

OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i



Financial Audit of the City and County of Honolulu State of Hawai'i

For the Fiscal Year Ended
June 30, 2004

Management Letter

Conducted by
PricewaterhouseCoopers LLP

December 23, 2004

The Chair and Members of
the City Council
City and County of Honolulu
Honolulu, Hawaii

In planning and performing our audit of the basic financial statements of the City and County of Honolulu, State of Hawaii ("City") as of and for the year ended June 30, 2004, we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. Although our audit was not designed to provide assurance on the internal control, we noted certain findings and matters involving the system of internal control and its operations, and are submitting for your consideration related deficiencies and recommendations to help the City improve the system of internal control and its operations. Our comments reflect our desire to be of continuing assistance to the City as your auditor.

This letter is intended solely for the information and use of the City Council, City Administration and others within the City and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss any questions that you or your associates may have regarding this letter.

Very truly yours,

PricewaterhouseCoopers LLP

DMT:cy

City and County of Honolulu
State of Hawaii
Index
June 30, 2004

Page(s)

Current Year Comments

Rental Integrity Monitoring of Section 8 Housing Choice Voucher Program	1
Findings Based on Federal Agency’s On-Site Review.....	1
Late Filing of Federal Report	2
Section 8 Housing Choice Vouchers Could Not Be Located.....	3
Bank Reconciliations Should Be Improved.....	3

Status of Prior Year Comments

Comments Which Are Still Applicable

Lack of Monitoring of Subrecipient Loans	5
Adequacy of the Workers Compensation Reserve	5
Allowance for Extra Work Should Not Be Encumbered.....	6
Loan Agreements Should Be Properly Executed	6
Inadequate Monitoring of Properly Management Companies.....	7
Accounting for Infrastructure Costs Should Be Improved.....	7

Comments Which Have Been Resolved

Equipment Costs Should Be Obtained From the Contractors	9
Unamortized Discount on Long-Term Debt Should Be Properly Recorded.....	9
Findings Based on Federal Agency’s On-Site Monitoring.....	9
Noncompliance with the State Procurement Code	10
Delinquent Collections on Subsidy Agreements	10
Inclusion of Certain Funds as Fiduciary Funds	11
Information Technology Policies and Procedures Should Be Improved.....	11
Ensure Proper Section 8 Utility Allowances Are Utilized	11
Changes in the Government Reporting Model	12

CURRENT YEAR COMMENTS

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Current Year Comments
Year Ended June 30, 2004**

No. 04-1: Rental Integrity Monitoring of Section 8 Housing Choice Voucher Program

In July 2004, the Department of Housing and Urban Development's (HUD) Honolulu Office of Public Housing conducted a follow-up Rental Integrity Monitoring review of the City's Section 8 Housing Choice Voucher Program's tenant files, due to a nationwide effort to correct improper calculation of subsidy payments. The Office of Public Housing issued a report dated September 3, 2004 which identified certain findings and observations as follows:

1. The City did not properly calculate income, social security benefits, interest earned from assets and medical deductions that resulted in an overpayment or underpayment of housing assistance payments or tenant rent.
2. The City had improperly transferred data from the tenant file to the HUD-50059, Family Report, and to the Multifamily Tenant Characteristics System.
3. The City has not utilized the Quality Control Plan to monitor program compliance in tenant files.
4. Certain files were missing birth certificates, missing signatures on the HUD-9886 form and missing documents to verify the U.S. citizenship of a head of household.

Pursuant to a letter from the City to HUD dated November 5, 2004, the City has indicated that all of the corrections have been made and documented on a master correction list as well as on the tenant file error reports. The City has also implemented HUD's recommendations. The City is currently awaiting a response from HUD.

Recommendation

We recommend that the City work with HUD to resolve these findings and observations in a timely manner.

No. 04-2: Findings Based on Federal Agency's On-Site Review

In August 2003, the Federal Transit Administration (FTA) performed a Triennial Review of the City's FTA program and issued a report dated September 30, 2003 with their findings.

The FTA findings included the following:

1. Technical - The City did not consistently update milestones or provide reasons why milestones were not met on its Milestone Progress Reports (MPRs). Additionally, the City did not notify FTA of all change orders in excess of \$100,000 on its MPRs during the review period.
2. Satisfactory Continuing Control - The City was unable to document that it had ever sought or received FTA approval to lease a portion of the Kalihi-Palama bus facility to the Oahu Transit Services Credit Union. The FTA also noted that the City must re-evaluate its active fleet size of buses to comply with FTA guidelines for spare ratio.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Current Year Comments
Year Ended June 30, 2004**

3. Disadvantaged Business Enterprise (DBE) - The City did not monitor its contractors to ensure that DBE obligations are fulfilled.
4. Buy America - The City did not perform separate pre-award and post-delivery Buy America audits and certifications related to two option orders under a single bus procurement.
5. Title VI – Several of the City's service standards and policies were not quantifiable or sufficient for assessing Title VI compliance. The City has not performed any compliance assessments in the past four years pursuant to FTA Circular 4702.1.
6. Americans with Disabilities Act (ADA) – Some of the City's ADA policies and procedures for FTA funded services did not meet ADA requirements.
7. Drug and Alcohol Program - The City was unable to document that the private operator of a City trolley service had a Drug and Alcohol Policy/Program for its safety-sensitive employees that conformed to FTA regulations.

Pursuant to a letter from the FTA to the City dated July 8, 2004, all of the above findings have been closed, except for the Title VI finding. The City submitted their corrective actions related to the Title VI finding on July 30, 2004 and is currently awaiting a response from FTA.

Recommendation –

We recommend that the City continue to work with the FTA to resolve the remaining finding in a timely manner.

No. 04-3: Late Filing of Federal Report

During our testing of the City's FTA program, we noted that the City filed the March 31, 2004 Report of Disadvantaged Business Enterprise (DBE) Awards and Commitments on November 17, 2004, rather than on the required due date of June 1, 2004. We were informed that the City was unable to file this report in a timely manner because of lack of adequate staff. The individual whose primary responsibility was related to DBE matters had transferred to another City department and the position remained unfilled.

In accordance with the Rules and Regulations of the *Federal Register, Volume 68, No. 115, June 16, 2003*, recipients of FTA funds are required to file these reports on a semiannual basis on June 1 and December 1 of each year.

The City's failure to comply with these federal requirements may jeopardize future FTA funding of the City's programs.

Recommendation –

We recommend that the City establish procedures to ensure that the reports are completed and filed timely.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Current Year Comments
Year Ended June 30, 2004**

No. 04-4: Section 8 Housing Choice Vouchers Could Not Be Located

During our testing of the City's Section 8 housing choice voucher program, we noted 3 instances out of 40 items tested, in which the tenant's applicable housing choice voucher documents could not be located. The tenant's file did not include the voucher applicable to the tenant's current rental agreement, but included vouchers that were subsequently issued. We were informed that since the City is only required to maintain tenant information for three years and since certain leases exceeded three years, the City may have discarded these vouchers.

The housing choice voucher is the official document which verifies that the tenant is eligible for Section 8 tenant-based housing assistance. The vouchers include the recipient's name and signature, name of the public housing agency (i.e., the City), name and signature of the authorizing City official, date issued, expiration date, and expiration date of any extensions, if applicable. Recipients must enter into a lease prior to the expiration of the voucher to receive Section 8 assistance.

Without the applicable vouchers, the City has no documentation evidencing its agreement to offer these tenants the applicable housing assistance.

Recommendation –

The City should ensure that documentation is maintained in the tenant's file related to the tenant's current housing assistance. The documentation should include the housing choice vouchers related to the tenant's current rental agreement.

No. 04-5: Bank Reconciliations Should Be Improved

During our testing of the City's June 30, 2004 bank reconciliations of funds maintained in two financial institutions, we noted numerous reconciling items between the City's book balance and the bank balance. However, a number of these items should not have been listed as reconciling items. During our testing, we noted that the City had listed certain withdrawals as being posted to the City's general ledger as of June 30, 2004, but had not been posted by the bank as withdrawals as of June 30, 2004. However, we discovered that these withdrawals had actually cleared the bank per the June 30, 2004 bank statement, and therefore, these items should not have been listed as reconciling items. Per further investigation and review of the City's bank reconciliations, it was noted that these withdrawals were listed again as withdrawals per the bank as of June 30, 2004, but not posted to the City's general ledger as of June 30, 2004. Therefore, these reconciling items cancel out each other and should not have been listed as reconciling items. These items were not easily identified since the amounts were often grouped with other deposits or withdrawals. By inappropriately listing these items on the bank reconciliations, it creates inefficiencies and additional work for the preparer.

Recommendation

We recommend that the City exclude these types of items from the bank reconciliations to ensure bank reconciliations are properly and timely prepared. The bank reconciliations should be carefully reviewed by a supervisor.

STATUS OF PRIOR YEAR COMMENTS

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

The following represents the status of prior year comments reported in our management letter report for the year ended June 30, 2003. Comments which have not been resolved are included in the section entitled "Comments Which Are Still Applicable." Comments which have been resolved are included in the section entitled "Comments Which Have Been Resolved."

COMMENTS WHICH ARE STILL APPLICABLE

No. 03-1: Lack of Monitoring of Subrecipient Loans

During our prior year testing of federal grant loans between the City and its subrecipients, we noted that the City does not monitor these loans on a regular basis to ensure proper and timely payments from the subrecipients. Certain loan agreements require the subrecipients to make payments when the projects have residual receipts. Of the loans we tested which required payments based on residual receipts, we noted that no payments were made in fiscal 2003 as it appeared that the projects did not generate residual receipts. We also noted that the definition of residual receipts was not defined in the loan agreements and there were inconsistencies in the definition of residual receipts based on our review of the subrecipients' audited financial statements. We understand that although the City monitored loan payments for other subrecipient loans during the subrecipient monitoring procedures, the projects we tested were not selected for subrecipient monitoring review by the City in fiscal 2003.

We recommended that the City establish procedures to ensure all subrecipients are complying with the loan agreements by making required payments on a timely basis, including residual receipt payments. Proper monitoring of these loans should be performed annually. The City should also clearly define residual receipts in the loan agreements to ensure consistency.

Status –

Unresolved. Although the City has established procedures to monitor subrecipient loan payments and define residual receipts in new subrecipient loan agreements, no amendments were made to existing loan agreements to define residual receipts. Also, although the City collected residual receipts on several subrecipient loans in fiscal 2004, the City did not perform monitoring of residual receipts on several subrecipients with loan receivable balances that exceeded \$1 million as of June 30, 2004.

No. 03-4: Adequacy of the Workers Compensation Reserve

Although the City is substantially self-insured for worker's compensation claims, we noted that the City's actuaries had assumed the City's liability for loss and allocated loss adjustment expense was limited to \$1 million per occurrence in determining the City's case and incurred but not reported reserves ("IBNR") as of June 30, 2003. As a result of using incorrect retention amounts, the actuarial liability may have underestimated the required reserves.

We recommended that the City communicate this inconsistency with the actuaries and ensure future actuarial studies assume an unlimited self-insurance retention, which would provide more accurate estimates of case and IBNR reserves.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

Status –

Unresolved. Although the City has instructed its workers compensation claims reserve actuary to ensure that future studies assume unlimited self-insurance retention, as the actuarial study as of June 30, 2003 included projections through fiscal 2005, the City did not have an actuarial study performed as of June 30, 2004.

No. 03-6: Allowance for Extra Work Should Not Be Encumbered

During our testing of professional services contracts, we noted that a contract allotted \$5,000 for the pre-stage of a project for which the scope and services had been detailed and agreed upon by the City and the consultant. An additional \$45,000 had been allotted as “allowance for extra work” for the implementation of improvements determined during the pre-stage services. However, no further information was provided in the contract related to the additional \$45,000. Therefore, the allowance for extra work does not comply with the City’s encumbrance policy, as an encumbrance is defined as follows:

1. Encumbrances reserve an appropriation (or a portion of an appropriation) to cover obligations or commitments that have been incurred against the appropriation.
2. Encumbrances are not firm liabilities but are converted to liabilities upon performance of the acts required by the obligations or commitments (such as delivery of goods or services).
3. Encumbrance obligations or commitments are not merely anticipated future expenses, but are enforceable rights that bind the parties involved to complete a transaction based on proper performance of the acts called for by the obligation or commitment.

Based on the above definition, the allowance for extra work does not satisfy the third point as it is unclear as to what the scope of services are to ensure proper performance by the consultant.

We recommended that the City should not execute contracts and encumber funds for projects that provide “allowance for extra work,” unless the scope of services are clearly defined and complies with the City’s encumbrance policies.

Status –

Unresolved. Although the City is in the process of issuing guidance to clarify the encumbrance policy, we noted a contract that included an allowance for extra work for nonbinding future work.

No. 02-2: Loan Agreements Should Be Properly Executed

During our testing of federal grant loans between the City and its subrecipients, we noted that the loan agreement with Kailua Elderly Housing of \$4.7 million, which was effective in February 1995, has not been formally executed. We were informed by the City that the delays are due to disputes between the City and the subrecipient regarding payment of certain fees and also due to a change in City personnel handling the execution of this loan.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

We recommended that the City resolve the Kailua Elderly Housing dispute and ensure the loan agreement is properly executed. The City should also ensure that future loan agreements are fully executed prior to the disbursement of funds.

Status –

Unresolved. The Kailua Elderly Housing loan agreement has not been formally executed.

No. 01-3: Inadequate Monitoring of Property Management Companies

In fiscal 2000, we reported this finding as a reportable condition in the separate Single Audit report. The City performed certain corrective measures to improve monitoring of the property management companies and therefore, the comment was no longer considered a reportable condition. However, we continued to recommend that the City strengthen its procedures and controls over the following areas:

1. The City should ensure that the property budgets submitted by the property management companies to the City are reviewed and approved before the beginning of the fiscal year.
2. The City should formalize the policy regarding reimbursement of general overhead costs (e.g., photocopying, office supplies, postage, etc.).
3. The City should work with the property management companies to ensure that receivables deemed uncollectible are submitted to the City for write-off.

Status –

1. Unresolved. The 2004 property budget approval process was not completed prior to the beginning of fiscal 2004. However, we noted that the 2005 budgets were approved prior to the beginning of fiscal 2005.
2. Resolved. The City has amended its agreements with the property management companies to state the City's formalized policy regarding reimbursement of general overhead costs.
3. Resolved. The City has worked with the property management companies to ensure timely receipt of significant old outstanding receivables previously deemed uncollectible.

No. 00-3: Accounting for Infrastructure Costs Should Be Improved

In accordance with the establishment of the Sewer Fund as an enterprise fund effective July 1, 1999, the City was required to value infrastructure costs and record them on the Sewer Fund's books. The City utilized the Geographic Information System ("GIS"), which included most of the sewer lines for operational purposes, as a basis for establishing infrastructure costs. However, we noted that developers often did not provide cost information to the City when projects were completed and sewer lines were dedicated to the City, which resulted in incomplete cost information. We also noted that there were delays in inputting the information into GIS by the City. Although we understand that the City had recently assessed the physical conditions of these infrastructure components, no adjustments (i.e., possible write-downs) were made to the cost estimates.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

During fiscal 2002, over \$200 million of capital assets, net of accumulated depreciation, were identified which should have been recorded in prior years. These errors were due to delays in inputting current information into GIS by the City and also due to certain inaccurate information already in GIS. The City did a comprehensive review of the capital assets as of June 30, 2002, which resulted in various changes to the information in GIS and adjustments to the financial records.

We recommended that the GIS system be kept current, accurate, and complete. Periodic assessments should be performed on the infrastructure values to determine whether any write-downs are necessary. The City should also ensure that appropriate cost information is obtained from developers and recorded on a timely basis.

Status –

Unresolved. During fiscal 2004, the Department of Environmental Services coordinated with the Department of Design and Construction to obtain the appropriate information to update the GIS system. The Department of Budget and Fiscal Services continues to work with the operating agencies and developers to establish procedures for obtaining the cost information of assets dedicated to the City.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

COMMENTS WHICH HAVE BEEN RESOLVED

No. 03-2: Equipment Costs Should Be Obtained From the Contractors

During our prior year audit of the separate Public Transportation System – Bus and Paratransit Operations financial statements, we noted that the City was unable to obtain an accurate, detailed listing of the equipment purchases for the Pearl City facility from the contractor which amounted to \$4.5 million. The contractor provided a detail listing that grouped similar, but not the same, types of equipment and assigned a total value. Oahu Transit Services, Inc. personnel, who manage the City’s bus and paratransit services, reviewed the assigned values and determined estimated costs for each equipment item to properly manage and track the equipment.

Status –

Resolved. The City has requested and obtained detailed listing of equipment costs from their contractors or vendors. No exceptions were noted in our current year testing.

No. 03-3: Unamortized Discount on Long-Term Debt Should Be Properly Recorded

During our audit, we noted that the City had previously recorded certain long-term debt net of the unamortized discount. The City adjusted the financial records and financial statements to gross-up the long-term debt and unamortized discount by \$27 million at June 30, 2003. We also noted that since the City had not amortized the debt discount in prior years, the amortization of debt discount was overstated in fiscal 2003 by \$4.9 million.

Status –

Resolved. The City has properly recorded debt discounts and premiums and recorded the proper amortization of unamortized debt discounts or premiums over the life of the bonds. No exceptions were noted in our current year testing.

No. 03-5: Findings Based on Federal Agency’s On-Site Monitoring

During January 2003 through February 2003, the U.S. Department of Housing and Urban Development (“HUD”) performed an on-site monitoring review of the City’s Community Planning and Development (“CPD”) Programs and issued a report dated March 13, 2003 with their findings.

The HUD findings included the following:

1. Designate which units are HOME units and keep the information in all Loliana project files.
2. Ensure invoices from an organization reflect that technical assistance was provided.
3. Project files must contain verification that invoices have actually been paid.
4. Ensure HOME eligible families occupy units at Kulana Nani that are rehabilitated with HOME funds.

City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004

5. There were incorrect and inconsistent clauses in project Deeds and Declaration of Land Use documents.
6. Ensure records used to verify the eligibility of low-income families are contained in the files.
7. Lack of control over project records resulted in incomplete project files.

Status –

Resolved. We noted that the City properly addressed all of the HUD findings and received written confirmation from HUD stating that all of the findings were closed.

No. 03-7: Noncompliance with the State Procurement Code

During our prior year testing of the City's procurement process related to competitive sealed bidding contracts, we noted that for 6 out of 10 contracts tested, the names of witnesses during the bid opening were not recorded. The Hawaii Administrative Rules Section 3-122-30(b)(2) states that along with the name and bid price of each bidder, "the name(s) and address(es) of the required witnesses shall also be recorded at the opening." We understand that due to the numerous bid openings in December 2002, other City employees were utilized to administer some of the bid openings, who may not have been properly instructed on completing the City's standard forms and on the state procurement rules.

Status –

Resolved. During our current audit, we noted that names and addresses of the witnesses for the bid opening of the contracts selected for testing were properly recorded. No exceptions were noted in our current year testing.

No. 03-8: Delinquent Collections on Subsidy Agreements

During our testing of the Community Development Block Grants' program income, we noted that certain tenants were delinquent in making subsidy payments based on the terms of the subsidy agreements. We understand that due to the tenants' financial difficulties, the City verbally agreed to revise payment plans. However, there was no written documentation of the revised terms.

We recommended that the City either amend the subsidy agreements or maintain written documentation of the revised payment plans, which has been approved by the appropriate City personnel, in the tenant files.

Status –

Resolved. During our current audit, we noted that subsidy agreements were amended or written documentation of properly approved revised payment plans were included in the tenant files. No exceptions were noted in our current year testing.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

No. 02-4: Inclusion of Certain Funds as Fiduciary Funds

Governmental Accounting Standards Board Statement No. 34 (“GASB 34”) provides that fiduciary funds should only be used to report assets held in a trustee or agency capacity for others and therefore, cannot be used to support the government’s own programs. The fiduciary fund category may include pension trust funds, investment trust funds, private-purpose trust funds and agency funds. The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations or other governments.

We noted that certain funds included in the City’s fiduciary funds at June 30, 2002 may not have met the GASB 34 definition of fiduciary funds. Consequently, these funds should not have been reported as fiduciary funds but included in another fund.

Although the City identified and transferred certain funds included in the fiduciary funds to other City funds during fiscal 2003, we identified other funds that did not qualify as fiduciary funds.

Status –

Resolved. During our current year audit, we noted that the City transferred account balances to the proper funds. No exceptions were noted in our current year testing.

No. 01-11 and 00-11: Information Technology Policies and Procedures Should Be Improved

During our audit, we noted that a “High-Level Security Assessment” was performed by Network Care in 2000. This report was finalized and presented to management in July 2000. The report detailed several weaknesses around the City’s network. Lack of controls around the existing network could result in unauthorized access and control around the City’s information assets.

During our 2003 audit, we noted that all of the issues noted in the “High-Level Security Assessment” report have been resolved by the City, except one.

Status –

Resolved. We noted that the City has addressed the final issue noted in the report.

No. 00-10: Ensure Proper Section 8 Utility Allowances Are Utilized

In accordance with the Code of Federal Regulations (“CFR”) 982.517(c)(1), a public housing agency must review its schedule of utility allowances each year, and must revise its allowance for a utility category if there has been a change of 10% or more in the utility rate since the last time the utility allowance schedule was revised.

During our fiscal 2000 testing of the Section 8 housing assistance payments program monthly utility allowance schedule, we noted that the subsidy amount for a certain utility rate was understated. This resulted in less subsidy to certain tenants of approximately \$600.

**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

During our fiscal 2001 audit, we noted that the utility allowance schedule for certain utility classifications was erroneously adjusted when the current rate did not require an adjustment. Consequently, there were overpayments to 23 families which amounted to \$226 and underpayments to 18 families which amounted to \$483 in fiscal 2001. We also noted one instance where the utility classification exceeded the 10% adjustment threshold, but the utility schedule was not adjusted.

During our fiscal 2002 audit, we noted that the utility rates for certain classifications exceeded the 10% adjustment threshold, but the utility schedule, which was effective January 1, 2002 was not adjusted. The total estimated overpayment to 11 families amounted to \$114 and underpayments to 35 families amounted to \$1,280 for fiscal 2002.

During our fiscal 2003 audit, we noted that the utility rates for certain classifications exceeded the 10% threshold, but the utility schedule, which was effective March 1, 2003 was not adjusted until August 2003. This error resulted in an overpayment to one family.

Status –

Resolved. In the current year, we noted that the City used the correct utility allowance schedule, which was effective from March 1, 2003. A revised utility allowance schedule went into effect in July 2004.

Changes in the Government Reporting Model

GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis - for State and Local Governments*, dramatically changed the presentation of the City’s external financial statements effective in fiscal 2002. In the GASB’s view, the objective of the new reporting model is to enhance the clarity and usefulness of these financial statements to the citizenry, oversight bodies, investors and creditors.

We understand the City’s current financial accounting system, CIFIS, is unable to process the required information under this new financial reporting. Therefore, the City is required to prepare manual spreadsheets to generate government-wide financials using the CIFIS reports. The City is also retrieving information from other systems that are maintained by the various departments instead of being retrieved from a central system.

Although the City implemented GASB 34 in conjunction with the preparation of its fiscal 2002 financial statements, the completion of the Comprehensive Financial Annual Report (“CAFR”) was not until April 2003 due to certain significant task deadlines not being met. We recommended that the City ensure that the required information and necessary resources are available for timely and accurate completion of its financial statements.

Status –

As the City implemented GASB 34 in fiscal 2002 and delays in completing the CAFR are incorporated into reportable condition Finding No. 04-02 in the separate Single Audit Report, this comment will not be carried forward. The City acknowledges that its current financial system, CIFIS, is costly, inefficient and unable to provide the necessary information required for financial reporting in accordance with GASB 34.

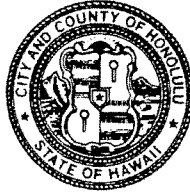
**City and County of Honolulu
State of Hawaii
Findings and Internal Control Comments
Status of Prior Year Comments
Year Ended June 30, 2004**

However, the City has informed us that until funding is available, they will continue to rely on CIFIS and other systems to meet its financial reporting requirements.

CORRECTIVE ACTION PLAN

DEPARTMENT OF BUDGET AND FISCAL SERVICES
CITY AND COUNTY OF HONOLULU
530 SOUTH KING STREET, ROOM 208 • HONOLULU, HAWAII 96813
PHONE: (808) 523-4616 • FAX: (808) 523-4771 • INTERNET: www.honolulu.gov

MUFI HANNEMANN
MAYOR



MARY PATRICIA WATERHOUSE
DIRECTOR

PATRICK T. KUBOTA
DEPUTY DIRECTOR

March 21, 2005

Mr. Leslie I. Tanaka, City Auditor
Office of the City Auditor
City and County of Honolulu
1000 Uluohia Street, Suite 313
Honolulu, Hawaii 96707

Dear Mr. Tanaka:

RE: MANAGEMENT LETTER – COMPREHENSIVE FINANCIAL
AUDIT FOR THE FISCAL YEAR 2003-2004

Attached is the City Administration's response to PricewaterhouseCoopers LLP preliminary draft of the management letter findings and internal control comments resulting from the audit of the City and County of Honolulu for the fiscal year ended June 30, 2004. The response includes actions taken or contemplated, anticipated completion dates, and City personnel responsible for the corrective action.

Sincerely,

A handwritten signature in black ink, appearing to read "MP Waterhouse", is written over a horizontal line.

MARY PATRICIA WATERHOUSE
Director of Budget and Fiscal Services

MPW:ve
Attachments

FORWARDED:

A handwritten signature in black ink, appearing to read "Jeff J. Coelho", is written over a horizontal line.

JEFF J. COELHO
Acting Managing Director

cc: BFS – Internal Control

**RESPONSE TO MANAGEMENT LETTER
FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2004**

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Finding No. 04-1: Rental Integrity Monitoring of Section 8 Housing Choice Voucher Program

Audit Recommendation: We recommend that the City work with HUD to resolve these findings and observations in a timely manner.

Administration's Comment: The City has been working with HUD and is awaiting their approval of the City's corrections for the 2004 Rental Integrity Monitoring Report.

Anticipated Completion Date: June 2005

Contact Person: Sandy Toma, Program Administrator, Department of Community Services (DCS)

Finding No. 04-2: Findings Based on Federal Agency's On-Site Review

Audit Recommendation: We recommend that the City continue to work with the FTA to resolve the remaining finding in a timely manner.

Administration's Comment: FTA Region 9 staff indicated that the City's Title VI corrective actions were satisfactory and the City is awaiting a formal fiscal 2003 Triennial Review close-out letter.

Anticipated Completion Date: December 2005

Contact Person: Phyllis Kurio, Transportation Planner, Department of Transportation Services

Finding No. 04-3: Late Filing of Federal Report

Audit Recommendation: We recommend that the City establish procedures to ensure that the reports are completed and filed timely.

Administration's Comment: We do not believe that establishing procedures will ensure that the reports will be completed and filed in a timely manner because the position whose primary responsibility is to carry out the DBE program requirements is vacant. Current Department of Transportation Services' staff have limited time to carryout the duties of a full-time DBE Liaison Officer. The City's Fiscal 2006 Executive Operating Budget and Program has a request for funds

**RESPONSE TO MANAGEMENT LETTER
FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2004**

to fill the vacant position whose primary duties will be to cover the DBE program. Filling the position will be instrumental in submitting reports in a timely manner.

Anticipated Completion Date: December 2005

Contact Person: Kenneth Hamayasu, Chief, Department of Transportation Services

Finding No. 04-4: Section 8 Housing Choice Vouchers Could Not Be Located

Audit Recommendation: The City should ensure that documentation is maintained in the tenant's file related to the tenant's current housing assistance. The documentation should include the housing choice vouchers related to the tenant's current rental agreement.

Administration's Comment: The City has implemented procedures to ensure that the proper documentation relating to the tenant's current housing assistance is maintained in the tenant's file. A "Tenant File Checklist" will be used when reviewing the tenant's file.

Anticipated Completion Date: Implemented in February 2005

Contact Person: Sandy Toma, Program Administrator, DCS

Finding No. 04-5: Bank Reconciliations Should Be Improved

Audit Recommendation: We recommend that the City exclude these types of items from the bank reconciliations to ensure bank reconciliations are properly and timely prepared. The bank reconciliations should be carefully reviewed by a supervisor.

Administration's Comment: The City will provide additional supervisory oversight and instruction to the accountant responsible for the bank reconciliations.

Anticipated Completion Date: June 2005

Contact Person: Nelson Koyanagi Jr, Chief Accountant, Budget and Fiscal Services (BFS)

**RESPONSE TO MANAGEMENT LETTER
FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2004**

PRIOR YEAR COMMENTS THAT ARE STILL APPLICABLE

Finding No. No. 03-1: Lack of Monitoring of Subrecipient Loans

Audit Status: Unresolved. Although the City has established procedures to monitor subrecipient loan payments and define residual receipts in new subrecipient loan agreements, no amendments were made to existing loan agreements to define residual receipts. Also, although the City collected residual receipts on several subrecipient loans in fiscal 2004, the City did not perform monitoring of residual receipts on several subrecipients with loan receivable balances that exceeded \$1 million as of June 30, 2004.

Administration's Comment: The promissory notes that accompany the existing loan agreements include a definition of residual receipts and it is not necessary to amend the loan agreements. The City is in the process of reviewing the remaining projects on the monitoring list. The review includes an inquiry of program income and residual receipts.

Anticipated Completion Date: June 2005

Contact Person: Holly Kawano, Federal Grants Coordinator, BFS

Finding No. 03-4: Adequacy of the Workers Compensation Reserve

Audit Status: Unresolved. Although the City has instructed its workers compensation claims reserve actuary to ensure that future studies assume unlimited self-insurance retention, as the actuarial study as of June 30, 2003 included projections through fiscal 2005, the City did not have an actuarial study performed as of June 30, 2004.

Administration's Comment: The next actuarial study of the City Workers Compensation Reserve is due for fiscal 2005 and will be based on the City's unlimited self-insured retention as planned.

Anticipated Completion Date: December 2005

Contact Person: Beverly Braun, Risk Manager, BFS

**RESPONSE TO MANAGEMENT LETTER
FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2004**

Finding No. 03-6- Allowance for Extra Work Should Not Be Encumbered

Audit Status: Unresolved. Although the City is in the process of issuing guidance to clarify the encumbrance policy, we noted a contract that included an allowance for extra work for nonbinding future work.

Administration's Comment: The City continues to evaluate contractual and operational issues in developing guidelines to ensure that contracts comply with the encumbrance policy requirements.

Anticipated Completion Date: June 2005

Contact Person: Nelson Koyanagi, Chief Accountant, BFS

Finding No. 02-2: Loan Agreements Should Be Properly Executed

Audit Status: Unresolved. The Kailua Elderly Housing loan agreement has not been formally executed.

Administration's Comment: The City has completed discussions with the subrecipient's lawyers and is awaiting the subrecipient's approval of the Kailua Elderly Housing loan agreement.

Anticipated Completion Date: December 2005

Contact Person(s): Charles Woodward, Division Chief, Facilities Maintenance (DFM)
Randy Wong, Division Chief, DCS

Finding No. 01-3: Inadequate Monitoring of Property Management Companies

Audit Status:

1. Unresolved. The 2004 property budget approval process was not completed prior to the beginning of fiscal 2004. However, we noted that the 2005 budgets were approved prior to the beginning of fiscal 2005.
2. Resolved. The City has amended its agreements with the property management companies to state the City's formalized policy regarding reimbursement of general overhead costs.
3. Resolved. The City has worked with the property management companies to ensure timely receipt of significant old outstanding receivables previously deemed uncollectible.

**RESPONSE TO MANAGEMENT LETTER
FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2004**

Administration's Comment: The City has implemented and will continue to enforce procedures to ensure that the property management budgets are approved prior to the beginning of the fiscal year.

Anticipated Completion Date: June 2005

Contact Person: Charles Woodward, Division Chief, DFM

Finding No. 00-3: Accounting for Infrastructure Costs Should Be Improved

Audit Status: Unresolved. During fiscal 2004, the Department of Environmental Services coordinated with the Department of Design and Construction to obtain the appropriate information to update the GIS system. The Department of Budget and Fiscal Services continues to work with the operating agencies and developers to establish procedures for obtaining the cost information of assets dedicated to the City.

Administration's Comment: The Department of Environmental Services (ENV) will continue its efforts to update the GIS system for additions and write-downs as changes in infrastructure assets occur. The Department of Budget and Fiscal services is in the process of establishing written procedures to obtain the cost information for dedicated assets.

Anticipated Completion Date: June 2005

Contact Person(s): Timothy Houghton, Deputy Director, ENV
Les Yoshino, Property Management Specialist, BFS