

OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i

Audit of the Policies and Procedures Relating to the Honolulu City Council's Annual Contingency Allowance



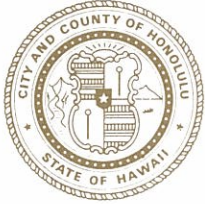
Audit of the Policies and Procedures Relating to the Honolulu City Council's Annual Contingency Allowance

A Report to the
Mayor
and the
City Council
of Honolulu

Submitted by

THE CITY AUDITOR
CITY AND COUNTY
OF HONOLULU
STATE OF HAWAII

Report No. 12-07
December 2012



OFFICE OF THE CITY AUDITOR
CITY AND COUNTY OF HONOLULU

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EDWIN S.W. YOUNG
CITY AUDITOR

December 28, 2012

The Honorable Ernest Y. Martin, Chair
and Members
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawai'i 96813

Dear Council Chair Martin:

This audit was conducted pursuant to City Council Resolution 10-73 which requested that the city auditor conduct a review and make recommendations to improve the policy and procedures relating to the Honolulu City Council's Annual Contingency Allowance (ACA). During the review, we (1) reviewed the Annual Contingency Allowance policy and procedures; (2) assessed clarifications to the categories of expenses and the ACA reimbursement process; and (3) made recommendations to improve ACA policies and procedures. The audit was performed in accordance with generally accepted governmental auditing standards between May 2011 and December 2012, including interruptions for higher priority work in December 2011.

Background: The Honolulu City Council is comprised of nine elected members, who are provided an Annual Contingency Allowance to cover expenses incurred in the course of carrying out their duties. The expenses must be related to official City business. Guidance on the use and administration of the ACA funds is incorporated in the City Council Administrative Manual. In FY2012, the ACA was \$16,032 for each councilmember.

Expenses must conform with Ethics Commission guidelines on the use of public funds and must be related to the councilmember's roles and responsibilities. In response to the Ethics Commission's 2010 recommendations, the Annual Contingency Allowance (ACA) policy was revised in May 2011 and incorporated into the Council Administrative Manual.

Audit Results: In our sampling of ACA reimbursements, we found most claims complied with the revised ACA policy. The potential violations we found indicated additional changes are needed to prevent reimbursements for invalid and unauthorized expenses. The potential violations may have occurred because the revised ACA policy and reimbursement process does not include best practices such as management reviews; clear guidance on what is permitted and reasonable; and a designated entity authorized to verify and deny all unauthorized claims. The result is that improper reimbursements may occur and past violations may recur. Our recommendations address the need for these best practices.

The Honorable Ernest Y. Martin, Chair
December 28, 2012
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After our fieldwork, the City Council implemented a purchasing card program and procedures for ACA expenditures for using a city issued credit card. Our follow-up sample indicated the original audit results and recommendations were still valid. We recommend that the purchasing card procedures should be expanded to all claims and formally incorporated into the Council Administrative Manual.

We wish to express our appreciation for the cooperation and assistance provided to us by your office, Council Administrative Services, the Office of Council Services, the City Clerk, the Department of Budget and Fiscal Services, the Honolulu Ethics Commission, and the many others who assisted us during this audit.

We are attaching the final report of our *Audit of the Policies and Procedures Relating to the Honolulu City Council's Annual Contingency Allowance*. We are also available to meet with you and your staff to discuss the review's results, provide more information, and to answer any questions. If you have any questions regarding the audit report, please call the auditor-in-charge, Susan Hall at 768-3132, or me at 768-3130.

Sincerely,



Edwin S. W. Young
City Auditor

c: Peter Carlisle, Mayor
Douglas Chin, Managing Director
Charmaine Doran, Director, Office of Council Services
Bernice Mau, City Clerk
Susan Hall, Deputy City Auditor

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Chapter 1

Introduction

The Honolulu City Council is comprised of nine elected members, one from each of the nine districts on O’ahu. Each councilmember is provided an annual contingency allowance (ACA) to cover expenses incurred in the course of carrying out their duties. The expenses must be related to official city business. Guidance on the use and administration of the ACA funds is incorporated in the City Council Administrative Manual. Resolution 10-73 requested that the Office of the City Auditor review and make recommendations to improve the policies and procedures relating to the use and expenditure of the city council’s annual contingency allowance.

Background

The city council is responsible for setting city-wide policies by enacting ordinances and adopting resolutions related to city programs and services. The council’s major duties and functions include establishing city policies and exercising oversight powers over city programs and services.

ACA funds are approved and appropriated through the city’s annual legislative budget process. Each fiscal year, the council chair notifies councilmembers by memorandum the amount of ACA funds available for each district. The table below shows the ACA amounts for the last seven fiscal years.

Exhibit 1.1
City Council Annual Contingency Allowance Per Councilmember, FY 2006 to FY 2012

<i>Fiscal Year</i>	<i>Annual Contingency Allowance</i>
FY 2006	\$9,920
FY 2007	\$12,000
FY 2008	\$18,011
FY 2009	\$18,111
FY 2010	\$16,000
FY 2011	\$14,000
FY 2012	\$16,032

Source: Honolulu City Council

Councilmembers may use personal funds for official city purposes and seek reimbursement from their ACA funds. The City Council Administrative Manual defines official purposes as, “...reasonable and necessary for City business, and related to the conduct of official duties and activities of a Member.”

Expenses must conform with Honolulu Ethics Commission guidelines on the use of public funds and must be related to the councilmember’s roles and responsibilities. Examples of appropriate ACA expenditures include cellular and wireless plans, subscriptions, honorary certificates, lei, office equipment, and furniture. Other appropriate expenditures include postage, copying and printing, vehicle allowance, meals, conference fees, and travel costs. Additional authorized expenditures include community and public meeting expenses, room and equipment rental fees, light refreshments, security, and miscellaneous office expenses.

The City Council Administrative Manual establishes limitations and prohibited uses of ACA funds. For example, ACA funds cannot be used for “*personal, private, political or other non-City business purposes*”. Other prohibitions include alcoholic beverages; personal mobile/cellular plans for staff; personal or non-city portions of travel; and trips cancelled for personal reasons.

Council’s Annual Contingency Allowance Reimbursement Process

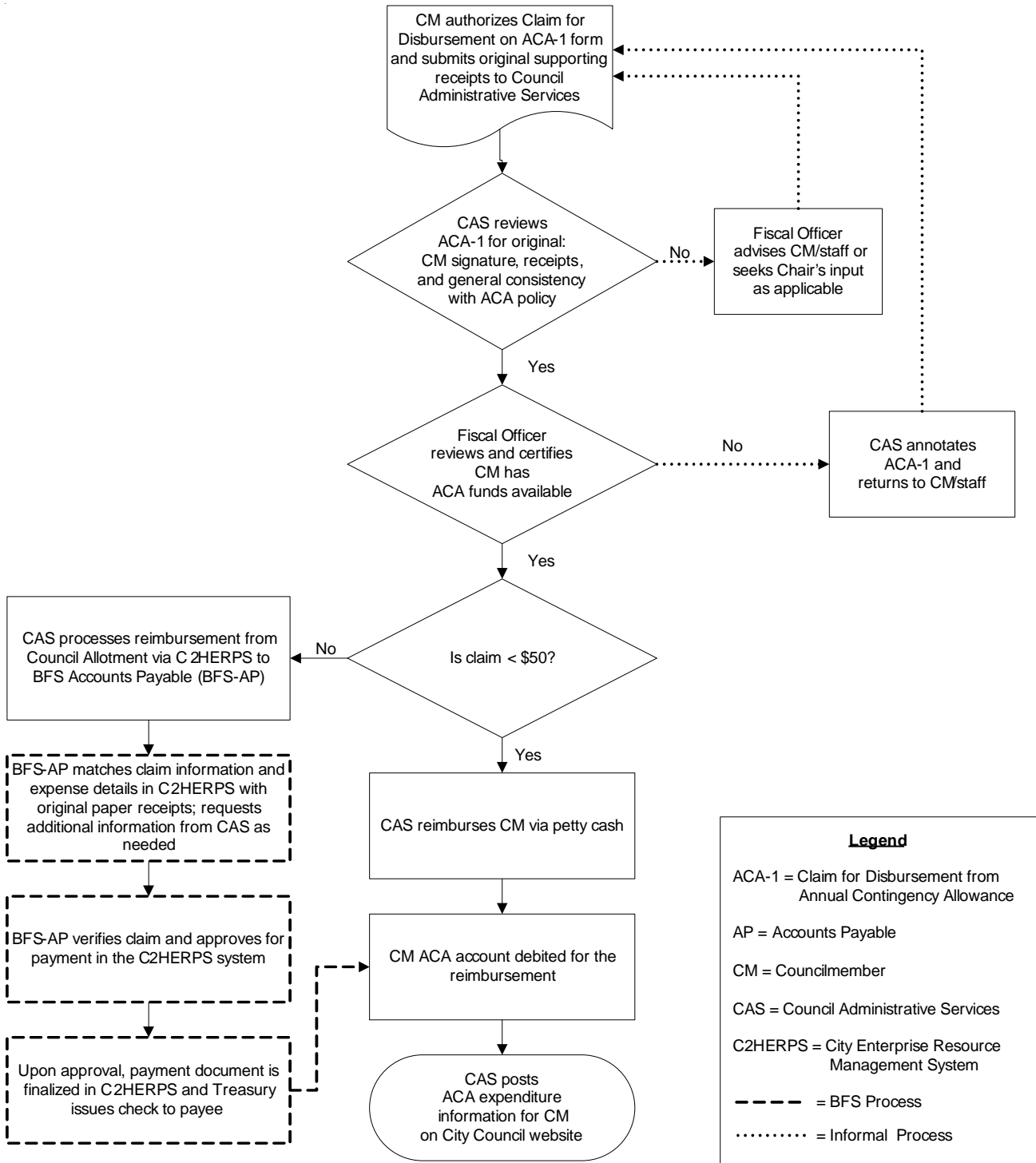
The processing of ACA claims involves city councilmembers, the Council Administrative Services (CAS), and the Department of Budget and Fiscal Services’ (BFS) Accounts Payable Section. Exhibit 1.2 provides details on the ACA claim reimbursement process.

- **Councilmember:** Under the ACA policy, each councilmember is responsible for authorizing payments from their allowance. Councilmembers and their staff may pay for eligible expenses and then request reimbursement by completing ACA claim forms and submitting original receipts.
- **Council Administrative Services:** The CAS is responsible for processing claims, accounting for, reporting, and posting online ACA transactions for each city councilmember. CAS processes petty cash reimbursements for amounts less than \$50.00; enters ACA claim information into the city’s accounts payable system; and forwards supporting receipts to the BFS Accounts

Payable Section. CAS deducts applicable usage and recurring charges as authorized from the members' allowance. These include vehicle allowance, printing and copying, cellular and wireless plans, and subscriptions.

- ***BFS Accounts Payable Section:*** BFS reviews and processes ACA claims for \$50.00 or more that are approved for payment through the city's accounts payable system. BFS follows the Finance Director's Accounts Payable policy.

**Exhibit 1.2
Overview of the Annual Contingency Allowance (ACA) Reimbursement Process**



Sources: Council Administrative Services, Department of Budget and Fiscal Services (BFS)

Audit Objectives, Scope and Methodology

The audit was conducted pursuant to Resolution 10-73, *Requesting the Office of the City Auditor to Conduct a Review of and Make Recommendations to Improve the Policy and Procedures Relating to the Honolulu City Council's Annual Contingency Allowance*. The audit sub-objectives were to (1) review the annual contingency allowance policy and procedures; (2) assess clarifications to the categories of expenses and the ACA reimbursement process; and (3) make recommendations to improve ACA policies and procedures.

We reviewed the Honolulu City Council Annual Contingency Allowance Policy (May 2011) and related ACA policies and procedures in the City Council Administrative Manual; and Rules of the Council. We compared the current policies and procedures with former policies (2005 and 2007).

We reviewed pertinent sections of the Revised Charter of Honolulu, the Revised Ordinances of Honolulu, and pertinent sections of the Hawai'i State Constitution and the Hawai'i Revised Statutes (HRS). In addition, we obtained information from the state Office of Information Practices related to the state's Sunshine Law (Chapter 92, HRS).

We reviewed the Honolulu Ethics Commission's *Guidelines on the Use of City Resources* and related guidance. We reviewed the Honolulu Ethics Commission's Advisory Opinion 2010-2 and related documents, including the *Stipulation Regarding Alleged Violations of Standards of Conduct*, the promissory note, and the *Restitution Request Form and Victim Impact Statement*. We obtained a former councilmember's online ACA expense reports, information on the investigation conditions and documentation related to the former councilmember's misuse of ACA funds, and obtained the ethics commission's assessment of the May 2011 ACA policy.

We conducted Internet searches to identify best practices from accounting, auditing, ethics and fraud prevention professional organizations. We searched the Internet for practices, policies and procedures adopted by the neighbor island counties and other local government jurisdictions that were related to council discretionary expense accounts.

We conducted several interviews on current practices, policies, procedures and forms related to council expense accounts. The interviewees included the current and previous council chairs, Council Administrative Services staffs, and the deputy managing

director. We interviewed the Director of the Department of Budget and Fiscal Services, BFS Accounts Payable Section staffs, and the Legal Counsel to the Honolulu Ethics Commission. We interviewed Hawai'i and Maui County council administrative staffs responsible for council expense accounts.¹ We also obtained background information on city policies and procedures for the mayor's contingency funds.

We developed an understanding of various ACA expenditure and reimbursement processes, procedures and forms. As part of our audit work, we reviewed the online posting of ACA expenditures and selected samples of the different types of ACA expenses and reimbursement methods for each of the nine council districts for the period May 2011 through September 2011. We selected and examined a follow-up sample for the period March 2012 through June 2012 after the city council established a purchasing card program for ACA expenditures.

We examined the sampled expenditures for compliance with the ACA policy. We reviewed ACA claim forms and supporting documentation on file at the Council Administrative Services and BFS Accounts Payable Section. The review examined the claims forms and documents as submitted and authorized, and was not an extensive review of individual claims.

This performance audit was conducted in accordance with generally accepted government auditing standards. These 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. We obtained evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our review started in May 2011 and was suspended in December 2011 due to higher priority projects. The Honolulu City Council Chair was briefed on the interim audit results in August 2011. The restarted project was performed from April 2012 to October 2012.

¹ The Kauai County Council Administration was unavailable for any interviews. The audit excluded the Mayor's contingency fund.

Audit Results

The annual contingency allowance policy was revised in May 2011 and incorporates some elements consistent with best practices and the ethics commission's 2010 recommendations. In our sampling of ACA reimbursements, we found potential violations of ACA policies and reimbursements for potentially unauthorized expenses. In our opinion, these occurred because the revised ACA policy and reimbursement process do not include critical best practices, such as management reviews, adequate clarifications of what is permitted and reasonable, and a designated entity with the authority to verify and deny unauthorized claims. As a result, improper reimbursements may occur and past violations may recur.

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Chapter 2

Although the Revised City Council Procedures Have Improved ACA Reimbursement Processes, More Needs to Be Done

In response to the Honolulu Ethics Commission recommendations, the annual contingency allowance (ACA) policy was revised in May 2011 and incorporated into the Council Administrative Manual. Our review and testing of ACA reimbursements indicated most claims complied with the revised ACA policy. The violations we found indicated additional changes are needed to prevent reimbursements for invalid and unauthorized expenses. The potential violations may have occurred because the revised ACA policy and reimbursement process do not include critical best practices such as management reviews; clear guidance on what is permitted and reasonable; an entity with the responsibility to audit claims for compliance with the ACA and city ethics policies, and a designated entity authorized to verify and deny unauthorized claims. The result is that past violations by a former councilmember could be repeated.

Background

Prior to May 2011, ACA policy stated the discretionary allowance was available for “expenditures incurred when carrying out official duties or activities; enhancing accessibility to, and communications with, the community and constituents; and carrying out the public’s expectations of a councilmember’s role and responsibility to the community and constituents.”²

Since May 2011, the revised ACA policy states that “each member is provided an Annual Contingency Allowance that may be used to cover expenses incurred in the course of official city business in carrying out the duties of the office.”

² The Honolulu City Council Chair has established the same level of ACA funding for each councilmember since July 1, 2004.

In Advisory Opinion 2010-2, the Honolulu Ethics Commission reviewed the ACA reimbursements to a former councilmember and reported that the councilmember violated the standards of conduct. The advisory opinion stated the councilmember paid less for meals than the amount charged to the city; the justification for the meals were false; the meals were not directly related to the councilmember's duties; or were for personal business associates or family members.

The ethics commission recommended that the council review the ACA policy and amend the language to reduce the likelihood of similar problems recurring. The ethics commission specifically recommended that the ACA policy (1) narrow and better define the categories of expenses permitted; (2) adopt a process to examine the reimbursement requests to ensure a valid government purpose and an auditable justification exists; and (3) include a process by which a reimbursement may be denied.

The city council subsequently passed Resolution 10-73 requesting the city auditor to review and make recommendations to improve the policy and procedures relating to the use and expenditure of the council's annual contingency allowance.

The Revised ACA Policies and Reimbursement Process Are Incomplete and May Not Prevent Future Violations

The Council Administrative Manual (CAM) and ACA policies were revised in May 2011. The revised policies incorporated some of the recommendations made by the ethics commission. The changes clarified the categories of expenses permitted, authorized, and prohibited. The changes required original, unaltered, itemized receipts; required additional information; and required justification for meal reimbursements. The policy clarified Council Administrative Services' (CAS) responsibilities for handling the financial accounting; processing the transactions; and using fiscal policies, procurement regulations and other guidelines in making ACA disbursements. Online reporting was delineated and councilmembers and staff are responsible for monitoring the online postings.

The revisions, however, did not include some important best practices for ensuring reimbursement claims were valid. As a result, the ethics commission recommendations were not fully implemented. In our opinion, a process for denying reimbursements and other best practices are needed to prevent violations from occurring.

Best Practices

Our review of best practices related to expense account reimbursements indicated the following:

Tone from the Top: Top management must set the ethical tone from the top for the organization and accept responsibility for ensuring expense account reimbursements are valid. The goals can be attained by establishing pertinent policies; identifying applicable laws; requiring reports that facilitate monitoring of reimbursement claims; and following up on potential and actual violations of the policies.

Administrative, Oversight and Enforcement Responsibilities: Executive management should authorize a specific entity to have overall responsibility for administering the program. The designated entity should be required to comply with expense account and ethics policies, and be authorized to review, audit, and process reimbursement claims, including the authority to disallow unauthorized and prohibited expenses. It should also identify weaknesses and report problems so that top management can take prompt action to correct weaknesses and take actions to prevent the potential misuse of funds. When needed, top management should have the authority to enforce the policies. Individuals submitting the reimbursement claims should be required to provide supporting documents to support claims and be prohibited from interfering with the proper processing of expense reimbursements.

Training: Training for officials, staff, and employees is also important. The training should cover ethical behavior; responsibility for the proper use of public funds; preventing fraud, waste, abuse, and misuse; and unacceptable activities. Other training should cover applicable laws, policies, and procedures; roles and responsibilities; identify unacceptable documents; and the importance of submitting complete, accurate, and adequate forms and documents. Staff training should focus on how to perform compliance reviews; the process for auditing claims; identifying violations; and reporting expense account violations.

Certification: Individuals should be required to certify that the claim submitted is *true and correct*; and claims for reimbursement are submitted and processed in a timely manner. Individuals should be required to submit original, unaltered receipts; and provide substantiation for missing receipts. Best practices include personal responsibility for the use of public funds. A confidential

hotline operated by a third-party professional should augment the process.

Absence of Best Practices Result in Larger Losses: The “2012 Report to the Nation on Occupational Fraud and Abuse” issued by the Association of Certified Fraud Examiners reports organizations that lacked the best practices had fraud losses that were approximately 45 percent larger than organizations with the recommended best practices.

Sample Results Indicate Potentially Invalid Claims Are Reimbursed

Our sample of ACA expenses and reimbursements showed that most claims complied with the ACA policy requirements. Exceptions, however, were found in meal reimbursements, missing forms, and a beverage reimbursement. Implementing best practices adopted by other entities could strengthen the current ACA policy and reduce the potential for misuse of ACA funds.

We reviewed a sample of 48 ACA³ charges and reimbursements valued at \$17,154. The sample included reimbursement claims and expenses from each of the nine councilmembers and the nine council districts, and included different categories of ACA claims and different methods of reimbursement and charges. Travel expenses comprised the largest reimbursement claims. The sample results are shown below.

- 30 claims complied with ACA policy and had no exceptions,
- 14 claims had incomplete information (6 claims had incomplete justification for the meals, guest or organization names, and/or itemized receipts. 8 claims had incomplete justification or missing forms that explained how the expenditures advanced city purposes),
- 3 claims used obsolete forms, and
- 1 claim reimbursement included a prohibited expense (alcoholic beverage).

³ Subsequent to our field work, the city council initiated a *purchasing card* pilot program which allowed councilmembers to use the city's credit card for ACA expenditures. The program procedures were finalized and the pilot program was implemented in November 2011. A follow-up sample of 19 ACA reimbursements from March 2012 through June 2012 showed similar results.

The discrepancies indicated meal expenses could be abused and the city council could be exposed to unneeded criticisms.

Claims for Meal Expenses: The current ACA policy advises that food and beverage purchases must be *reasonable*, but does not define reasonable. There is no limitation placed on the amount of personal meals or the number of people who may be offered a meal at a dining establishment. Meal claims included meals and refreshments related to community volunteer activities; meals at local restaurants; and meals at conferences. Meals at restaurants lacked justification, diners' or organization names, and/or itemized receipts. While the ACA policy requires information useful in justifying reimbursements, it does not assign authority and responsibility to ensure compliance with the ACA and city policies. As a result, the CAS is unable to deny any reimbursement claims for meals and could not function as a check and balance on excessive or potentially questionable expenses.

Alcoholic Beverage: The staffs of CAS and the BFS Accounts Payable Section reported they verify claim reimbursement documentation and certify that funds were available to pay the reimbursement claim. Council Administrative Services reported they consider the BFS Accounts Payable review as an additional check for compliance with the city's policy. However, BFS Accounts Payable staff reported they accept the ACA claims from Council Administrative Services as "Approved" and did not audit or question expenses. The BFS Accounts Payable staff reported that they confirm mathematical calculations and request missing original receipts, but they do not question any reimbursement claims. As a result, a reimbursement claim for an alcoholic beverage was paid although it was prohibited by both the city's Purchase of Food and Beverage policy and the ACA policy.

Setting meal limits could reduce the potential for questionable or excessive meal expenses

We compared the council's ACA and city meal policies with other entities in the State of Hawai'i and elsewhere. Although a standard model for meal expenses does not exist, in our opinion, setting meal limits could reduce the potential for questionable or excessive meal expenses. That is, meal expense limits could reduce the potential for excessive meal reimbursements. For example,

- The Institute for Local Government's model policy for expense and use of public resources recommends that localities set per meal caps on breakfast, lunch and dinner

costs; or align reimbursements with established per diem rates such as the federal General Services Administration.

- The City Council of Toronto, Canada set a total annual reimbursement of \$500 for business meals. The Toronto City Council also placed additional requirements for meal reimbursements, including the full name of all participants, date and purpose of the meeting, and the original, itemized receipt to document diners for the meal expense claimed.

Exhibit 2.1 compares the policy differences among the State of Hawai'i and other entities we researched.

**Exhibit 2.1
Comparison of Expense Account Policies for Personal Meals and Refreshments**

<i>Entity</i>	<i>Personal Meals</i>	<i>Food & Beverage</i>	<i>Alcoholic Beverage</i>	<i>Notes</i>
City Council ACA Policy (May 2011)	Allowed Moderate amount of food and beverage can be purchased. Light refreshments for community and public meetings.	Allowed	Prohibited	ACA shall not be used for any personal, private, political or other non-City business purposes. Meals charged to ACA must document the names of the people present (or the organization name) and with justification. No dollar limit or per diem.
City Finance Policy, 11.2 Purchase of Food and Beverage	Allowed Moderate amount of food/beverages allowed for official city functions.	Allowed	Prohibited	Prohibits expenditure of city funds for food/beverage for predominately social, political, or entertainment purposes.
Hawai'i County Council	Public funds not allowed for purchase of meals for others. Any exception requires recipient names and receipt.	Allowed	Prohibited	Public funds not allowed for purchase of bottled water and/or water service for staff unless water service is not available.
Maui County Council	No meals for employees. Principle: taxpayer should not be paying for a personal expense.	Allowed Exceptions	Not Prohibited Exceptions Allowed	Refreshments for staff meetings or office consumption considered a personal expense of the county officers or employees. The Council Chair is authorized to disallow meal expenses deemed unreasonable.
Hawai'i Legislature-House of Representatives	Allowed	Allowed	Not Prohibited	Food and beverage allowed as incidental expense. No dollar limit stated.
Hawai'i Legislature-Senate	Allowed	Allowed	Not Prohibited	Food and beverage allowed as incidental expense. No dollar limit stated.
City Council of Toronto, Canada	Maximum annual business meal allowance (per diem not claimed) = \$500.	Allowed	Meals or receptions – allowed. Business meals - not allowed.	Dollar limit of \$500 for business meals. Justification required. Eligible business meal expenses listed. Food and beverage, excluding alcohol, allowed for business meal, constituents, business contacts, government representatives, international delegations, and visitors.
University of California - Davis	Allowed for official university business.	Allowed	Prohibited for general fund and state appropriation activities. Alcohol allowed.	Maximum per person meal expenditures: breakfast (\$26); lunch (\$38); dinner (\$64); light refreshments (\$17).

Sources: Honolulu City Council Annual Contingency Allowance Policies (May 2011); Department of Budget and Fiscal Services Policies and Procedures Manual; Hawai'i County Council; Maui County Council; Hawai'i Legislature-House of Representatives; Hawai'i Legislature-Senate; City Council of Toronto, Canada; and University of California-Davis

Potential Criticism: Setting meal reimbursement limits could reduce the potential for criticism by the ethics commission and others. Although the ACA policy prohibits the use of ACA funds for “any personal benefit”, the Honolulu Ethics Commission considers a taxpayer subsidized meal as not necessary to handle constituent matters. It contends that there are a number of less costly, more traditional ways to meet with constituents — such as at the office, in the constituent’s home or business, or other public places. The ethics commission contends a councilmember could pay for a meal, without reimbursement by the city, if a meal is needed. Rather than a full meal, the meal could be for coffee and pie, for example, or some other “light refreshment” as allowed in the ACA policy. Anything more than light refreshments could result in abuse. For instance, a meal paid at taxpayers’ expense through the ACA fund could be used to influence and generate goodwill from the voter, business associate, or community group.

Critical Best Practices Need to Be Incorporated into the CAM

The ethics commission noted that the city charter requires a city officer to demonstrate that the expense was reasonable and necessary. A former councilmember interpreted the policy that “almost any meal could be charged to the ACA as long as it touched on a topic of potential relevance to the city.” To prevent a recurrence of this situation, the Council Administrative Manual (CAM) and ACA policies were revised. However, some of the changes recommended by the ethics commission and considered best practices for expense reimbursements were not implemented.

These best practices included authorizing the CAS or another entity to review, audit, question, and deny unauthorized reimbursement requests. During our review of the CAM’s ACA policies and the current ACA claim reimbursement process, we found management reviews are not performed and the authority to deny unauthorized or prohibited claims does not exist. The need to adequately define reasonable meal expenses was discussed earlier.

Our search of best practices for safeguarding organizations from fraud and abuse are listed in Exhibit 2.2. In the exhibit, we also indicate if the revised CAM incorporates the best practice. The exhibit shows that 4 of the 15 best practices are partially incorporated in the CAM and 11 of the 15 best practices are not addressed in the CAM.

Exhibit 2.2

Overview of Best Practices for Safeguarding an Organization from Expense Account Fraud and Abuse

	Best Practice	Council Administrative Manual: ACA Policies, May 2011
1	Top management* establishes, communicates, supports, and enforces an ethical <i>Tone from the Top</i> .	The Council Administrative Manual (CAM) <u>partially</u> implements this practice in the ACA policy guidance, and the Standards of Conduct.
2	Top management has responsibility to oversee the use of expense account funds. The governing body also monitors, assesses and takes action to reduce identified risks.	The CAM does <u>not</u> implement this practice. The ACA policy does not establish top management's responsibilities for oversight, monitoring and addressing risks.
3	Top management establishes a policy regarding spending violations; and follows up on potential and actual violations. Officials and staff are personally financially responsible for unauthorized or prohibited expense account reimbursements.	The CAM does <u>not</u> implement this practice. The CAM and ACA policy do not establish the authority of the top management to restrict, suspend or cancel expense account privileges in response to potential or actual violations. Council members or their staff are not required to repay public funds reimbursed in excess of the annual allowance and are not required to repay reimbursements for unauthorized or prohibited expenses.
4	Laws and policies that apply to the expense account process are identified.	The CAM does <u>not</u> implement this practice. The absence of clear guidance on the specific policies and legal requirements hinders the processing and review of ACA claims.
5	Regular reports on expense account activities are prepared and submitted to top management for oversight and monitoring purposes.	The CAM does <u>not</u> implement this practice. Council Administrative Services posts ACA claims information online. However, the ACA policy does not require CAS to prepare regular reports for top management on expense account activities, such as compliance with ACA and ethics policies, for oversight and monitoring purposes.
6	Top management is responsible for investigating incidents, taking corrective actions when needed.	The CAM <u>partially</u> implements this practice. The CAM's Standards of Conduct chapter includes ethics commission guidelines and city charter citations, but responsibilities for investigating and taking corrective actions are not identified.
7	Top management takes prompt action to correct weaknesses when initially detected and to prevent potential misuse of funds.	The CAM does <u>not</u> implement this practice. The ACA policy does not authorize or require prompt action when control weaknesses, problems, or potential misuse of funds are detected.
8	Top management designates a specific entity to review, audit, and process reimbursement claims. The entity has authority and responsibility to disallow unauthorized and prohibited expenses that do not comply with the expense account policy.	The CAM does <u>not</u> implement this practice. The CAM's ACA policy does not designate a specific entity to review, audit, or disallow claims that do not comply with ACA policy. Council Administrative Services has detected potential non-compliance, violations, or misuse of funds, but has not disallowed prohibited expenses because the current and previous ACA policies did not authorize or require these actions.
9	The governing body establishes a prohibition for officials and their staffs from interfering with the entity responsible for the proper processing of expense reimbursements. Top management is responsible for upholding the policy.	The CAM does <u>not</u> implement this practice. Concerns exist regarding the potential for undue influence over the office presently administering claim reimbursements. The CAM's Standards of Conduct establishes that members and staff represent the office and are expected to conduct themselves in a professional manner and shall not attempt to take personal advantage of their position. It advises that "All Council staff" remain cognizant of the individual and unique role of each agency and strive to develop respectful and productive working relationships with office personnel. The ACA policy does not establish CAS' fiscal officer, city clerk or council chair's ultimate authority for the administration of the ACA program. The policy also does not establish that council members and staff must not use their position or authority to impose undue influence on CAS staffs' responsibilities for ACA processing contrary to ACA and ethics policies.

Exhibit 2.2 (continued)

	Best Practice	Council Administrative Manual: ACA Policies, May 2011
10	Officials, staff and employees receive training on ethical behavior; personal financial responsibility for the proper use of public funds; preventing fraud, waste, abuse, or misuse of funds; and unacceptable activities. Officials and staff receive training on the proper use of expense account funds; applicable laws, policies, and procedures; and roles and responsibilities.	The CAM does <u>not</u> implement this practice. The CAM instructs council members and staff to take an ethics course within six months of their commencement dates of city employment and refresher training every two years. Training on the revised CAM and ACA policy was informally discussed, but not implemented reportedly due to questions about the Sunshine Law, Chapter 92 HRS. Training on topics such as ethics, the revised CAM, and the ACA Policy are allowed and are not subject to the Sunshine Law when the nature of the discussion pertains to office procedures or ministerial matters. According to the state Office of Information Practices, discussions cannot include matters currently pending or that are likely to come before the council.
11	Officials and staff are required to submit complete and accurate forms; provide supporting documentation for the claim; and are required to certify that the claim submitted is <i>true and correct</i> .	The CAM <u>partially</u> implements these practices. ACA claims are authorized by a council member's <u>original</u> signature. The ACA claim form includes the statement that <u>the expense is true and correct</u> . The Claim for Travel Reimbursement statement should also include the statement, <u>the expense is true and correct</u> . ACA claims are processed and paid, even though information and/or documents are incomplete or missing.
12	The governing body designates a specific entity the authority and responsibility to administer claims in accordance with the expense account policy. The entity processing the reimbursement claims receives adequate training to perform compliance reviews; audit claims; identify violations; and report expense account violations. The governing body establishes an appeal process or supplemental approval process for disputed claims.	The CAM does <u>not</u> implement this practice. The ACA policy does not establish Council Administrative Services' authority and responsibility to verify, audit, and process ACA reimbursement claims in compliance with the ACA and city ethics policies. Neither CAS nor the BFS Accounts Payable section deduct prohibited expenses from a claim reimbursement. The ACA policy does not authorize CAS to disallow questionable expenses; to request additional documents if needed; or require council members or staffs to provide additional documents, if requested by CAS. There is no appeal or supplemental approver process since there is no authority or process to deny claims. CAS and BFS Accounts Payable only certify that funds are available to pay the claim.
13	Claims for reimbursement are submitted and processed in a timely manner.	The CAM does <u>not</u> implement this practice. Although the Council Administrative Services processes and posts ACA claims online in a timely manner, the ACA policy does not establish time limits or require claims to be submitted in a timely manner.
14	All expenses are subject to verification for compliance with the expense account and applicable policies. Original, unaltered receipts are required. Unacceptable documents are identified. A procedure and authorization for missing receipts exists.	The CAM <u>partially</u> implements this practice. The ACA policy requires unaltered, original receipts that display the business name, date, amount, and itemized purchases. All receipts must be itemized and show what was purchased. The policy states adding machine tapes are not acceptable. The ACA policy does not provide procedures for handling claims with missing receipts.
15	A confidential, 24 hour, 7 day a week hotline operated by a third-party professional exists.	The CAM does <u>not</u> implement this practice. The ACA policy does not provide information on the city's confidential hotline or guidance on reporting the misuse of ACA funds.

* Top management refers to the Council Chair.

Sources: Honolulu City Council Administrative Manual and Annual Contingency Allowance Policies (May 2011), Association of Certified Fraud Examiners, Institute for Internal Auditors, KPMG International, Office of the New York State Comptroller, Institute for Local Government, City Council of Toronto, Canada, Columbia University, and University of California - Davis

Need for Oversight and Enforcement Entity: Consistent with best practices, the ethics commission specifically recommended that the ACA policy adopt a process to examine the reimbursement requests and to ensure a valid government purpose and auditable justification existed. The ethics commission advisory opinion recommended a process by which a reimbursement may be denied. These recommendations were not included in the CAM and ACA policy revisions. As a result, the CAS reports instances when claims were questionable, but it could not deny the claims. As an alternative, CAS sought additional information regarding the ACA claims.

For example, if there were altered receipts, or a claim appeared questionable, or a claim involved expenses that could be related to political campaign purposes, CAS reported it could not deny the claim. Rather, the CAS staff followed up informally with a councilmember's staff or asked the council chair for clarification. CAS staff stated the ACA policy does not authorize the CAS to verify claims, and the policy does not require councilmembers or their staffs to provide additional supporting documents if needed. Therefore, CAS could not enforce the ACA and city ethics policies. CAS was also apprehensive about reviewing and auditing the elected officials' ACA expenses.

Subsequent to our field work, the city council implemented its pilot program that allows councilmembers to use the city's credit card program to pay for ACA expenditures. The city council's new *Purchasing Card Program and Procedures (November 2011)* authorizes CAS staff to review pCard transactions and to reject purchases that do not meet council rules and administrative policies, city procurement rules, ethics guidelines, or purchasing card program and procedures. This authorization will need to be incorporated into the city council's administrative manual and its ACA policy to ensure the CAS staff will have the authority to review all ACA claims, reject unauthorized claims, and prevent the possibility of recurring or future violations.

Training: Mandatory training in the revised CAM, ACA, and pCard policies for officials and staffs is also a critical best practice. Training provides both a foundation for understanding the intent of council policies and provides practical information on procedures to be followed. While the ACA policy advises members to seek further consultation and advice from the council chair's office when clarification is needed, the policy provides inadequate assurance that the policy will be consistently and properly interpreted.

No formal training on the revised CAM and ACA policies, and its forms was given to councilmembers and their staff due to concerns that a training session would be subject to the state Sunshine Law requirements (Chapter 92, HRS). In our opinion, formal training could have helped a former councilmember from violating ethics standards regarding meals and other expenditures.

According to the Office of Information Practices (OIP), not all council meetings are automatically subject to the Sunshine Law. Providing a training session to all city councilmembers and staffs regarding the annual contingency allowance and applicable laws, rules, policies, procedures and instructions on completing forms is not necessarily going to trigger the Sunshine Law requirements. OIP can provide further clarification as needed.

According to OIP, training can be accomplished by avoiding discussions on matters currently pending or likely to come before the council for decision making. We believe the ACA training provided to officials and staffs could be combined with the council's ethics training.

Exhibit 2.3 lists the best practices we found for defining roles and responsibilities related to expense account reimbursements.

Exhibit 2.3 Best Practices For Expense Account Reimbursement



Sources: Office of the New York State Comptroller; City Council of Toronto, Canada; and Columbia University

Chapter 3

Conclusion and Recommendations

The annual contingency allowance policy provides each councilmember discretionary funds intended to cover official city business expenses in carrying out the duties of the office. Council's ACA policy provides examples of a wide variety of allowable expenses to facilitate community meetings, honor community members' accomplishments, facilitate professional education and communicate with constituents. As public funds, these expenses must conform with ethics commission guidelines, and cannot be used for personal, private, political or other non-city business purposes.

In response to the ethics commission's 2010 advisory opinion related to a former councilmember's misuse of ACA funds, the city council revised its administrative manual and expanded its ACA policies. It also adopted Resolution 10-73 requesting the city auditor to review and make recommendations to improve the ACA policy and procedures to minimize the opportunities for future violations of the city's standards of conduct and improve and maintain public confidence in the integrity of government.

During our review, we found that the annual contingency allowance policy revised in May 2011 incorporates some elements consistent with best practices and the ethics commission's recommendations. The changes clarified the categories of expenses permitted, authorized, and prohibited. The changes required original, unaltered, itemized receipts; required additional information; and required justification for meal reimbursements. The policy clarified Council Administrative Services' responsibilities for handling the financial accounting; processing the transactions; and using fiscal policies, procurement regulations and other guidelines in making ACA disbursements. However, the revisions did not include important best practices and ethics commission recommendations.

Our evaluation of a sample of ACA reimbursements from all councilmembers from each of the nine council districts found that most complied with the ACA policy requirements. However, we found potential violations of ACA policies and reimbursements for potentially unauthorized expenses. In our opinion, these occurred because the revised ACA policy and reimbursement process do not include critical best practices for ensuring reimbursement claims are valid.

These best practices included authorizing the CAS or another entity to review, audit, question, and deny unauthorized reimbursement requests. In addition, we found that management reviews are not performed. As a result, improper reimbursements may occur and past violations may recur.

Subsequent to our field work, the city council implemented its pilot program that allowed councilmembers to use the city's credit card program to pay for large ACA expenditures. The council's new *Purchasing Card Program and Procedures (November 2011)* authorizes CAS staff to review pCard transactions and to reject purchases that do not meet City Council Rules and Administrative Policies, city procurement policies, ethics guidelines, or purchasing card program and procedures. This authorization to reject purchases will need to be incorporated into the city council's administrative manual and its ACA policy to ensure the CAS staff will have the authority to review all ACA claims, reject unauthorized and prohibited claims, and prevent the possibility of recurring or future violations.

Recommendations

To minimize the possibility of future violations, we recommend the following:

1. Update the Honolulu City Council's Annual Contingency Allowance policies to authorize the council chair to oversee, monitor, and ensure that ACA claims comply with applicable ACA policies, city ethics, city finance policies, and procurement laws.
2. Update council's annual contingency allowance policies to authorize the council chair to delegate the authority and responsibility for administering the ACA program; processing, verifying and auditing claims; denying claims for improper reimbursements, and formalize a supplemental approval process for disputed claims.
3. Clarify the council's annual contingency allowance policies regarding reimbursements for personal meals or establish per meal or an annual dollar limit on personal meal reimbursements with ACA funds.
4. Incorporate best practices into the City Council Administrative Manual and annual contingency allowance policies.

5. Amend the City Council's Standards of Conduct to prohibit councilmembers and staffs from applying undue influence or taking retribution against any staff responsible for administering the annual contingency allowance program.
6. Provide administrative staff, city councilmembers and their staff initial and periodic training on annual contingency allowance policies and procedures, city ethics policies, fraud training, and the processing of ACA claims.
7. Update the Council Administrative Manual and annual contingency allowance policies to include the council's new Purchasing Card Program and Policy on the use of city purchasing cards (pCards) and for consistency in administering ACA expenditures.

Management Response

The Council Chair, on behalf of the Honolulu City Council, expressed some concerns but overall had positive comments and was responsive to the audit's recommendations. The Office of the City Auditor looks forward to working with the city council in implementing these recommendations. A copy of the Council Chair's full response can be found on page 24.

We made non-substantive changes to the draft report for purposes of accuracy, clarity and style.

We wish to express our appreciation for the cooperation and assistance provided to us by your office, Council Administrative Services, the Office of Council Services, the City Clerk, the Department of Budget and Fiscal Services, the Honolulu Ethics Commission, and the many others who assisted us during this audit.



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December 27, 2012

Mr. Edwin Young, Director
Office of the City Auditor
1001 Kamokila Blvd., Ste. 216
Honolulu, HI 96707

Dear Mr. Young:

Thank you for the opportunity to review the draft of the City Council's Annual Contingency Allowance (ACA) Audit. After reviewing your preliminary findings with the Office of Council Services (OCS) and Council Administrative Services (CAS), I have the following comments on your recommendations and their potential to minimize the possibility of future violations.

The Council Chair already has the responsibility to oversee, monitor and ensure that ACA claims comply with applicable ACA policies and procurement laws as the Council Chair is the top management position of the Council Administration. As such, the Chair can delegate the authority and responsibility for administering the ACA program, including the verification and processing of claims. That responsibility is now delegated to the Council Administrative Services. I see no compelling reason to significantly revise the current policy at this point in time.

However, as you have reported that the CAS has had some difficulty in the past with questionable claims and now feels that the office lacks the ability to require further substantiation or to deny a claim in the absence of sufficient documentation, I agree that the ACA policy should reflect a clear procedure for the processing of such claims. Therefore, with the input of the CAS staff, I will initiate a revision of the ACA policy that would include the delegation of such specific authority to the CAS. In the event of any resistance, perceived intimidation or evidence of retribution, it would be a matter of expressed ACA policy that the CAS would be obligated to refer the matter to the Office of the Chair for resolution.

As for reimbursement for personal meals from ACA funds, the City Council Administrative Manual already establishes certain limitations and prohibited uses of ACA funds. Prohibitions such as alcoholic beverages, personal cell phones, personal travel and any other non-City business purposes are clear. With sufficient documentation, including unaltered and itemized receipts, the CAS should be able to

make a determination on an acceptable level of compliance with ACA policy before approving any claim. In the event of a questionable claim, such as an excessive expenditure on food or other purchases, the CAS would again be obligated to investigate further, requiring adequate substantiation or referring the matter to the Office of the Chair.


As you reported, the majority of the 48 claims examined in your Discussion Draft were found in full compliance. The 3 obsolete forms should have been corrected, the 14 incomplete forms should have been returned and resubmitted after corrections were made and the one claim that included a prohibited expense should have been rejected. All of these steps should have been taken by CAS or brought to the attention of the Chair in the event CAS did not feel authorized to request the corrective actions. I am confident that a modification of the ACA policy to empower CAS will greatly reduce the likelihood of such violations in the future.

I agree with your recommendation to provide initial and periodic training for administrative staff and for Council members and their staff on the ACA policies and procedures for the processing of ACA claims. As this is a function of top management, the Council Chair's office has scheduled a training session for incoming and existing Councilmember's staff on January 8, 2013. I will also update the Council Administrative Manual (CAM) to reflect annual training and refresher courses. Periodic training will ensure that new initiatives such as the use of P-cards will be communicated in a timely manner. The travel reimbursement form will be updated to include recommended language and incorporate the pCard manual into the CAM. Moreover, I will work towards establishing a process to repay public funds in the event of any charges that are inconsistent with the procedures set forth in the manual.

I also agree with your recommendation to include annual audits of claims for reimbursement. I will issue a Directive memo for the City Auditor to conduct such annual audits at the end of each fiscal year. The Auditor will then provide a report to the Office of the Chair for review and distribution to members.

It is my intention to have these modifications to current ACA policy and procedures in place prior to the January 30, 2013 Council meeting. Your review and recommendations of the City Council's ACA policy is sincerely appreciated. We share a mutual interest in improving the quality of government service to the residents of the City and County of Honolulu.

Respectfully,



Ernest Y. Martin
Council Chair & Presiding Officer
Honolulu City Council

EYM: kr

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