

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Money and Securities in the State Treasury Audit
June 30, 2013

DEAN H. SEKI
Comptroller
State of Hawai'i

STATE OF HAWAI‘I
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

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SECTION I

INTERNAL AUDITOR'S REPORT

NEIL ABERCROMBIE
GOVERNOR



Dean H. Seki
Comptroller

Maria E. Zielinski
Deputy Comptroller

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

P.O. BOX 119, HONOLULU, HAWAII 96810-0119

March 7, 2014

The Honorable Neil Abercrombie
Governor of Hawai'i
State Capitol
Honolulu, Hawai'i 96813

Dear Governor Abercrombie:

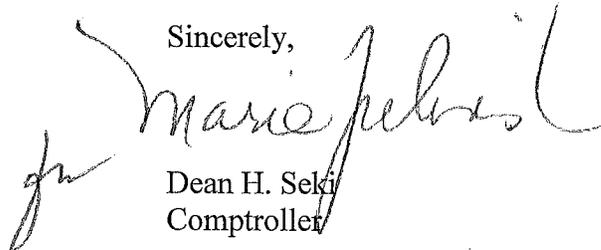
The Department of Accounting and General Services (DAGS) audited the money and securities in the State Treasury as of June 30, 2013, in accordance with the provisions of Sections 40-7 and 40-8 of the Hawai'i Revised Statutes.

The statutes provide that the Comptroller shall count the money and securities in the State Treasury once in each fiscal year and prepare statements for filing with the Governor and the Director of Finance showing: (1) the amount of money actually in the treasury reconciled with the amount of money as shown by the Comptroller's record; (2) the amount of securities owned by the State in the treasury reconciled with the amount of securities as shown by the Comptroller's records; and (3) the amount of the depository securities actually in the treasury as compared with the amount of cash deposited in the respective banks (depositories) provided that the sufficiency of these deposits shall not be made a part of the examination.

DAGS conducted this audit in accordance with generally accepted governmental auditing standards. These standards require that DAGS plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. DAGS believes the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

DAGS appreciates the courtesies extended to us by Administrator, Mr. Scott Kami, and the staff of the Financial Administration Division, Department of Budget and Finance. If you have any questions on the report, please call me at 586-0400.

Sincerely,



Dean H. Seki
Comptroller

OBJECTIVES

The Department of Accounting and General Services, Audit Division, conducted an audit of the money and securities in the treasury of the State of Hawai‘i, Department of Budget and Finance, Financial Administration Division, as of June 30, 2013, in accordance with the provisions of Sections 40-7 and 40-8 of the Hawai‘i Revised Statutes (HRS). The audit objectives were:

1. To count the money and securities in the State Treasury as of June 30, 2013.
2. To prepare statements showing:
 - a. The amount of money actually in the treasury reconciled with the amount of money as shown by the Comptroller’s records;
 - b. The amount of securities owned by the State in the treasury reconciled with the amount of securities as shown by the Comptroller’s records; and
 - c. The amount of the depository securities actually in the treasury as compared with the amount of cash deposited in the respective banks (depositories) provided that the sufficiency of these deposits shall not be made a part of the examination.

BACKGROUND

The Department of Budget and Finance (the Department) is part of the executive branch of the State of Hawai‘i. The Legislature established the Department through the Hawai‘i State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawai‘i, 1959). Section 26-8, HRS, describes the Department’s responsibilities, which include preparing and executing the executive budget of the state government. The Department is also responsible for conducting systematic and continuous reviews of the finances, organization, and methods of state departments, to assist each department in achieving the most effective expenditure of public funds, and to ensure that such expenditures are in accordance with budget laws. Additionally, the Department is the custodian of state funds, responsible for their safekeeping, management, investment, and disbursement. The Department is also responsible for administering the State’s debt.

The Department of Budget and Finance is headed by the Director of Finance. The Office of the Director of Finance plans, organizes, directs, and coordinates the various activities of the Department within the scope of laws, rules, and established policies. The Department has two divisions, which are responsible for administering financial and budgetary services to the State’s departments and agencies. The two divisions are the Financial Administration Division and the Budget, Program Planning and Management Division. The scope of our examination covered part of the responsibilities of the Financial Administration Division.

The Financial Administration Division (the Division) administers the State’s financial affairs by managing the State’s treasury, financial planning and research, and debt issues. The

2013 MONEY AND SECURITIES IN THE STATE TREASURY AUDIT REPORT

Division plans, directs, and coordinates development of the State's plans and strategies regarding cash management, investments, and bond financing. The Division is responsible for determining the State's investment policies and guidelines; accounting for all state treasury deposits and disbursements; planning, monitoring, and managing the issuance of state bonds; and administering the State's debt activities such as maintaining accounting records, paying bond and coupon holders, and assisting bond holders with lost, stolen, defaced, or destroyed bonds or coupons. The Division also administers the State's Unclaimed Property Program.

The Division works daily with local banks and brokers to invest available funds in the State's \$5.3 billion treasury (as of June 30, 2013), in liquid investments such as certificates of deposit, repurchase agreements and government agency securities.

Authorization of the Audit

Authority to conduct this audit resides in Sections 40-7 and 40-8, HRS, which state that the Comptroller shall report annually to the Governor the amount of money and securities in the State Treasury. This audit is part of the Audit Division's 2013-2014 Audit Plan. The Audit Division maintains its organizational independence in accordance with generally accepted governmental auditing standards.

SCOPE AND METHODOLOGY

The scope of the audit was: (1) to count the money and securities in the State Treasury as of June 30, 2013 and (2) to prepare financial statements as of June 30, 2013, in accordance with the provisions of Sections 40-7 and 40-8, HRS. The money and securities in the State Treasury are presented in the following statements prepared from the treasury's accounting records:

Statement of Cash Balances and Depository Securities
in the State Treasury

Statement of Reconciliation of Cash Balances in the
State Treasury with the Comptroller's Records

The audit was conducted in accordance with generally accepted governmental auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The term "audit" means a test of financial transactions for a specific period; the auditor is not expected to verify every transaction but may perform the audit based upon tests and samples as deemed necessary by the auditor.

The methodology was to gain an understanding of the cash and investments' year-end procedures and document the year-end procedures and internal controls related to the process. The Audit Division's staff familiarized themselves with the related State statutes, the Division's written cash and investment policies and procedures, interviewed appropriate

2013 MONEY AND SECURITIES IN THE STATE TREASURY AUDIT REPORT

personnel and documented their understanding of the established year-end accounting procedures and internal controls in place as of June 30, 2013 as a basis for designing audit procedures that were appropriate under the circumstances.

Scope Exclusions

Securities owned by the County of Kauai and other government agencies and the depository securities required for local depositories as protection for funds on deposit with them, held for safekeeping by the State Treasury, were not audited by us. While the securities were examined by us, the securities in safekeeping are not included in this report and the depository securities presented have not been audited for sufficiency as neither is required by Sections 40-7 and 40-8, HRS.

Results

Below are the results of our audit:

Objective No. 1: Count the money and securities in the State Treasury as of June 30, 2013.

Results: The money and securities in the state treasury were reconciled with the bank statements as of June 30, 2013.

- The cash deposited with local depositories in the treasury records is understated. Deposits totaling \$84 million were not recorded to the treasury records as of June 30, 2013. (See Finding 2013-01)
- The cash with a fiscal agent in the treasury records is understated. Transactions totaling \$238 thousand made by a fiscal agent have not been recorded in the treasury records. During the current fiscal year, the State's fiscal agent (bond paying agents) executed transactions on behalf of the State with advanced cash in their custody, but the Division did not record the transactions to fund the advance in the treasury's records. (See Finding 2013-02)
- The cash with the Unemployment Trust Fund in the treasury records is understated. The U.S. Treasury deposited \$1,077,750.39 into the State's U.S.A. – Unemployment Trust Fund in June, 2013 that was not recorded in the treasury records as of June 30, 2013. That deposit was offset by an unrecorded administrative fee of \$315,000.00. (See Finding 2013-03)

Conclusion: The cash balances in the treasury records were not adjusted for the above unrecorded transactions as of June 30, 2013. The findings are discussed in more detail in Section II of this report. The statements prepared for this report have been adjusted to account for the above unrecorded transactions.

2013 MONEY AND SECURITIES IN THE STATE TREASURY AUDIT REPORT

Objective No. 2: Prepare statements as of June 30, 2013 showing: (1) the amount of money actually in the treasury, reconciled with the amount of money as shown by the Comptroller's records; (2) the amount of securities owned by the State, in the treasury, reconciled with the amount of securities as shown by the Comptroller's records; and (3) the amount of the depository securities actually in the treasury as compared with the amount of cash deposited in the respective banks (depositories) provided that the sufficiency of these deposits shall not be made a part of the examination.

Results: The following statement was prepared.

- The Statement of Cash Balances and Depository Securities in the State Treasury was prepared to report the cash balances in the treasury records adjusted to include unrecorded deposits totaling \$84 million, unrecorded transactions of fiscal agents totaling \$238 thousand, and unrecorded transactions totaling \$762,750.39 of the Unemployment Trust Fund. Also included in the statement are the depository securities actually in the treasury, adjusted for unrecorded deposits and pay-downs totaling \$125.6 million, compared with the amount of cash deposited in the respective banks (depositories).

Conclusion:

- The cash balances in the State Treasury reported on the above statement are fairly stated. The par value of the depository securities in the treasury are fairly stated and exceed the amount of cash deposited in the respective banks by \$502 million.
- The Statement of Reconciliation of Cash Balances in the State Treasury with the Comptroller's Records was prepared to report the amount of money actually in the treasury reconciled with the amount of money as shown by the Comptroller's records. The reconciling items, including the adjustments noted above, have been identified and accounted for as proper reconciling items.
- The reconciling items are proper. Adjustments should be made to account for the unrecorded transactions mentioned above.

Management's Responsibilities for Internal Controls

In accordance with Section 40-2, HRS, "The departments and agencies of the executive branch are respectively charged with the responsibility to maintain an adequate system of internal control and with the further responsibility to see that the internal control system continues to function effectively as designed." The generally accepted criteria for evaluating an entity's internal control structure is described in the Committee of Sponsoring Organizations control framework. Our internal audit enhances and complements, but does not substitute for the Division's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in the Division's operating procedures, accounting practices, and compliance with State and Department policies.

SECTION II
DETAILED FINDINGS AND
RECOMMENDATIONS

DETAILED FINDINGS AND RECOMMENDATIONS

2013-01 – UNRECORDED DEPOSITS

Condition

The Division maintains a cash book for the Director of Finance which records all sums received and paid out of the State Treasury as required by Section 40-9, Hawai'i Revised Statutes. The cash book is used to reconcile the various bank account cash balances to the monthly bank statements.

A major difference between the cash book and the monthly bank statements is that numerous deposits made to banks during the month are not recorded to the cash book and the Financial Accounting Management and Information System (FAMIS) until the subsequent month. The ending cash balance in the cash book and FAMIS for the month the deposits are made is understated. This occurs each month during the fiscal year. Only at fiscal year-end does FAMIS record these deposits in the proper accounting period. The cash book does not make any year-end adjustments.

As a result, an audit adjustment of \$84 million was recorded to increase the cash balance of the cash book at June 30, 2013 for deposits made to State Treasury bank accounts during June, 2013 but not recorded to the cash book until July, 2013.

Cause

The State's accounting system requires departments and agencies to deposit cash received into the State's local bank accounts. The departments and agencies then prepare a multi-copy, unnumbered Treasury Deposit Receipt (TDR) with information to record the cash received to the cash book and FAMIS. The TDR and supporting documents are sent to the Division. The Division assigns a number to the TDR. The TDR is recorded to the cash book. A TDR copy is sent to DAGS for recording to FAMIS. There is a time lag up to 30 days between the date the deposit is made at the local banks and the date the TDR is recorded to the cash book by the Division. Prior to September 14, 1998 there was no time lag. State agencies deposited the checks with the TDR to the State Treasury. Subsequently, for efficiency, state agencies were allowed to make deposits directly to the local banks with the TDRs to be submitted to the Division at a later date, often weeks later.

Recommendation

We recommend that the Division and DAGS review the design of the accounting process used to record cash received to the cash book and FAMIS. To accomplish this, the current TDR process should be converted from manual to electronic procedures to ensure that deposits are recorded in the cash book and FAMIS in the same accounting month as the bank.

2013-02 – FISCAL AGENT’S UNRECORDED TRANSACTIONS

Condition

During the current fiscal year, the State’s fiscal agent (bond paying agent) executed transactions on behalf of the State but did not submit sufficient information to the Division for proper accounting and recording. These amounts appear as reconciling items on the fiscal agents’ bank reconciliation. As of June 30, 2013, the Division’s cash book is understated by \$238 thousand when compared to the cash balances per the fiscal agents’ statements.

Cause

The paying agent does not submit transactions in a timely manner.

Recommendation

We recommend that the Division strongly encourage the paying agent to submit transactions in a timely manner.

2013-03 – UNEMPLOYMENT TRUST FUND’S UNRECORDED TRANSACTIONS

Condition

The cash balance in the treasury records is understated. The U.S. Treasury deposited \$1,077,750.39 for quarterly interest into the State’s U.S.A. – Unemployment Trust Fund in June, 2013. That deposit was offset by an unrecorded administrative fee of \$315,000.00. The deposit and fee were recorded to the treasury records in July, 2013. Therefore, the treasury’s cash balance was understated by \$762,750.39 as of June 30, 2013.

Cause

The Department of Labor and Industrial Relations (DLIR), which administers the Unemployment Trust Fund for the State, did not prepare and submit timely the necessary journal vouchers to the Division to enable timely recording of the transactions.

Recommendation

We recommend that the Division strongly encourage DLIR to submit the necessary journal vouchers within the same accounting month as the receipt of the deposit.

STATUS OF PRIOR YEAR'S FINDINGS

2012-01 – UNRECORDED DEPOSITS

Condition

As of June 30, 2012, unrecorded deposits totaling \$162 million resulted from TDRs being prepared, processed and recorded within 30 to 60 days after the deposits had been made. As a result, deposits were made to the local banks but the Division did not record the cash into its cash book until it received the related TDR.

Status

The comment is still applicable. See current year's Finding No. 2013-01. This finding will not be carried forward.

2012-02 – FISCAL AGENTS' UNRECORDED TRANSACTIONS

Condition

As of June 30, 2012, the State's fiscal agents (bond paying agents) made payments during current and prior years totaling \$1.4 million and did not submit sufficient information for the State to properly account for and record these payments and adjustments.

Status

The comment is still applicable. See current year's Finding No. 2013-02. This finding will not be carried forward.

2012-03 – UNEMPLOYMENT TRUST FUND'S UNRECORDED TRANSACTIONS

Condition

The U.S. Treasury deposited \$285,021.28 for quarterly interest into the State's U.S.A. – Unemployment Trust Fund in June, 2012 but the deposit was recorded to the treasury records in July, 2012.

Status

The comment is still applicable. See current year's Finding No. 2013-03. This finding will not be carried forward.

2012-04 – UNRECORDED DEBIT MEMOS

Condition

As of June 30, 2012, we noted that 190 debit memos totaling \$693,159.49, which were more than 60 days old, were listed as reconciling items on 3 local bank reconciliations. These debit memos resulted from disputed items, the return of bad checks and errors in deposits.

Status

Resolved. No debit memos more than 60 days old were noted.

SECTION III
FINANCIAL STATEMENTS

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Cash Balances and Depository Securities in the State Treasury
June 30, 2013

	Time		Investments and Others	Total	Depository Securities at Par Value
	Certificates and CD Account Registry	Single Demand Deposit Accounts			
Cash deposited with local depositories:					
American Savings Bank, F. S. B.	\$ -	435,780	-	435,780	2,800,454
Bank of Hawaii'i	179,818,399	11,146,986	-	190,965,385	234,751,340
Bank of the Orient	-	100,093	-	100,093	-
Central Pacific Bank	495,000,000	255,101	-	495,255,101	554,875,445
First Hawaiian Bank	1,229,344,282	134,300,395	-	1,363,644,677	1,587,890,502
Hawai'i National Bank	78,003,000	158,741	-	78,161,741	86,954,213
Pacific Rim Bank	10,000,000	-	-	10,000,000	-
Territorial Savings Bank	95,000,000	265,080	-	95,265,080	138,840,061
	<u>2,087,165,681</u>	<u>146,662,176</u>	<u>-</u>	<u>2,233,827,857</u>	<u>2,606,112,015</u>
Cash with fiscal agents:					
U.S. Bank Trust N.A.	-	-	50,000	50,000	-
	<u>-</u>	<u>-</u>	<u>50,000</u>	<u>50,000</u>	<u>-</u>
Carried forward	<u>\$2,087,165,681</u>	<u>146,662,176</u>	<u>50,000</u>	<u>2,233,877,857</u>	<u>2,606,112,015</u>

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Cash Balances and Depository Securities in the State Treasury, Continued

	Time Certificates and CD Account	Single Demand Deposit Accounts	Investments and Others	Total	Depository Securities at Par Value
Brought forward	\$2,087,165,681	146,662,176	50,000	<u>2,233,877,857</u>	<u>2,606,112,015</u>
Cash with the Secretary of the Treasury, U.S.A. - Unemployment Trust Fund	-	-	193,257,094	<u>193,257,094</u>	-
Investments:					
U.S. Treasury bonds and notes	-	-	10,764	10,764	-
U.S. government securities	-	-	2,250,195,608	2,250,195,608	-
Repurchase agreements	-	-	<u>624,582,061</u>	<u>624,582,061</u>	<u>743,844,985</u>
	-	-	<u>2,874,788,433</u>	<u>2,874,788,433</u>	<u>743,844,985</u>
	<u>\$2,087,165,681</u>	<u>146,662,176</u>	<u>3,068,095,527</u>	<u>5,301,923,384</u>	<u>3,349,957,000</u>

The accompanying notes are an integral part of this financial statement.

STATE OF HAWAI‘I
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Cash Balances in the State Treasury
with the Comptroller's Records
June 30, 2013

	<u>Cash Deposited with Local Depositories</u>	<u>Cash with Fiscal Agents</u>	<u>Investments and Others</u>	<u>Total</u>
Amount in State Treasury as adjusted	\$2,233,827,857	50,000	3,068,045,527	5,301,923,384
Deposits in the State Treasury (as adjusted) not reported to Comp- troller for recordation as of June 30, 2013	(83,876,146)	-	-	(83,876,146)
Deposits in the U.S. Treasury (as adjusted) not reported to Comp- troller for recordation as of June 30, 2013	-	-	(762,750)	(762,750)
Deposits recorded by the Comptroller not recorded by the State Treasury as of June 30, 2013	<u>133,180,413</u>	<u>-</u>	<u>-</u>	<u>133,180,413</u>
Carried forward	<u>\$2,283,132,124</u>	<u>50,000</u>	<u>3,067,282,777</u>	<u>5,350,464,901</u>

STATE OF HAWAI‘I
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Cash Balances in the State Treasury
with the Comptroller’s Records, Continued

	<u>Cash Deposited with Local Depositories</u>	<u>Cash with Fiscal Agents</u>	<u>Investments and Others</u>	<u>Total</u>
Brought forward	\$2,283,132,124	50,000	3,067,282,777	5,350,464,901
Matured coupons, bonds redeemed and interest coupons paid by fiscal agents (as adjusted) and recorded by Comptroller but not by the State Treasury as of June 30, 2013	-	(237,788)	-	(237,788)
Disbursements and adjustments recorded by the State Treasury not recorded by the Comptroller as of June 30, 2013	1,672,336	-	-	1,672,336
Disbursements recorded by the State Treasury (as adjusted) not reported to the Comptroller for recording as of June 30, 2013	<u>78,582,842</u>	<u>-</u>	<u>-</u>	<u>78,582,842</u>
Carried forward	<u>\$2,363,387,302</u>	<u>(187,788)</u>	<u>3,067,282,777</u>	<u>5,430,482,291</u>

STATE OF HAWAI‘I
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Cash Balances in the State Treasury
with the Comptroller’s Records, Continued

	<u>Cash Deposited with Local Depositories</u>	<u>Cash with Fiscal Agents</u>	<u>Investments and Others</u>	<u>Total</u>
Brought forward	\$2,363,387,302	(187,788)	3,067,282,777	5,430,482,291
Disbursements and adjustments recorded by the Comptroller not recorded by the State Treasury as of June 30, 2013	(38,098,209)	-	-	(38,098,209)
Bank debits recorded by the State Treasury (as adjusted) not reported to the Comptroller for recording as of June 30, 2013	3,927,814	-	-	3,927,814
Other adjustments and reclassifications as of June 30, 2013	(54,644)	-	-	(54,644)
Amount per Comptroller’s Records	<u>\$2,329,162,263</u>	<u>(187,788)</u>	<u>3,067,282,777</u>	<u>5,396,257,252</u>

The accompanying notes are an integral part of this financial statement.

NOTES TO FINANCIAL STATEMENTS

(1) Financial Statements Presentation

The accompanying financial statements present the amount of money and securities, except for those securities held in safekeeping for the County of Kauai and other government agencies, in the State Treasury of the State of Hawai‘i, Department of Budget and Finance, Financial Administration Division (the Division), as of June 30, 2013, in accordance with the provisions of Sections 40-7 and 40-8, Hawai‘i Revised Statutes (HRS).

Securities deposited by local depositories as protection for funds on deposit with them as required by Section 38-3, HRS, to the credit of the Director of Finance, State of Hawai‘i, are valued at par value and the sufficiency of such deposits is not a part of the audit required by Section 40-7, HRS.

(2) Significant Accounting Policies

Cash - Cash includes cash deposited with local depositories, cash with fiscal agents, cash with the Secretary of the Treasury, U.S.A. - Unemployment Trust Fund and all time certificates of deposit.

Investments – Investments include repurchase agreements, U.S. Treasury bonds and notes, and U.S. government securities, and are carried at cost. Securities acquired by donation are carried at their fair market value at the date of acquisition.

Depository Securities – Section 38-3, HRS, states that for the protection of funds deposited under this chapter, securities shall be deposited with the Director of Finance, or with the State’s fiscal agents in the name of the State. Funds deposited under this chapter include cash deposited, time certificates of deposit, and repurchase agreements with local depositories. Funds on deposit with Bank of the Orient and Pacific Rim Bank were fully guaranteed by the Federal Deposit Insurance Corporation under various Federal programs so no depository securities were required to protect these funds. Cash with fiscal agents, brokers, and investments are funds deposited under Sections 39-13 and 36-21, HRS, and do not require collateral securities.

(3) Cash and Investments

The Director of Finance, through the Division, is responsible for the safekeeping of all monies paid into the State Treasury. The Division pools and invests any monies of the State, which in the Director of Finance’s judgment, are in excess of the amounts necessary for meeting the specific requirements of the State. Allocation of investment earnings is based on equity interest in the pooled monies. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally-insured savings and checking accounts, time

certificates of deposit, auction rate securities, and repurchase agreements with federally-insured financial institutions.

Cash – Information relating to the bank balance, insurance, and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions. Total cash deposited with local depositories is covered by federal deposit insurance or by collateral held either by the State Treasury or by the State’s fiscal agents in the name of the State. The cash deposited with the U.S. Department of the Treasury for the State’s Unemployment Trust Fund is not collateralized and the cash balances held by fiscal agents in the State’s name for the purpose of satisfying outstanding bond obligations is uninsured and not collateralized. These deposits were exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State’s deposits may not be returned to it.

For demand or checking accounts and time certificates of deposit, the Division requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. All securities pledged as collateral are held either by the State Treasury or by the State’s fiscal agents in the name of the State. The depository securities for the protection of funds deposited with the Bank of Hawai‘i and First Hawaiian Bank, to the credit of the Director of Finance, State of Hawai‘i, include certain securities deposited for the protection of repurchase agreements totaling \$255,283,335 and \$369,298,726, respectively. The State monitors the value of these securities and obtains additional collateral when appropriate.

No more than 60% of state funds may be deposited in any one depository under Section 38-2, HRS, unless the depository offers yields greater than those offered by other depositories in the State of Hawai‘i. In order to maximize the yield on state funds, the Division, on occasion, deposits more than 60% of the aggregate amount of moneys available for deposit in the State Treasury in one depository when that depository offers higher yields than other depositories in the State of Hawai‘i. The Attorney General, State of Hawai‘i, has stated that the higher interest rate offered by that depository need not be materially higher to qualify under Section 38-2, HRS.

Investments – The Division holds investments both for the State and as an agent for other parties. The Division’s investment of funds not required for immediate payments are predominantly comprised of U.S. government securities.

Interest Rate Risk – As a means of limiting its exposure to fair value losses arising from rising interest rates, the Division’s investment policy generally limits maturities on investments to not more than five years from the date of investment.

Credit Risk – The Division’s investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers’ acceptances, money market funds, and student loan resource securities maintaining a Triple-A rating.

Custodial Risk – For an investment, custodial risk is a risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Division’s investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms’ insurance policies.

Concentration of Credit Risk – The Division’s policy provides guidelines for portfolio diversification by placing limits on the amount the Division may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

SECTION IV

DIVISION'S RESPONSE

NEIL ABERCROMBIE
GOVERNOR



KALBERT K. YOUNG
DIRECTOR

LUIS P. SALAVERIA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
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EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER
PUBLIC UTILITIES COMMISSION

ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT

February 28, 2014

The Honorable Dean Seki, Comptroller
Department of Accounting and General Services
State of Hawaii
P.O. Box 119
Honolulu, Hawaii 96810

Dear Mr. Seki:

We appreciate the opportunity to comment on the Audit Division's report, *Money and Securities in the State Treasury Audit, Department of Budget and Finance Financial Administration Division (FAD)*, as of June 30, 2013, issued in accordance with the provisions of Sections 40-7 and 40-8, HRS.

We would like to take this opportunity to provide our division's responses to the Detailed Findings, Recommendations described in Section II of the report. There were no new findings in this year's audit, and since the department is now current in performing the bank reconciliations, one of the prior year findings regarding outstanding debit memos has been resolved and is no longer noted for this audit year.

The following outlines our plan to address the internal control findings noted in the report.

Issue 2013-01: Unrecorded Deposits

Background: This has been a recurring issue in the audit report. The Financial Administration Division maintains a "cash book" in accordance with Section 40-9, HRS. In order to do this, it keeps its own internal financial management system which records deposits of cash into the state treasury via Treasury Deposit Receipts (TDR State accounting form B-13). The FAD system cash accounts are reconciled with the State's general ledger accounts on a monthly basis by DAGS, Uniform Accounting and Reporting Branch (UARB). The division reconciles its cash accounts to the bank statements on a monthly basis. This process identifies deposits and other bank transactions that have not been recorded in the books, but these transactions are only posted

into the division cash accounts when the Treasury office is in receipt of the Treasury Deposit Receipt (TDR) form, which is prepared by the agency which made the actual deposit into the bank. We are of the understanding that an audit adjustment is recorded to the state's financial statements by UARB at the fiscal year-end for these deposits for which no TDR has been submitted to B&F as of June 30.

Audit Recommendation: The Division and DAGS should review the design of the accounting process to record cash received to the cash book and FAMIS. To accomplish this, the current TDR process should be converted from manual to electronic procedures to ensure deposits are recorded in the cash book and FAMIS in the same accounting month as the bank.

B&F Response: Of the \$84 million unrecorded deposits mentioned in the Condition section, \$76 million or 91% was recorded in the subsequent month. There will always be this timing difference due to the cutoff dates for the Division's cash book and FAMIS.

We agree with the audit report in that these deposits should be recorded on a timely basis. Director of Finance memo No. 13-03 instructs the department heads that "TDRs are required to be prepared as soon as possible, but within one week of receipt/deposit of funds into the state's bank account". This is based on HRS section 40-32 (Payments by Honolulu accountants) which requires "public accountants collecting or receiving revenue or other moneys ...shall pay weekly...into the Treasury...". However the continuing challenge has been how to enforce these timelines for the agencies to submit the TDR to B&F.

The TDR provides the accounting codes which enable recording of the deposit into the division accounting system and into FAMIS. Without the TDR, the revenue cannot be recorded into the proper account. Currently FAD staff sends a reminder email in the subsequent month, to department fiscal personnel with any outstanding deposits that are over 30 days old. With the bank reconciliation process now current, it is easier to identify the outstanding deposits in a timely manner. With this, and increased follow-up to the department staff, the number of outstanding deposits has shown continuing improvement.

DAGS is aware of this issue regarding the review and design of the accounting process to address differences in the cash book and FAMIS balance. In the past, FAD had discussed the possibility of having agencies record their deposits on-line into FAMIS, similar to the way most of them process payments. In 2011, DAGS spearheaded initiation of work with Hawaii Information Consortium (HIC) who had offered to develop and host an automated front-end "electronic TDR" system to provide appropriate files for uploading to FAMIS and FAD's systems at no cost for their state customers. State of Hawaii OIMT, DAGS, B&F, ICSD and HIC are involved in the ongoing project, called "eTDR", an online system in which agencies enter their deposits and TDR information. Although timeline to roll-out eTDR has not been solidified, this new system should significantly increase efficiencies compared to the current manual paper TDR routing process. Unrecorded deposits would hopefully be reduced if agencies can input their deposits on a timely basis into the automated system.

A fully-integrated enterprise resource planning-type system would be an ideal solution and appears to be on the horizon with OIMT's initiatives. However, it will require a significant amount of time, budgetary and human resources.

Issue 2013-02: Fiscal Agents' Unrecorded Transactions

Background: This has been a recurring issue in the audit report. The finding involves bond paying agent bank reconciliations including prior year unrecorded adjustments and unclaimed State of Hawaii matured bond payments returned. The major portion of these reconciling items, consists of payments received from a paying agent bank back in 1999. The paying agent bank did not provide sufficient information at that time to identify the bond series which the payment related to, so FAD staff was unable to determine how to properly record the payment. Subsequent efforts to obtain any information were unsuccessful, and to complicate matters, the paying agent was acquired by another bank and records were not available. The item appears to be an accumulation over the years of adjustments or payments by the paying agent banks for which sufficient information was not provided to determine the proper entries to the books. Attempts over the years to correct the entries, and staff turnover further complicated matters. The prior 2012 audit report mentions an overstatement of \$1.4 million in cash at paying agent banks, on the books. This was a total amount of all items listed as reconciling items as of June 30, 2012. The current 2013 audit mentions an understatement of \$238 thousand for cash held at one fiscal agent (U.S. Bank Trust).

Audit Recommendation: The Division should strongly encourage the paying agent to submit transactions in a timely manner.

B&F Response: Current division staff spent numerous hours going back through years of records to try to determine the trail of entries that have resulted in the current book balance being overstated. They also attempted numerous times to contact the paying agent bank for assistance to obtain more information. Based on prior audit recommendation, a process was determined to remove these old reconciling items via JV adjustment to decrease the difference between the book balance and bank. There had been significant improvement during the prior 2012 fiscal year as the balance of reconciling items has been reduced by \$13.4 million over the prior year. Of the \$1.4 million remaining as reconciling items at 6/30/12, 53% (or \$740,493.05) represented regular current debt service payments and timing differences in when information was received from the paying agents to enable recording of the item. The remaining unidentified differences at 6/30/12 of \$659,506.95 consisted of two fiscal agent accounts. During the current 2013 fiscal year, this unidentified difference was resolved with a JV processed to adjust to the correct balance at Deutsche Bank, and another JV to adjust to the correct balance at U.S. Bank which was recorded in FAMIS as of 6/30/13. Therefore this finding has been resolved and should not appear next year.

Several years ago, we established a review system for the monthly paying agent bank reconciliations. This enables B&F to immediately identify any current discrepancies and address the discrepancies in a timely manner. We will continue this review process to monitor the monthly reconciliations to ensure that no new unrecorded adjustments are added.

Issue 2013-03: Unemployment Trust Funds' Unrecorded Transactions

Background: This is a repeat issue in the audit report. At the end of each month, the Division prepares a TDR to record interest credited to the Department of Labor and Industrial Relations' (DLIR) Unemployment Trust Fund held at the US Treasury. DLIR retrieves and transmits the reports and information necessary for the Division to prepare the TDR. If this information is not received, the Division cannot prepare the TDR to record the interest correctly, nor can it prepare the reconciliation of the account. The audit finding states that cash balance in the US Treasury account was understated by \$762,750.39 at the end of June 2013, since the TDR for interest that DLIR received, was recorded in the subsequent month.

Audit Recommendation: DLIR should submit the necessary information and JVs within the same accounting month as the receipt of the deposit.

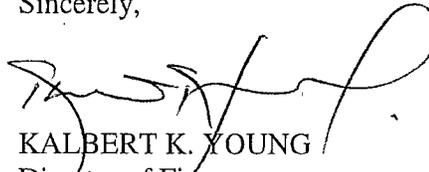
B&F Response: B&F received a response last audit year, from DLIR dated 2/14/13, on the same audit finding from the FYE 6/30/11 audit. We transmitted their response to DAGS via separate memo dated 3/25/13. Basically DLIR explains that they do not have the interest information available to them (online from the US Treasury) until the subsequent month, so it is not possible to give B&F the information for the TDR until then.

For the \$315,000 "unrecorded administrative fee" mentioned under Condition, according to DLIR this is actually a drawdown of cash from the Special Administration 2009 account for UI Modernization. It was not to record an administrative fee. Their JV to record the transaction in the US Treasury account was processed in FAMIS as of 6/30/13 and due to timing of report receipt at B&F, recorded in the Division's system in July.

DAGS UARB recorded the transactions in FAMIS in the correct fiscal year, so it will be reflected properly on the state's financial statements; however, Treasury records the transaction in the actual month the accounting document (TDR or JV) is received. For these reasons cited, we again request DAGS Audit consider removing this finding for next fiscal year.

Thank you for the opportunity to review and respond to your internal control findings and recommendations for the fiscal year ended June 30, 2013.

Sincerely,

A handwritten signature in black ink, appearing to read 'Kalbert K. Young', written in a cursive style.

KALBERT K. YOUNG
Director of Finance

A handwritten signature in black ink, appearing to read 'Scott Kami', written in a cursive style.

SCOTT KAMI, Administrator
Financial Administration Division