments comply with state law and the investment policy. The department should properly report the maturities of auction-rate securities based on the stated maturities of the underlying loans, rather than the next scheduled auction date, which significantly shortens the average maturity of the investment portfolio.

g. Ensure that investments comply with all provisions of Section 36-21, HRS, and the investment policy. The department should also perform adequate risk assessments of all current and potential investments to ensure it understands all risks related to an investment and that an investment complies with state law and the investment policy. Furthermore, the department should ensure that the State can exit any investment, without penalty, that no longer complies with state law.

Affected Agency's Response

(e) Investment decisions are being made in accordance with the Treasury Investment Policy.

(f) These actions have been taken. Treasury management meets regularly on a monthly basis with department director to review treasury performance, practices, and service issues to ensure conformance with investment policy.

(g) The department invests in statutorily authorized investments and in compliance with the Treasury Investment Policy. Investments may be liquidated if it is determined that it does not comply with State law.

Recommendations	Affected Agency's Response
h. Follow the guidance stated in Section V of the investment policy and obtain proper approvals from the Financial Administration Division administrator and, when exceptions are significant, the director of finance prior to the purchase of investments if they exceed quantitative guidelines but are deemed to be in the best interest of the State. Also, as required under the investment policy, inadvertent breaches of the policy should be immediately reported to the director of finance.	Section V of the Treasury Investment Policy dated March 28, 2011 is no longer applicable to this specific issue. Section X of the current policy addresses exceptions to the Treasury Investment Policy. Subsequent to this report, there have been no new instances of exceptions made to the policy and no inadvertent breaches.
2. We recommend that the department perform the following to ensure timely preparation and review of bank reconciliations:	
a. Establish formal policies and procedures for preparing and reviewing bank reconciliations. The policy should include the timeframe and individuals responsible for the preparation and review of reconciliations.	The department has policies and procedures related to the bank reconciliation process. As of this date, the department is implementing practices and personnel to address increased timeliness of bank reconciliations.
b. Report unrecorded items to DAGS for proper adjustment as of month/year-end and record adjustments in the department's subledger in a timely manner for the preparation of its own financial statements of cash and investments in the state treasury.	Workload volume and staffing limitations continue to be challenges. The department, with the assistance of the Department of Accounting and General Services, recently implemented a new reconciliation procedure utilizing programmed worksheets to work on reconciling items and also greatly reduced the need to manually input data at DAGS.
c. Record adjustments in a timely manner and provide the necessary information to DAGS for proper recording in the State's Comprehensive Annual Financial Report and dissemination to state departments and agencies for preparation of their financial statements.	Workload volume and staffing limitations continue to be challenges. The department, with the assistance of the Department of Accounting and General Services, recently implemented a new reconciliation procedure utilizing programmed worksheets to work on reconciling items and also greatly reduced the need to manually input data at DAGS.
d. Write off the difference with the fiscal agents of $1,196,062.	Staff continues to work on this as time permits. Workload volume and staffing limitations continue to be challenges.

Recommendations	Affected Agency's Response
e. Follow established procedures and timely complete reconciliations of FAD records to the comptroller's records received from DAGS. If necessary information is not received from DAGS on a timely basis, FAD should liaise with DAGS to obtain the information, review reconciliations, and ensure any necessary adjustments are recorded in the department's and/or DAGS's books in a timely manner.	The department has made improvements to the reconciliation process as noted above.
3. We recommend that the department perform the following related to the treasury and bond investment pools:	
a. Immediately complete interest allocations for the remaining months in fiscal year 2009. We also recommend the department ensure allocations for fiscal year 2010 are performed within the timeframe stated in Finance Memorandum No. 99-15.	Treasury investment pool distributions are now current. The department will continue to make efforts to become timely for the distribution of the bond investment pool earnings.
b. Formally document the methodology in allocating interest earned (received and accrued). In the event of employee turnover or absence, written procedures will allow individuals who assume the process to properly perform the allocation in a timely manner.	Documentation has been completed.
c. Formally inform investment pool participants of the revised interest earnings allocation methodology and any subsequent changes to the investment pool that may affect participating agencies.	This will be done as material changes are made to the methodology of the treasury investment pool.
4. To ensure compliance with Section 103D-304(i), HRS, we recommend that the department immediately post Notices of Award for the four underwriting contracts for special revenue bond issuances awarded in FY2009. We also recommend that the department comply with the provisions of Section 103D-304(i), HRS, for all current and future bond issuances.	The department has improved its monitoring process to ensure timely posting of awards by having the person responsible for the posting initial a form to indicate that an award was posted within the required time frame.
5. We recommend that the Budget Division document operational and administrative policies	Administrative policies and procedures are

Recommendations	Affected Agency's Response
and procedures to reflect current activities and procedures, including the documentation of common and unusual cases so that procedures are consistently performed within the division. This documentation will also aid in training new employees and guide management in performing tasks during an employee's absence or position vacancy.	documented in relevant administrative directives, executive memorandums, and finance memorandums. Operational policies are to a lare extent dependent on the fiscal situation and, as such, subject to frequent change. Operational policies are communicated expeditiously and implemented through staff e-mail updates and via frequent staff meetings.
6. Given current fiscal constraints and the State's general hiring freeze, we recommend that the department use cost-effective strategies to retain qualified staff, cultivate employees' skills to develop future leaders, promote knowledge transfer through job-shadowing and mentoring programs, and document internal procedures and practices with examples of how to perform critical tasks.	The Budget Division has been using job-shadowing and mentoring programs as cost-effective strategies to develop existing staff and to promote knowledge transfer. Extensively documenting internal procedures is the preferred method and long term objective practices. However, the Division currently is still challenged with adequate staff resource levels to devote to such documentation. Policies and procedures have been developed and implemented regarding IT user access reviews.
7. In regards to accurate reporting and use of measures of effectiveness, we recommend the department be held accountable for developing meaningful measures of effectiveness and that the department, governor, and Legislature utilize the performance data for actual decision making regarding budget and resource allocation. We also recommend that both agencies and decision-makers receive adequate training on how to effectively utilize performance-based budgeting and apply performance measures to the allocation or management of resources in the public sector. The Budget Division should set an example for other departments by accurately performing the variance analysis required under Section 37-75, HRS, to maximize effectiveness of the State's performance-based budgeting process. The Budget Division, as the agency responsible for optimizing the expenditure of all public funds by developing meaningful budgets and plans, should review its own performance targets on an annual basis to ensure they are realistic and relevant to divisional goals; the division should also report accurate performance results and information.	Agreed. A program to develop training and review for budgeting sources is monumental. Current systems and processes are not contemporary and budget systems are not efficient. Budget Division is working with IT/CIO to integrate budget technology into new process development. It should be noted that considerable time and money at all levels of state government were devoted to implementing the Program Planning and Budgeting System (PPBS) during the mid-1970's. Over time, however, the resources needed to maintain the focus on developing and utilizing the PPBS performance measures have been redirected to competing priorities and the personnel knowledgeable and trained in its use have left service. Rebuilding the focus and knowledge base in state government to the point where PPBS performance measures can be used for "actual decision making regarding budget and resource allocation" would be a major undertaking requiring Executive and Legislative commitment to apply and use the PPBS measures, and sufficient resources, in terms of staffing, con-

Recommendations	Affected Agency's Response
	sultant services and training time, to conduct the requisite comprehensive statewide training program for all levels and branches of state government.
8. We recommend that the department improve management and controls over its IT system by:	
a. Establishing a periodic review of user access to electronic applications and mainframe applications. For e-applications, a list of user accounts with access levels should be requested from ICSD and distributed to all departments' representatives for review. For the mainframe applications, the department should request the list of users for each application and have division managers review the lists for proper access levels.	Policies and procedures have been developed and implemented regarding IT user access reviews.
b. Implementing controls to secure and monitor direct access to the Microsoft Dynamics database.	
c. Enabling additional password settings for the Microsoft Dynamics application, including password age, history, and complexity. The department should utilize these settings to provide reasonable assurance that passwords are not easy to guess and force users to periodically change their passwords.	Stricter requirements for passwords, including password age, history, and complexity, were implemented in FY 2011. Additional password requirements were implemented in FY12.
d. Identifying physical security and environmental control alternatives and performing a risk assessment and cost-benefit analysis to determine what controls are reasonably necessary to protect the department's systems and information. The department may consider moving the server room to a more secure location or implementing additional physical security controls, such as closed circuit televisions monitored by building security or motion sensors within the server room. Possible environmental controls include installation of smoke detectors, fire extinguishers, heat sensors to detect systems overheating, or moisture sensors to detect flooding or high humidity. Implementation of	The cost of moving the server room is not financially feasible at this time. However, smoke detectors, fire extinguishers, and heat sensors have been installed.

Recommendations	Affected Agency's Response
unfeasible or cost-prohibitive measures is not required; however, the department should identify and implement economically viable controls to ensure its financial systems and data are reasonably protected.	
e. Establishing an off-site rotation of backup media (or off-site replication of data) for the Microsoft Dynamics application to prevent potential loss of financial data.	Arrangements have been made to store backup tapes in the State Archives' vault.
9. We also recommend that the Treasury Management Branch undergo Microsoft Dynamics training to take full advantage of the investment tools and capabilities of the Microsoft Dynamics system. We further recommend that the department keep abreast of technological efficiencies that other state are using to maintain investment information.	

Management Audit of the Aloha Tower Development Corporation

Report No. 10-04

Recommendations	Affected Agency's Response
1. The Legislature should:	
a. Repeal Chapter 206J, HRS, on June 30, 2011 to abolish the Aloha Tower Development Corporation;	
b. Direct the Aloha Tower Development Corporation, the Hawaiʻi Community Development Authority, and the Department of Transportation to develop and submit a plan to the Legislature, 20 days before start of the 2011 legislative session, to provide for the orderly transfer of the rights, powers, functions, and duties of the Aloha Tower Development Corporation to the Hawaiʻi Community Development Authority; and	
c. Direct the Aloha Tower Development Corporation and the Department of Transportation to develop and submit a plan to the Legislature, 20 days before start of the 2011 legislative session, to provide for the orderly transfer of rights, powers, functions, and duties of the harbors modernization group to the Department of Transportation, Harbors Division.	
2. The Hawaiʻi Community Development Authority should:	
a. Update the master plan and rules for the Aloha Tower Project Area and develop a strategic plan to carry out the plan, given the current constraints to development; and	
b. Enter into discussions with the Department of Transportation, Harbors Division, to resolve the Aloha Tower Development Corporation's $7.7 million debt to DOT-Harbors for lost revenues.	The HCDA has never had jurisdiction or responsibility for the ATDC. While there was some consideration given by the 2011 Legisla-

Recommendations	Affected Agency's Response
	ture for conveying responsibility for the ATDC upon the HCDA, there was no final action on that matter. The 2011 Legislature did enact legislation (Act 153, SLH 2011) which transferred the responsibility for administering the statute and the Aloha Tower Complex from the DBEDT to the DOT for administrative purposes. That act did name three members of the newly constituted ATDC baord. Those members include: the director of DOT, the director of DBEDT, and the deputy director of Transportation, Harbors Division. Act 153, SLH 2011 also provided that moneys deposited in the Aloha Tower Fund may be used for the purposes of the chapter and lease payments to the DOT.

Program and Management Audit of the State's Purchasing Card Program

Report No. 10-05

Recommendations	Affected Agency's Response
1. The State Procurement Office should ensure that the intent of the pCard program—to streamline the state and county government's small purchase payment process—is being met. To address this, the procurement office should:	The State Procurement Office (SPO) provided response to the Auditor's confidential draft report, *Management Audit of the State's Purchasing Card Program*, letter dated 5/20/2010, which was included in Report No. 10-05 as Attachment 2, which addressed the report and recommendations summarized on pages 17-18 of response letter. The following indicates the reference page number(s).
a. Set meaningful goals and objectives for the program and identify how they will be accomplished;	Pages 7-8, response to "Goals are nonexistent" and "Objectives and policies are vague."
b. Devise an action plan to include a timetable indicating how its objectives and policies will be implemented; and	See above reference page numbers.
c. Develop performance measures that are part of the action plan and that compare actual performance with expected results.	Page 8, response to "Performance measure are deficient."
2. The State Procurement Office should re-engineer the pCard program by formulating and adopting clear guidance that will help executive branch agencies in achieving consistency and efficiency in operating and administering the pCard program by:	Since Report 10-05, a new contract was awarded to First Hawaiian Bank to furnish an enhanced purchasing card program, which includes capabilities for online management tools, online consolidated statements, and an online bulletin board. Enchancements provide user agencies with additional oversight, monitoring tools, and accessibility.
a. Analyzing, streamlining, and unifying or codifying the various steps within the pCard program with a focus on simplification, standardization, and efficiency. This may include elimination of multiple reviews and the refinement of the functions and responsibilities of key personnel;	Page 11, response to "SPO's guidance for the pCard program is insufficient." Standardized forms have been developed to facilitate changes/deletions and/or new card set up and submissions.

Recommendations	Affected Agency's Response
	Page 11, response to "Oversight and monitoring reports are available, but barely used by SPO or departments."
b. Identifying and developing data and reporting requirements to assist in streamlining and monitoring the program;	Page 6, response to "SPO is the administrator of the pCard program, but has shifted its responsibilities to the executive departments."
c. Issuing minimum core standards and policies for pCard users to simplify and expedite the pCard transaction process; and	Page 12, response to "Executive Branch Agencies' Purchase Card Program Lacks Streamlined Procedures That Could Save Time and Money." Page 11, response to "SPO's guidance for the pCard program is insufficient."
d. Assisting and being more responsible for program implementation and improving its training to executive agencies.	SPO continues to work with user agencies through pCard administrator workshops, meetings, and cardholder training to identify areas to impove program performance and efficiencies.

Audit of the Department of Public Safety, Sheriff Division

Report No. 10-06

Recommendations	Affected Agency's Response
1. The Department of Public Safety, to enact an effective law enforcement program, should:	The Department of Public Safety and Sheriff Division are dedicated to addressing all the identified issues of the Auditor's Report No. 10-06. Recent changes in administrative appointments have facilitated the accomplishment of several goals toward this objective.
a. Perform a risk assessment of each section of the Sheriff Division. This risk assessment should focus on:	The appointment of Deputy Sheriff Shawn Tsuha to the Sheriff position has proven successful in bringing a fresh approach to the problems identified by the audit. Since his appointment, Sheriff Tsuha has diligently worked to meet the challenges that have developed during the year with the completion of their booking and receiving building, assisting with the development and implementation of state law enforcement's operation plans with APEC, and many others.
i. The duty or function performed by the deputy sheriffs; ii. The necessity of the duty or function performed; iii. The risk associated with the duty or function performed; iv. The resources, personnel, and equipment needed to adequately perform these functions; v. Determining whether the Sheriff Division is capable of performing the duty or function in a manner that properly protects public safety; vi. Determining whether the department is capable of supporting and maintaining	The Sheriff Division is in the process of developing a matrix through the gathering of working data from branch staff, supervisors, and the deputies themselves in order to establish a verifiable risk assessment. This process is in its infancy and should be completed by end of this legislative session, after which the division will begin the assessment process. In conjunction with developing a risk assessment matrix, the division will begin to return to its core functions as mandated by legislative intent of Act 221, SLH 1989, to include any additional responsibilities that have already been included since 1990 (i.e. Airport Detail and State Law Enforcement Coalition, etc.). This will enable the Division to perform its duties and functions in a manner that will effectively protect public safety.

Recommendations

this function of the Sheriff Division; and

vii. Engaging the agencies serviced by the Sheriff Division, such as the Judiciary and Department of Transportation, to clearly define interagency duties and responsibilities.

2. Build on the above risk assessment to develop a comprehensive stratetic plan for the Sheriff Division that, at a minimum, meets the requirements of Act 100, SLH 1999, and includes:

   a. Reassessing the established division goal(s) based on the risk assessment;

   b. Developing objectives that are measurable and linked to division goal(s);

   c. Establishing action plans for each objective, detailing how, by whom, and when each objective will be achieved; and

   d. Determining how the division will measure the success of each goal and objective.

3. Collaborate with the administration and potentially the Legislature to consider reorganizing and reevaluating the statutes pertaining to the duties and functions of the Sheriff Division, based on the results of the risk assessment. Policy decisions will need to be made to address areas that may be deemed important but beyond the capabilities of the Sheriff Division.

4. Draft administrative rules that clearly determine and define the responsibilities and jurisdiction of the Sheriff Division. In the process of drafting these rules, the department must collaborate with affected agencies as well as county police departments. These rules should include, but not be limited to:

   a. A definition of the division's area of j urisdiction and the functions performed in that area;

Affected Agency's Response

Once completed, the Department of Public Safety collectively with the Sheriff Division will begin the review of needed resources, training, and development of our employees as a first step.

With the completion of the risk assessment, we will review our core functions and determine what is necessary and what is optional. The department will then, along with its state and county law enforcement partners, begin to develop a comprehensive plan of its responsibility in the State's criminal justice system.

This will enable the department to establish realistic jurisdictional and geographical boundaries; and to provide essential information with required staffing and equipment along with the type, duration, and number of training classes, associated cost and the final draft of a Strategic Plan.

The Sheriff Division looks forward to working collectively with the Governor's Office and the Legislature to begin our "New Day."

Recommendations	Affected Agency's Response
b. Guidelines on the number of personnel needed to provide adequate coverage for each area of jurisdiction; c. Guidelines on mandatory in-service training and equipment maintenance; and d. Guidelines specific to the Judiciary and the division's service of judicial processes.	
5. Seek accreditation for the Sheriff Division from the Commission on Accreditation for Law Enforcement Agencies, Inc. (CALEA), to help ensure that proper law enforcement policies and procedures are enacted and followed. To prepare for these fundamental changes, the Department of Public Safety can enroll the Sheriff Division in the CALEA Recognition Program, which serves as a preliminary step to full accreditation.	The Sheriff Division has already begun its pro cess to meet the Commission on Accreditation for Law Enforcement Agencies, Inc. (CALEA) accreditation milestones for law enforcement by developing an additional 25 policies awaiting review by the union and our labor relations section for approval. Once completed, the major work will begin to align all the department's law enforcement policies and procedures to meet CALEA's guidelines, a process that takes approximately three to five years.

Sunrise Analysis: Real Estate Appraisal Management Companies

Report No. 10-07

Recommendations	Affected Agency's Response
Senate Bill No. 1606 proposed to require real estate appraisal management companies (AMCs) to register with the Real Estate Commission of the Department of Commerce and Consumer Affairs (DCCA). We found that regulation as proposed in S.B. No. 1606 was not warranted. However, the federal Wall Street financial reform bill enacted into law in July 2010, requires all states to register and supervise AMCs. As a result, we recommended that the Legislature consider asking the DCCA to submit, after the adoption of federal rules, a written analysis of its then-proposal to comply with the federal law and its final rules.	Senate Bill No. 1606 was not enacted by the Legislature.

Sunrise Analysis: Athletic Trainers

Report No. 10-08

Recommendations	Affected Agency's Response
Senate Bill No. 2601, Senate Draft 1, proposes to offer athletic trainers title protection. This means that no one could represent, advertise, or announce oneself either publicly or privately as an athletic trainer or registered athletic trainer unless registered with the Department of Commerce and Consumer Affairs. We recommended against enactment of Senate Bill No. 2601, Senate Draft 1 since it did not meet sunrise criteria. The DCCA agreed with our report findings.	Senate Bill No. 2601, Senate Draft 1 was not enacted by the Legislature.

Review of Revolving Funds, Trust Funds, and Trust Accounts of the Judiciary and the Departments of Commerce and Consumer Affairs, Hawaiian Home Lands, Health, and Human Services

Report No. 10-09

Recommendations	Affected Agency's Response
No recommendations	

Management Audit of the Department of Public Safety's Contracting for Prison Beds and Services

Report No. 10-10

Recommendations	Affected Agency's Response
1. To improve the compilation of its incarceration cost data, the Department of Public Safety should:	
a. Consider developing a useful calculation to be applied at regular intervals to more easily use cost accounting for cost savings or accounting for performance;	The department has altered its method for determining cost per day for both PSD and mainland contract beds to provide a more accurate calculation.
b. Utilize a more systematic process for cost comparisons, taking into consideration a need for a cost-accounting methodology;	For calculating FY2011 in-state facilities' cost per day, average end-of-month population reported for each facility was utilized rather than bed capacity. Once OffenderTrack data are audited and corrected for completeness and accuracy, actual bed days will be utilized.

Recommendations	Affected Agency's Response
	FY2011 calculations for mainland contracted facilities cost per day included the contracted bed-day rate plus additional costs for transportation, medical, inmate wages, site inspections, and administrative costs for the Non-State Facilities Division. Other PSD administrative costs were not included, as only a small percentage of administrative time and resources are dedicated to division work. No additional costs above contracted cost per day were attributed to the Federal Detention Center.
c. Rather than provide data simply because it is requested, communicate with the Legislature to gain an understanding as to why information is requested in order to provide pertinent information in return; and	The department discusses with those who request data what their objective is, explains what type of data are available, and comes to an agreement with the requestor as to what will be provided.
d. Compile useful, reliable, and complete data, utilizing available tools such as Offendertrak, for both the Legislature's and its own use.	The department is planning for a content audit of the Offender Trak system to review completeness and accuracy of electronic inmate records. Those data fields that are most important to develop inmate population projections, respond to mandated federal and state reporting requirements, and respond to common requests by the Hawai'i State Legislature and others will be corrected. Once completed, the department will compile a corrections data book which will be issued annually at the end of the calendar year.
2. To improve its processes for monitoring the operations of private prisons, the department should:	
a. Enhance processes used to test compliance with contract requirements to include what to test and how to validate compliance. This should include developing standardized tools that can be used by staff to measure compliance with all areas of the contract on a regular basis;	The Mainland Branch reviewed its compliance practices in accordance with its contractual requirements. They contacted other states that house offenders in private prisons, National Institute of Corrections, and American Correctional Association for guidance in measuring compliance in audits of correctional facilities; documented contract compliance issues and retention of records.

Recommendations	Affected Agency's Response
b. Develop a quality review program to ensure that monitoring records and reports accurately and thoroughly document inspection results;	The Mainland Branch is developing a process to ensure that all monitoring records and reports are completed accurately. In its revision of the audit tool, more attention is being placed on documenting inspection results.
c. Establish policies and procedures related to documenting contract compliance issues and the retention of monitoring records; and	The Mainland Branch is working on developing policies and procedures to cover how it audits its contracted correctional facilities; documents contract compliance issues and the retention of records.
d. Update its operating policies and procedures for fiscal monitoring and the approval and processing of invoices to ensure that the State is receiving the programs and services that it contracted for.	The Mainland Branch is working on developing policies and procedures to cover how it reviews, approves, and processes invoices to ensure that the State is receiving the programs and services that it contracted for.
3. To improve contracting for private prison beds in out-of-state facilities, the State chief procurement officer should suspend procurement authority delegated to the department for out-of-state prison contracts with private vendors until:	
a. The department's practices are reviewed and policies and procedures are in place to ensure compliance with Chapter 103F, HRS;	The State Procurement Office has been informed by PSD that their procurement policies and procedures have been updated and awaiting departmental review and approval from the director.
b. The Mainland/FDC Branch administrator and key staff have completed procurement training workshops related to contract administration and procurement of health and human services under Chapter 103F, HRS.	PSD's one key staff has completed only three of the eight training workshops required and must be in compliance with Procurement Delegation No. 2010-01 and Amendment 1, and Procurement Circular No. 2010-05, as appropriate, to participate in procurement activities.
4. The State chief procurement officer should also provide guidance and oversee the procurement process, including final approval over the next contract to replace the contract for housing the male prison population at Red Rock Correctional Center and Saguaro Correctional Center that expires on June 30, 2011.	PSD requested SPO's review of the new solicitation, for compliance with HRS Chapter 103F on 2/9/11 and SPO responded on 3/24/11 providing comments and noted areas that needed to be addressed.

Management and Financial Audit of the Department of Taxation's Contracts

Report No. 10-11

Recommendations	Affected Agency's Response
1. The Department of Taxation should:	
a. Develop and implement an effective IT strategic plan to guide the department's efforts to sustain and extend department-wide strategies and goals and ensure the plan addresses the four key elements of process, organization, technology, and people;	In 2011, the department developed a strategic plan focused on increasing voluntary compliance, modernizing processes, and fostering quality driven productivity. An important component of the plan is effective management and modernization of the department's IT processes and technology. The department instituted a transition plan for managing existing IT operations and stated the process of assessing long-term needs. In general, the plan encompasses: a baseline assessment of prior IT operations, a basic overview of how the IT processes have been improved, short-term priorities, and intitial work that is being done to assess long-term needs. The department also formed a Modernization Task Force to assess department needs. Suggestions and feedback were sought throughout the department and from the community. Based on the infomation, it is clear the department must modernize its IT infrastructure. This effort is being coordinated with the Office of Information Management and Technology (OIMIT) and the Department of Accounting and General Services (DAGS). In collaboration with OIMT, DAGS, and other stakeholders, the department looks forward to developing an IT strategic plan and business requirements for modernizing its aging infrastructure.
b. Discontinue any further enhancements to the IT system unless required by law until the department's needs and priorities are addressed through IT strategic planning;	In 2011, the department restricted system enhancements to those required by law. Critical system fixes are performed as needed, and are implemented based on available resources and priorities.

Recommendations	Affected Agency's Response
c. Ensure the transition upon the completion of the 2009 modification is completed and results in a sustainable and ongoing support and maintenance of its IT systems; and	The 2009 contract with CGI expired on June 30, 2011. Since that time, the department has successfully supported and maintained its IT systems. Due to the dedication and hard work of the Information Technology Services Office (ITSO), the department experienced little or no detrimental impact upon operations. However, current ITSO staff cannot continue to sustain this workload level; filling the additional positions provided by the 2010 Legislature remains a high priority in order to sustain service levels and address other responsibilities that had been delayed due to lack of adequate staffing. The department has been working to fill these positions, which includes a full-time project manager under ITSO.
d. Better manage its future IT systems by establishing an adequate project and contract management methodology and ensuring project management is competent to hold vendors accountable.	Numerous groups assist on IT projects within the department, with ITSO assuming the lead role and managing the IT infrastructure and performing programming work. The System Administration Office (SysAd) develops requirements, performs testing and interfaces with the operational units. The Tax Law Change (TLC) group develops requirements and performs testing for annual tax law changes. Due to their interrelated IT responsibilities, close coordination is critical. Prior to 2011, SysAd and TLC were overseen by operational divisions with limited technology expertise. As a result of changes instituted in 2011, they are now overseen (along with ITSO) by the director's office. This new arrangement facilitates coordinated IT action and provides management oversight to fairly balance overall department needs with operational unit priorities. ITSO is in the process of hiring a full-time project manager who will spearhead projects and coordinate outside vendors. The aforementioned groups have formalized the process of (1) requesting fixes and enhancements, (2) evaluating, prioritizing and scheduling work, and (3) assigning resources. The enhanced coordination has led to streamlined

Recommendations	Affected Agency's Response
	decisionmaking, greater accountability, and significant improvements in how IT resources are utilized. The improvements have also led to a more collaborative, team-oriented work environment for addressing IT challenges.
2. With regard to the department's management conflicts, the department should:	
a. Tackle the root cause of problems impeding the department's performance. A cultural transformation will be the key to the department's success. The existing culture of hierarchical management approaches will need to yield to one of partnerships among managers; process-oriented ways of doing business will need to yield to results-oriented ones, and organization "silos" will need to become integrated.; and	At the time of the audit, the department had no strategic plan to direct the department's performance. In March 2011, a four-year strategic plan covering values, vision, mission, and goals was developed and communicated to all employees. The prior culture of two competing divisions is now being transformed into participative management by involving all four levels of management: group manager, branch chief, division administrator, and director/deputy director. In carrying out the strategic plan's three broad goals, each unit takes part in the process of developing objectives and performance measures to support the department's goals. By being a part of the process, each unit becomes committed to achieving success for the group, the branch, the division and the department as a whole.
b. Improve its performance by altering the way department leaders and managers treat each other and manage their people, as well as building committment and accountability through involvement and trust. Effective changes can only be made and sustained through the cooperation of management and staff throughout the department.	As part of the strategic plan, employees were invited to submit their suggestions for what should be the "values" shared by all department employees in their dealings with each other, whether with managers or with staff members. These "values" have been communicated to all employees and will be posted to an intranet that is now being developed to facilitate communication throughout the department. The top three values cited were respect, teamwork, and communication. The lack of these values indicates a prior management that may have disregarded or did not seek input from the units that were impacted by a managerial decision. Under our strategic plan, we noted there are

Recommendations	Affected Agency's Response
	many areas for improvement and we recognize that implementation will require a change in organizational culture. In our department organization, we have identified 65 program management units. These units have been included in the process of developing improvements, we have shown appreciation for their involvement and we will continue to provide positive reinforcement during implementation. To monitor progress toward the objectives in our strategic plan, we will form committees consisting of members from a cross section of the department, cutting across division lines. Each committee member will have an opportunity to be heard and to present the unit's implementation of initiatives that support the department as a whole.

Office of the Auditor Appropriations and Expenditures on a Budgetary Basis for the Fiscal Year Ended June 30, 2011

Appropriations

Act 1, SLH 2010 (operations)	2,408,013
Act 1, SLH 2010 (special studies)	150,000
Act 1, SLH 2010 (Audit Revolving Fund)	2,550,828
	$5,108,841

Expenditures

Staff salaries	1,893,049
Contractual services (operational)	132,993
Other expenses	173,593
Special studies	-
Contractual services (audit revolving fund)	2,550,828
	$4,750,463

Excess of Appropriation Over Expenditures

Act 1, SLH 2010 (operations)	208,378
Act 1, SLH 2010 (special studies)	150,000
Act 1, SLH 2010 (Audit Revolving Fund)	
	$358,378

The Office of the Auditor

Hawai'i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

To carry out its mission, the office conducts the following types of examinations:

1. **Financial audits** attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. **Management audits**, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. **Sunset evaluations** evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. **Sunrise analyses** are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. **Health insurance analyses** examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. **Analyses of proposed special, trust, and revolving funds** determine if proposals to establish these funds meet legislative criteria.

7. **Analyses of existing trust and revolving funds determine if such funds** meet legislative and financial criteria.

8. **Procurement reports** include studies and audits relating to the State's procurement of goods, services, and construction.

9. **Special studies** respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

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