

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Money and Securities in the State Treasury Audit
June 30, 2015

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

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SECTION I

INTERNAL AUDITOR'S REPORT

DAVID Y. IGE
GOVERNOR



DOUGLAS MURDOCK
Comptroller

AUDREY HIDANO
Deputy Comptroller

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

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

November 9, 2015

The Honorable David Ige
Governor of Hawai'i
State Capitol
Honolulu, Hawai'i 96813

Dear Governor Ige:

The Department of Accounting and General Services (DAGS) audited the money and securities in the State Treasury as of June 30, 2015, 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,

A handwritten signature in black ink, appearing to read "Douglas Murdock".

DOUGLAS MURDOCK
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, 2015, 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, 2015.
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

2015 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 \$5.95 billion treasury (as of June 30, 2015), 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 2015-2016 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, 2015 and (2) to prepare financial statements as of June 30, 2015, 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 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

2015 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, 2015 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, 2015.

Results: The money and securities in the state treasury were reconciled with the bank statements as of June 30, 2015.

- The cash deposited with local depositories in the treasury records is understated. Deposits and adjustments totaling \$141.7 million were not recorded to the treasury records as of June 30, 2015. (See Finding 2015-01)
- The cash with the Unemployment Trust Fund in the treasury records is understated. The U.S. Treasury deposited \$2,500,551.66 into the State's U.S.A. – Unemployment Trust Fund in June, 2015 that was not recorded in the treasury records as of June 30, 2015. (See Finding 2015-02)

Conclusion: The cash balances in the treasury records were not adjusted for the above unrecorded transactions as of June 30, 2015. 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.

Objective No. 2: Prepare statements as of June 30, 2015 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.

2015 MONEY AND SECURITIES IN THE STATE TREASURY AUDIT REPORT

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 \$141.7 million and unrecorded interest totaling \$2.5 million in the Unemployment Trust Fund. Also included in the statement are the depository securities actually in the treasury, adjusted for unrecorded pay-downs totaling \$11.9 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 \$657 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.

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

2015-01 – 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 \$141.7 million was recorded to increase the cash balance of the cash book at June 30, 2015 for deposits and adjustments made to State Treasury bank accounts during June, 2015 but not recorded to the cash book until July, 2015.

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 of 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.

STATUS OF PRIOR YEAR'S FINDINGS

2014-01 – UNRECORDED DEPOSITS

Condition

As of June 30, 2014, unrecorded deposits totaling \$69 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. 2015-01. This finding will not be carried forward.

2014-02 – UNEMPLOYMENT TRUST FUND'S UNRECORDED TRANSACTION

Condition

The U.S. Treasury deposited \$2,131,325.01 for quarterly interest into the State's U.S.A. – Unemployment Trust Fund in June, 2014. The deposit was recorded to the treasury records in July, 2014.

Status

The comment is no longer applicable. Because the amount of interest earned for the quarter ended June 30 is not available until July 1, the Division is unable to record the interest as of June 30. Therefore, since recording the interest earned in a timely manner is not possible, this finding will no longer be cited.

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, 2015

	Time Certificates and CD Account Registry	Single Demand Deposit Accounts	Investments and Others	Total	Depository Securities at Par Value
Cash deposited with local depositories:					
American Savings Bank, F. S. B.	\$ -	685,342	-	685,342	747,695
Bank of Hawaii'i	111,770,411	1,233,831	-	113,004,242	245,646,483
Central Pacific Bank	481,978,597	996,301	-	482,974,898	539,203,475
First Hawaiian Bank	1,166,973,080	244,686,451	-	1,411,659,531	1,731,951,988
Hawai'i National Bank	88,044,899	158,773	-	88,203,672	101,558,849
Pacific Rim Bank	10,000,000	-	-	10,000,000	-
Territorial Savings Bank	<u>131,200,000</u>	<u>600,448</u>	-	<u>131,800,448</u>	<u>152,877,157</u>
	<u>1,989,966,987</u>	<u>248,361,146</u>	-	<u>2,238,328,133</u>	<u>2,771,985,647</u>
Cash with fiscal agent:					
U.S. Bank Trust N.A.	-	-	80,000	80,000	-
Carried forward	<u>\$1,989,966,987</u>	<u>248,361,146</u>	<u>80,000</u>	<u>2,238,408,133</u>	<u>2,771,985,647</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 Registry	Single Demand Deposit Accounts	Investments and Others	Total	Depository Securities at Par Value
Brought forward	<u>\$1,989,966,987</u>	<u>248,361,146</u>	<u>80,000</u>	<u>2,238,408,133</u>	<u>2,771,985,647</u>
Cash with broker: UBS Financial Services, Inc.	<u>-</u>	<u>-</u>	<u>2,792,361</u>	<u>2,792,361</u>	<u>-</u>
Cash with the Secretary of the Treasury, U.S.A. - Unemployment Trust Fund	<u>-</u>	<u>-</u>	<u>435,459,130</u>	<u>435,459,130</u>	<u>-</u>
Investments:					
U.S. Treasury bonds and notes	<u>-</u>	<u>-</u>	<u>538,236,735</u>	<u>538,236,735</u>	<u>-</u>
U.S. government securities	<u>-</u>	<u>-</u>	<u>2,464,956,046</u>	<u>2,464,956,046</u>	<u>-</u>
Repurchase agreements	<u>-</u>	<u>-</u>	<u>270,348,036</u>	<u>270,348,036</u>	<u>383,796,948</u>
	<u>-</u>	<u>-</u>	<u>3,273,540,817</u>	<u>3,273,540,817</u>	<u>383,796,948</u>
	<u>\$1,989,966,987</u>	<u>248,361,146</u>	<u>3,711,872,308</u>	<u>5,950,200,441</u>	<u>3,155,782,595</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, 2015

	<u>Cash Deposited with Local Depositories</u>	<u>Cash with Fiscal Agent</u>	<u>Investments and Others</u>	<u>Total</u>
Amount in State Treasury as adjusted	\$ 2,238,328,133	80,000	3,711,792,308	5,950,200,441
Deposits in the State Treasury (as adjusted) not reported to Comp- troller for recordation as of June 30, 2015	(141,790,571)	-	-	(141,790,571)
Deposits in the U.S. Treasury (as adjusted) not reported to Comp- troller for recordation as of June 30, 2015	-	-	(2,500,552)	(2,500,552)
Deposits recorded by the Comptroller not recorded by the State Treasury as of June 30, 2015	<u>132,801,947</u>	<u>-</u>	<u>-</u>	<u>132,801,947</u>
Carried forward	<u>\$ 2,229,339,509</u>	<u>80,000</u>	<u>3,709,291,756</u>	<u>5,938,711,265</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

	Cash Deposited with Local Depositories	Cash with Fiscal Agent	Investments and Others	Total
Brought forward	\$ 2,229,339,509	80,000	3,709,291,756	5,938,711,265
Disbursements and adjustments recorded by the State Treasury not recorded by the Comptroller as of June 30, 2015	1,227,665	-	-	1,227,665
Disbursements recorded by the State Treasury (as adjusted) not reported to the Comptroller for recording as of June 30, 2015	163,188,284	-	-	163,188,284
Disbursements and adjustments recorded by the Comptroller not recorded by the State Treasury as of June 30, 2015	(19,683,529)	-	-	(19,683,529)
Carried forward	\$ <u>2,374,071,929</u>	<u>80,000</u>	<u>3,709,291,756</u>	<u>6,083,443,685</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 Agent</u>	<u>Investments and Others</u>	<u>Total</u>
Brought forward	\$ 2,374,071,929	80,000	3,709,291,756	6,083,443,685
Bank debits recorded by the State Treasury (as adjusted) not reported to the Comptroller for recordation as of June 30, 2015	55,794,883	-	-	55,794,883
Other adjustments and reclassifications as of June 30, 2015	(4,322)	-	-	(4,322)
Amount per Comptroller’s Records	\$ <u>2,429,862,490</u>	<u>80,000</u>	<u>3,709,291,756</u>	<u>6,139,234,246</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, 2015, 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, cash with broker – UBS Financial Services, Inc, 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 donation.

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 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 for 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 and cash deposited with broker UBS Financial Services, Inc. are 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 American Savings Bank, 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 \$65,601,175, \$64,448,135, and \$140,298,726, 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.

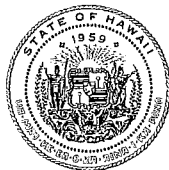
Custodial Risk – For an investment, custodial risk is a risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Division's investments are held at broker/dealer 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

DAVID Y. IGE
GOVERNOR



WESLEY K. MACHIDA
DIRECTOR

RODERICK K. BECKER
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

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

November 2, 2015

The Honorable Douglas G. Murdock, Comptroller
Department of Accounting and General Services
State of Hawaii
P.O. Box 119
Honolulu, Hawaii 96810

Dear Mr. Murdock:

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, 2015, 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 is one current year finding and no new findings in this year's audit report. As the department is now current in performing monthly bank reconciliations and successfully completed adjustments for long-outstanding fiscal agent unrecorded transactions, these two prior findings, which had been repeated for numerous years, have been resolved and are no longer noted.

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

Issue 2015-01: Unrecorded Deposits

Background: This has been a continually recurring finding 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 departmental accounting 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 central (FAMIS) general ledger accounts on a monthly basis by DAGS, Uniform Accounting and Reporting Branch (UARB). The division also 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 (and FAMIS) when the Treasury office receives the Treasury Deposit Receipt (TDR) form, prepared by the agency

which made the actual deposit into the bank. Since 1998 B&F policy has been for agencies to deposit directly into the bank and then submit the TDR with validated deposit slip (or other proof of deposit). However, because this remains a paper-based process, there is often a time lag between the date the deposit is made and the TDR is delivered to Treasury.

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, so that the state's cash balances on the financial statements are not understated.

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 \$141.7 million unrecorded deposits mentioned in the "Condition" section, at least \$134.1 million or almost 95% was recorded in the subsequent month. There will always be this timing difference for two primary reasons: 1) the state utilizes bank sub accounts which collect detail transactions and then "roll-up" to the main account each night; therefore, the amount can only be recorded the next business day; and 2) the cutoff dates for the Division's cash book (last business day of the fiscal year) and FAMIS (3-5 business days after fiscal year end) along with the fact that the deposit needs to be made prior to submitting the TDR and the manual process of transporting the paper forms to Treasury.

We agree with the audit report in that these deposits should be recorded on a timely basis. Director of Finance Memo No. 15-06 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 Treasury's 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

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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 were involved in the project, called "eTDR," an online system in which agencies enter their deposits and TDR information. Although the project was put on hold in mid-2014 and will most likely now not be implemented, an electronic/more automated system would significantly increase efficiencies compared to the current manual paper TDR routing process. Unrecorded deposits would hopefully be reduced if agencies could input their deposits on a timely basis into an electronic system.

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


Because this finding will be recurring due to the systemic nature of the underlying cause, and the response will remain unchanged, we again request DAGS Audit to consider removing the finding for next fiscal year, and instead include it in the "notes" section of the report.

Thank you for the opportunity to review and respond to your detailed findings and recommendations for the fiscal year ended June 30, 2015.

Sincerely,



WESLEY K. MACHIDA
Director of Finance



SCOTT KAMI, Administrator
Financial Administration Division