

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Verification of Money and Securities in the State Treasury
June 30, 2019

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

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SECTION I
COMPTROLLER'S REPORT

DAVID Y. IGE
GOVERNOR



CURT T. OTAGURO
COMPTROLLER

AUDREY HIDANO
DEPUTY COMPTROLLER

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES

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

October 21, 2019

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) has verified the money and securities in the Hawai'i State Treasury as of June 30, 2019, 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 verify 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 records (unaudited); (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 (unaudited); 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 planned and performed the verification to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. DAGS believes the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.

DAGS appreciates the courtesies extended to us by the Administrator, Mr. Roderick K. Becker, 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,


CURT T. OTAGURO
Comptroller

OBJECTIVES

The Department of Accounting and General Services, Audit Division, conducted a verification of the money and securities in the treasury of the State of Hawai'i, Department of Budget and Finance, Financial Administration Division (Division), as of June 30, 2019, in accordance with the provisions of Sections 40-7 and 40-8 of the Hawai'i Revised Statutes (HRS). The objectives were:

1. To verify the money and securities in the State Treasury as of June 30, 2019.
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 (unaudited);
 - 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 (unaudited); 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.

Authorization of the Verification

Authority to conduct this verification resides in Sections 40-7 and 40-8, HRS, which states that the Comptroller shall count the money and securities in the State Treasury once in each fiscal year and report annually to the Governor the amount of money and securities in the State Treasury. Our verification procedures included confirming amounts and terms with third parties, reconciling the Comptroller's records with the records at the Division, and analyzing the transactions to verify the money and securities in the State Treasury. This verification is part of the Audit Division's 2019-2020 Audit Plan.

SCOPE AND METHODOLOGY

The scope of the verification was: (1) to verify the money and securities in the State Treasury as of June 30, 2019, and (2) to prepare statements as of June 30, 2019, 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 Division's accounting records:

Statement of Cash Balances and Depository Securities
in the State Treasury

Statement of Reconciliation of Money and Securities in the
State Treasury with the Comptroller's Records (unaudited)

2019 VERIFICATION OF MONEY AND SECURITIES IN THE STATE TREASURY

We planned and performed the verification to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives.

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 personnel and documented their understanding of the established year-end accounting procedures and internal controls in place as of June 30, 2019, as a basis for designing procedures that were appropriate under the circumstances.

RESULTS

Below are the results of our examination:

Objective No. 1: Verify the money and securities in the State Treasury as of June 30, 2019.

Results: The money and securities balances were confirmed with the respective depositories and reconciled with the Division's balances as of June 30, 2019.

Conclusion: The money and securities in the State Treasury as of June 30, 2019 were verified as required by statute.

Objective No. 2: Prepare statements as of June 30, 2019 showing: (1) the amount of money actually in the treasury, reconciled with the amount of money as shown by the Comptroller's records (unaudited); (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 (unaudited); 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 statements were prepared.

- Statement of Cash Balances and Depository Securities in the State Treasury.
- Statement of Reconciliation of Money and Securities in the State Treasury with the Comptroller's Records (unaudited).

Conclusion:

- The cash balances and par value of depository securities in the State Treasury reported in the Statement of Cash Balances and Depository Securities in the State Treasury are fairly stated in accordance with the accounting policies of the Division.

2019 VERIFICATION OF MONEY AND SECURITIES IN THE STATE TREASURY

- The Statement of Reconciliation of Money and Securities in the State Treasury with the Comptroller's Records (unaudited) was prepared to report the amount of money in the treasury, reconciled with the amount of money as shown in the unaudited Comptroller's records. The reconciling items have been identified and recognized as proper reconciling items.

SECTION II
DETAILED FINDING AND
RECOMMENDATION

DETAILED FINDING AND RECOMMENDATION

2019-01 – BANK HAD INSUFFICIENT COLLATERAL SECURITIES

Condition

A bank did not provide sufficient collateral securities during the fiscal year ended June 30, 2019, as required by Section 38-3, HRS. For three months during the fiscal year ended June 30, 2019, the total month end bank balances and securities deposited with the bank exceeded the sum of the Federal Deposit Insurance Corporation (FDIC) of \$250,000 and the bank's pledged depository securities.

Cause

The Division was not informed by the bank that the letters of credit with the Federal Home Loan Bank totaling \$400,000,000 (\$200,000,000 each) matured on August 22, 2018 and September 30, 2018. These letters of credit were used as pledged depository securities. The bank did not provide replacement depository securities which resulted in collateral deficiencies for the months ended January 31, 2019, April 30, 2019, and June 30, 2019.

Recommendation

We recommend that the Division periodically monitor during the term of the letters of credit, the adequacy of the pledged collateral on its public deposits.

STATUS OF PRIOR YEAR'S FINDINGS

No findings were noted during the verification of money and securities in the State Treasury as of June 30, 2018, or the preparation of the required statements as of June 30, 2018, in accordance with the provisions of Sections 40-7 and 40-8, HRS.

SECTION III

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, 2019

	<u>Cash with Local Depositories</u>	<u>Securities</u>	<u>Others</u>	<u>Total</u>	<u>Depository Securities</u>
Balance in the State Treasury, June 30, 2019	\$ 533,033,373	\$6,839,487,011	\$571,719,581	\$ 7,944,239,965	\$2,417,393,245
Transactions subsequently processed by State departments and agencies	(115,083,444) ¹	-	6,706,315 ²	(108,377,129)	-
Balance in the State Treasury, as adjusted, June 30, 2019	<u>\$ 417,949,929</u>	<u>\$6,839,487,011</u>	<u>\$578,425,896</u>	<u>\$ 7,835,862,836</u>	<u>\$2,417,393,245</u>

Transactions subsequently processed by State departments and agencies are detailed below:

1. Net unrecorded transactions of local depositories of (\$115,083,444), were comprised of deposits totaling \$52,358,801, offset by disbursements and debit memos totaling \$161,812,580 and \$5,629,665, respectively, were recorded by local depositories as of June 30, 2019, but were recorded by the Financial Administration Division after June 30, 2019.
2. Net unrecorded transactions of "Others" of \$6,706,315, were comprised of deposits totaling \$8,575,645, offset by a disbursement of \$1,869,330, recorded by the Secretary of the Treasury, U.S.A. as of June 30, 2019, but recorded by the Financial Administration Division after June 30, 2019.

The accompanying significant accounting policies are an integral part of this statement.

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Money and Securities in the State Treasury
with the Comptroller's Records (Unaudited)
June 30, 2019

	Cash with Local Depositories	Securities	Others	Total
Amount in State Treasury, as adjusted	\$ 417,949,929	\$ 6,839,487,011	\$ 578,425,896	\$ 7,835,862,836
Deposits in the State Treasury (as adjusted) not reported to Comptroller for recordation as of June 30, 2019	(52,358,801)	-	(4,727,525)	(57,086,326)
Deposits in the U.S. Treasury (as adjusted) not reported to Comptroller for recordation as of June 30, 2019	-	-	(3,848,120)	(3,848,120)
Deposits recorded by the Comptroller not recorded by the State Treasury as of June 30, 2019	<u>109,171,807</u>	<u>-</u>	<u>-</u>	<u>109,171,807</u>
Carried forward	<u>\$ 474,762,935</u>	<u>\$ 6,839,487,011</u>	<u>\$ 569,850,251</u>	<u>\$ 7,884,100,197</u>

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Money and Securities in the State Treasury
with the Comptroller's Records (Unaudited), Continued

	<u>Cash with Local Depositories</u>	<u>Securities</u>	<u>Others</u>	<u>Total</u>
Brought forward	\$ 474,762,935	\$ 6,839,487,011	\$ 569,850,251	\$ 7,884,100,197
Disbursements and adjustments recorded by the State Treasury not recorded by the Comptroller as of June 30, 2019	1,365,343	-	-	1,365,343
Disbursements recorded by the State Treasury (as adjusted) not reported to the Comptroller for recording as of June 30, 2019	161,812,580	-	1,869,330	163,681,910
Disbursements and adjustments recorded by the Comptroller not recorded by the State Treasury as of June 30, 2019	(52,521,072)	-	-	(52,521,072)
Carried forward	<u>\$ 585,419,786</u>	<u>\$ 6,839,487,011</u>	<u>\$ 571,719,581</u>	<u>\$ 7,996,626,378</u>

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
FINANCIAL ADMINISTRATION DIVISION

Statement of Reconciliation of Money and Securities in the State Treasury
with the Comptroller's Records (Unaudited), Continued

Brought forward	\$ 585,419,786	\$ 6,839,487,011	\$ 571,719,581	\$ 7,996,626,378
Bank debits recorded by the State Treasury (as adjusted) not reported to the Comptroller for recordation as of June 30, 2019	5,629,666	-	-	5,629,666
Other adjustments and reclassifications as of June 30, 2019	(43,235)	-	-	(43,235)
Amount per Comptroller's Records - Unaudited	<u>\$ 591,006,217</u>	<u>\$ 6,839,487,011</u>	<u>\$ 571,719,581</u>	<u>\$ 8,002,212,809</u>

The accompanying significant accounting policies are an integral part of this statement.

2019 VERIFICATION OF MONEY AND SECURITIES IN THE STATE TREASURY

Significant Accounting Policies

The accompanying statements are presented on the cash basis of accounting. Under the cash basis of accounting, deposits and credits are recognized when received, disbursements and debits are recognized when paid or debited.

The accompanying 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, 2019, 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 verification required by Section 40-7, HRS.

Cash - Cash includes cash deposited with local depositories, cash with the Secretary of the Treasury, U.S.A. - Unemployment Trust Fund, cash with mainland depositories and all time certificates of deposit. Major differences that normally occur between the Division's records or cash book and the balances reflected in bank records and statements are due to the accounting policies of the Accounting Division of the Department of Accounting and General Services (DAGS) and the Division. Such differences are summarized as follows:

Deposits - Deposits made to local depositories during the month may not be recorded in the Division's cash book until the subsequent month in compliance with the accounting policies that require State departments and agencies to immediately deposit cash received directly into the State's local depositories. Departments and agencies then prepare a multi-copy, unnumbered Treasury Deposit Receipt (TDR) with the necessary information to record the cash received into the State's accounting system maintained by DAGS. The TDR, validated deposit slips and other supporting documents are then submitted to the Division for recording into the cash book maintained by the Division. Accordingly, there is a time lag between the date the deposit is made at the local depositories and the date the TDR is recorded in the Division's cash book. This time lag is a major contributing factor for the difference between the Division's cash book and the bank statements.

Disbursements – Disbursements that clear the local depositories at month-end may not be recorded in the Division's cash book until the subsequent month. Because the Division does not receive the information until the next business day, disbursements that clear the local depositories at month-end are recorded

2019 VERIFICATION OF MONEY AND SECURITIES IN THE STATE TREASURY

by the Division as disbursements the next business day of the subsequent month.

Debit Memos - Debit memos recorded by local depositories during the month are not recorded immediately to the Division's cash book. The process to properly record debit memos requires the Division to notify State departments and agencies to investigate and prepare adjustment vouchers for recording into the accounting systems maintained by DAGS and the Division's cash book.

Interest Income from the Secretary of the Treasury, U.S.A. - Fourth quarter interest income that is recorded by the Secretary of the Treasury, U.S.A. at fiscal year-end is recorded by the Division after June 30th. The State Department of Labor and Industrial Relations (DLIR) retrieves and transmits the reports and information necessary for the Division to prepare the TDR. However, the necessary interest reports and information from the Secretary of the Treasury, U.S.A. are not available to DLIR until the subsequent month.

Investments – Investments include U.S. Treasury bonds and notes, and U.S. government securities which 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 demand deposits and time certificates of deposit with local depositories. Cash with fiscal agents, brokers, and investments are funds deposited under Sections 39-13 and 36-21, HRS, and do not require collateral securities.

The following schedule shows the Division's unadjusted cash balances compared with the amount of depository securities in the respective banks as of June 30, 2019:

2019 VERIFICATION OF MONEY AND SECURITIES IN THE STATE TREASURY

	Cash with Local Depositories	Securities	Others	Total	Depository Securities at Par Value
Cash deposited with local depositories:					
American Savings Bank, F. S. B.	\$ 265,958	\$ 260,126,012	-	\$ 260,391,970	\$ 284,059,924
Bank of Hawaii	254,891	351,300,000	-	351,554,891	562,708,763
Central Pacific Bank	257,214	291,458,968	-	291,716,182	340,830,011
First Hawaiian Bank	531,849,548	624,639,900	-	1,156,489,448	1,009,132,233
Hawaii National Bank	246,640	221,336	-	467,976	12,674,296
Territorial Savings Bank	159,122	191,112,289	-	191,271,411	205,669,615
	<u>533,033,373</u>	<u>1,718,858,505</u>	-	<u>2,251,891,878</u>	<u>2,415,074,842</u>
Cash with mainland depository:					
Wells Fargo Bank	-	-	14,000	14,000	2,318,403
Cash with the Secretary of the Treasury, U.S.A. - Unemployment Trust Fund	-	-	571,705,581	571,705,581	-
Investments:					
U.S. Treasury notes: Bank of Hawaii	-	10,764	-	10,764	-
U.S. Government Securities:					
Bank of Hawaii	-	1,759,614	-	1,759,614	-
Merrill Lynch	-	1,974,434,966	-	1,974,434,966	-
UBS Financial Services, Inc.	-	3,144,423,162	-	3,144,423,162	-
	-	5,120,617,742	-	5,120,617,742	-
	-	5,120,628,506	-	5,120,628,506	-
	<u>\$533,033,373</u>	<u>\$6,839,487,011</u>	<u>\$571,719,581</u>	<u>\$7,944,239,965</u>	<u>\$2,417,393,245</u>

Collateral Requirements

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 and time certificates of deposit 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 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 are 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 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, and money market funds 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. Excess SIPC coverage is provided by the firms’ insurance policies. In addition, the Division requires the institutions to set aside in safekeeping certain types of securities to collateralize repurchase agreements. The Division monitors the market value of these securities and obtains additional collateral when appropriate.

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, type of investment instruments, and position limits per issue of an investment instrument.

SECTION IV

DIVISION'S RESPONSE

DAVID Y. IGE
GOVERNOR



NEAL H. MIYAHIRA
DIRECTOR

ROBERT YU
DEPUTY DIRECTOR

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

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

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

October 14, 2019

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

Dear Mr. Otaguro:

We appreciate the opportunity to comment on the Audit Division's report, *Verification of Money and Securities in the State Treasury, Department of Budget and Finance Financial Administration Division (FAD)*, as of June 30, 2019, 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 response to the Detailed Finding and Recommendation described in Section II of the report. There is one new current year finding and no repeat findings in this year's audit report.

The following outlines how we have addressed the internal control finding noted in the report.

Issue 2019-01: Bank had insufficient collateral securities

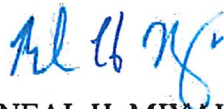
Background: A bank did not provide sufficient collateral securities during the fiscal year ended June 30, 2019, as required by Section 38-3, HRS. The Division was not informed by the bank that the letters of credit with the Federal Home Loan bank totaling \$400,000,000 (\$200,000,000 each) matured on August 22, 2018 and September 30, 2018. These letters of credit were used as pledged depository securities. The bank did not provide replacement depository securities which resulted in collateral deficiencies for the months ended January 31, 2019, April 2019, and June 30, 2019.

Audit Recommendation: The Division periodically monitor, during the term of the letters of credit, the adequacy of the pledged collateral on its public deposits.

Division's Response: Concur. FAD has implemented procedures to more effectively monitor the FHLB letters of credit (LOC) pledged as collateral for bank deposits. All active LOCs are now monitored daily and FAD will remind banks of upcoming expiration dates on LOCs. FAD has notified the bank and they have put procedures in place for their staff to monitor LOCs pledged. The division has also reminded the banks that the standard procedures for depositing and withdrawing collateral apply to LOCs as well. Finally, FAD requested depositing banks to include LOCs in their monthly collateral statement for FAD to reconcile to the state's collateral system records.

We appreciate the efforts of your staff and thank you for the opportunity to review and respond to the detailed finding and recommendation contained in the Verification of Money and Securities in the State Treasury report for the fiscal year ended June 30, 2019.

Sincerely,



NEAL H. MIYAHIRA
Director of Finance



RODERICK K. BECKER, Administrator
Financial Administration Division