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# 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, 2006

Management Letter

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Conducted by  
Nishihama & Kishida, CPAs, Inc.

# CITY AND COUNTY OF HONOLULU

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**NISHIHAMA & KISHIDA, CPAs, INC.**  
CERTIFIED PUBLIC ACCOUNTANTS

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

In planning and performing our audit of the financial statements of the City and County of Honolulu, State of Hawaii (City) and the City's compliance with major federal program requirements for the fiscal year ended June 30, 2006, we considered the City's internal control to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and its compliance with major federal program requirements and not to provide assurance on internal control.

However, during our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The comments that accompany this report summarize our findings and recommendations regarding these matters. This letter does not affect our report dated December 12, 2006, on the financial statements of the City.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
December 12, 2006



## CURRENT FINDINGS AND RECOMMENDATIONS

### 06-1 Monitor Third Party's Landfill Closure Financial Assurance

We noted that the estimated final cover cost of \$4.8 million remained the same for the fiscal years ended June 30, 2004 through 2006 for the Waimanalo Gulch landfill. It is unlikely that the cost would remain the same for three consecutive years.

We also noted that the face value of the insurance of \$1,078,543 for closure costs was less than the estimated final cover cost of \$4,800,000 for the Waimanalo Gulch landfill. The City did not question the third-party landfill operator, Waste Management of Hawaii, Inc., on the shortfall in coverage. Insurance was the only form of financial assurance filed by Waste Management of Hawaii, Inc. to the State Department of Health.

40 CFR 258.71(a)(2) states, "During the active life of the MWSLF unit, the owner or operator must annually adjust the closure cost estimate for inflation."

When using insurance as a financial assurance mechanism, 40 CFR 258.74(d)(3) states, "The insurance policy must be issued for a face amount at least equal to the current cost estimate for closure or post-closure care, whichever is applicable, except as provided in paragraph (k) of this section. The term face amount means the total amount the insurer is obligated to pay under the policy. Actual payments by the insurer will not change the face amount, although the insurer's future liability will be lowered by the amount of the payments."

Another financial assurance mechanism is provided by 40 CFR 258.74(h) which states, "Local government guarantee. An owner or operator may demonstrate financial assurance for closure, post-closure, and corrective action, as required by Sections 258.71, 258.72, and 258.73, by obtaining a written guarantee provided by a local government. The guarantor must meet the requirements of the local government financial test in paragraph (f) of this section, and must comply with the terms of a written guarantee."

40 CFR 258.74(k) allows "[u]se of multiple mechanisms. An owner or operator may demonstrate financial assurance for closure, post-closure, and corrective action, as required by Sec. 258.71, 258.72, and 258.73 by establishing more than one mechanism per facility, except that mechanisms guaranteeing performance rather than payment, may not be combined with other instruments. The mechanisms must be as specified in paragraphs (a), (b), (c), (d), (e), (f), (g), (h), (i), and (j) of this section, except that financial assurance for an amount at least equal to the current cost estimate for closure, post-closure care, and/or corrective action may be provided by a combination of mechanisms rather than a single mechanism."

As the landfill owner, the City is ultimately responsible for compliance with the financial assurance requirements in accordance with federal regulations. Without updated cost estimates, the City cannot be assured that the third party operator has sufficient financial coverage for closure costs. There is a risk that the City will have to provide financial funding for any shortfall in landfill cover costs should the third party be unable to finance the closure costs.

### **Recommendation**

To comply with the financial assurance requirements for the Waimanalo Gulch landfill, the City should perform the following:

1. Require the landfill operator to annually adjust the closure cost estimate for inflation, and
2. Require the landfill operator to obtain financial assurance through insurance or in combination with other allowable means in an amount equivalent to the current cost estimate for closure costs. This may include a provision that the City provide written guarantee that the City will provide some or all financial assurance for the landfill closure costs. The City should specify the amount of the guarantee, if any.

## 06-2 Ensure Adequate Subrecipient Monitoring

The City serves as the pass-through entity of federal awards to various subrecipients and is therefore responsible for ensuring that all of its subrecipients are complying with the applicable federal rules and regulations. During the fiscal year ended June 30, 2006, the City passed-through approximately \$33,000,000 in federal awards to its subrecipients.

During our testing of the HOME Investment Partnerships Program (CFDA number 14.239), Workforce Investment Act Cluster programs (CFDA numbers 17.258, 17.259, and 17.260) and the Aging Cluster programs (CFDA numbers 93.044 and 93.045), we noted that the most recently issued audited financial statements of subrecipients of federal awards passed through from the City were not in file for 14 out of 17 subrecipient files tested. This resulted from an inconsistency between the various City divisions in timely monitoring to ensure its subrecipients are audited in accordance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations* and the corresponding follow up on the results of the audit.

OMB Circular A-133 Compliance Supplement, Part 3 - Compliance Requirements, states that pass-through entities are responsible for "(1) Ensuring that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003 as provided in OMB Circular A-133, as revised) or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133 and that the required audits are completed within 9 months of the end of the subrecipient's audit period, (2) issuing a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and (3) ensuring that the subrecipient takes timely and appropriate corrective action on all audit findings. In cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity shall take appropriate action using sanctions."

Because it is not uncommon for the City to pass-through federal awards in excess of \$500,000 to individual subrecipients, it is probable that many of its subrecipients will require an audit in accordance with OMB Circular A-133 on an annual basis. Furthermore, it is likely that the specific federal programs that are funded through the City will be audited as major programs at the subrecipient level, due to the level of funding passed through from the City. Consequently, it is in the City's best interest to monitor and follow up on these subrecipient audits in a timely manner to determine whether the results of these audits indicate any significant deficiencies in internal control over compliance with applicable federal requirements or any direct and material non-compliance with federal requirements at the subrecipient level that may be applicable to federal programs administered by the City.

## **Recommendation**

The City should implement procedures to adequately monitor whether its subrecipients are audited in accordance with OMB Circular A-133 in a timely manner. This includes correspondence with its subrecipients regarding whether an audit in accordance with OMB Circular A-133 will be required, when the audit will be performed, what federal programs will be audited as major programs, and the expected completion date of the audit. The City should request the audit reports as soon as available to review the report to determine whether any findings necessitate adjustment of the City's records. All audit reports and correspondence regarding the City's decision on any audit findings noted and the sufficiency of the corrective action plan of the subrecipient should be maintained and properly filed. We also recommend that the City consider centralizing the above mentioned responsibilities to ensure consistency in complying with subrecipient monitoring requirements.

### **06-3 Resolve Old Outstanding Encumbrances**

We noted encumbrances originating ten or more years ago remained outstanding as of June 30, 2006. Encumbrances as of June 30, 2006 that originated from 1985 through 1995 amounted to approximately \$7.8 million. It is probable that much of the balance is associated with completed contracts and purchase orders and is unnecessarily reserving funds that could be used for needed projects.

#### **Recommendation**

The City should investigate the status of long outstanding encumbrances and lapse encumbrances that are no longer needed. The City should also review outstanding encumbrances on an annual basis for any unnecessary encumbrances that should be cancelled.



#### **06-4 Establish Written Policies and Procedures for Conditional Awards**

The City does not have written policies and procedures that directly address encumbrances for conditional awards. Well-developed policies and procedures form the basis for effective management practices. Without clear written procedures, personnel may not execute procedures as intended.

It is the City's practice to encumber funds for contracts based on conditional award letters for winning bids. The letters notify the party of the winning bid that the contract award is conditioned upon completion of negotiations and further administrative review. The letters also instruct the winning bidder to not proceed with any delivery of the intended contract services or goods until final notice of award, contract execution, and notification from the City to proceed. The City intends to contract with the party of the winning bid but not all documents required for a signed contract may be ready by the last day funds may be encumbered before the related appropriations are lapsed. Reservation of the appropriation by encumbrance of the conditional awards avoids unintended lapsing of appropriations which would require the City to re-secure appropriations and re-procure contracts, resulting in additional delay and expense. Corporation Counsel determined that the encumbrances based on conditional award letters are legal.

#### **Recommendation**

The City should establish written policies and procedures to encumber contracts based on conditional award letters.

## STATUS REPORT

This section contains the current status of the prior audit recommendations. The recommendations are referenced to the pages of their management advisory report for the fiscal year ended June 30, 2005, dated November 30, 2005.

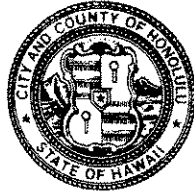
Recommendations	Status
<b>05-1 Demonstrate Financial Assurance for Landfill Postclosure Care Costs Under State Approved Mechanism</b> (pages 4-5)	Partially accomplished. The City documented its financial assurance for landfill postclosure care costs within 180 days after the fiscal year ended June 30, 2005. Although the City requested for approval of the landfill financial assurance mechanism used, the State of Hawaii's Department of Health has not responded.
The City should obtain approval of its landfill financial assurance mechanism from the State of Hawaii Department of Health and ensure that it demonstrates financial assurance for postclosure costs for the Waipahu and Kapaa landfills by 180 days after the end of each fiscal year until released of the responsibility as provided by state and federal laws.	
<b>05-2 Continue Risk-Based Monitoring of Section 8 Housing Choice Voucher Program</b> (pages 5-6)	Accomplished. The City provided additional training to those individuals that could benefit from the additional training.
The City should continue its effort in performing on-going quality control reviews of the Section 8 Housing Choice Voucher Program. The City should put an emphasis on identifying personnel who are more prone to errors in order to assist them in addressing the problem.	
<b>05-3 Improve Documentation of Subrecipient Monitoring</b> (pages 6-7)	Not accomplished. There continues to be inconsistencies within the City as it relates to the monitoring of subrecipients. Refer to 06-2.
The City should implement procedures to adequately document correspondence with its subrecipients regarding all findings that were noted during the City's review of its subrecipients' audited financial statements. This includes the City's decision on any audit findings noted and the corrective action taken by its subrecipients. If a finding noted during the City's review is determined to be not applicable to the City-funded project and therefore no further follow up is deemed necessary, that fact should be documented as well as the rationale that supports this determination.	

Recommendations	Status
<p><b>04-3 Late Filings of Federal Report</b> (page 10)</p> <p>To comply with federal regulations, the City should establish procedures to ensure that the Report of Disadvantaged Business Enterprise (DBE) Awards and Commitments is completed and filed timely.</p>	<p>Accomplished. The City hired personnel whose job duties include the completion and timely filing of the Report of Disadvantaged Business Enterprise (DBE) Awards and Commitments.</p>
<p><b>04-5 Bank Reconciliations Should Be Improved</b> (page 10)</p> <p>To ensure bank reconciliations are properly and timely prepared, the City should exclude items that offset each other as reconciling items on the bank reconciliations. A supervisor should carefully review the bank reconciliations.</p>	<p>Accomplished. Bank reconciliations as of June 30, 2006 did not include offsetting items.</p>
<p><b>02-2 Loan Agreement Should Be Properly Executed</b> (page 11)</p> <p>The City should resolve the Kailua Elderly Housing dispute and ensure that the loan agreement is properly executed. The City should also ensure that future loan agreements are fully executed prior to the disbursement of funds.</p>	<p>Not accomplished. The loan agreement has not been executed.</p>

## **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

February 21, 2007

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

Dear Mr. Tanaka:

Re: Management Advisory Report for the Fiscal Year 2005-2006

Enclosed is the response to the recommendations included in Nishihama & Kishida, CPA's Inc. preliminary draft of the management advisory report resulting from the audit of the City and County of Honolulu for the fiscal year ended June 30, 2006. 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:al  
Attachments

APPROVED:

A handwritten signature in black ink, appearing to read "Wayne M. Hashiro", is written over a horizontal line.

WAYNE M. HASHIRO, P.E.  
Managing Director

cc: BFS – Internal Control

**RESPONSE TO MANAGEMENT ADVISORY REPORT  
FINDINGS AND RECOMMENDATIONS  
For the Year Ended June 30, 2006**

**CURRENT YEAR FINDINGS AND RECOMMENDATIONS**

**Finding No. 06-1: Monitor Third Party's Landfill Closure Financial Assurance**

Audit Recommendation: To comply with the financial assurance requirements for the Waimanalo Gulch landfill, the City should perform the following:

1. Require the landfill operator to annually adjust the closure cost estimate for inflation, and
2. Require the landfill operator to obtain financial assurance through insurance or in combination with other allowable means in an amount equivalent to the current cost estimate for closure costs. This may include a provision that the City provide written guarantee that the City will provide some or all financial assurance for the landfill closure costs. The City should specify the amount of the guarantee, if any.

Administration's Comment: The City will require the landfill operating contractor to annually adjust closure and post closure cost estimates for inflation and provide documentation ensuring financial assurance equivalent to the current cost estimate for closure and post closure costs.

Anticipated Completion Date: March 2007

Contact Person: Wayne Hamada, Disposal Engineer, Environmental Services (ENV)

**Finding No. 06-2: Ensure Adequate Subrecipient Monitoring**

Audit Recommendation: The City should implement procedures to adequately monitor whether its subrecipients are audited in accordance with OMB Circular A-133 in a timely manner. This includes correspondence with its subrecipients regarding whether an audit in accordance with OMB Circular A-133 will be required, when the audit will be performed, what federal programs will be audited as major programs, and the expected completion date of the audit. The City should request the audit reports as soon as available to review the report to determine whether any findings necessitate adjustment of the City's records. All audit reports and correspondence regarding the city's decision on any audit findings noted and the sufficiency of the corrective action plan of the subrecipient should be maintained and properly filed. We also recommend that the City consider centralizing the above mentioned responsibilities to ensure consistency in complying with subrecipient monitoring requirements.

Administration's Comment: The City has revised and standardized the procedures to facilitate the timely receipt and to document the monitoring of subrecipients' audited financial statements. The City is in the process of implementing the revised procedures.



**RESPONSE TO MANAGEMENT ADVISORY REPORT  
FINDINGS AND RECOMMENDATIONS  
For the Year Ended June 30, 2006**

**Anticipated Completion Date:** June 2007

**Contact Person:** Rolanse Crisafulli, Division Chief, Department of Community Services (DCS)  
Ernie Martin, Division Chief, DCS  
Karen Miyake, Division Chief, DCS  
Randy Wong, Division Chief, DCS  
Beryle Matsumura, Fiscal Officer, Budget and Fiscal Services (BFS)

**Finding No. 06-3 Resolve Old Outstanding Encumbrances**

**Audit Recommendation:** The City should investigate the status of long outstanding encumbrances and lapse encumbrances that are no longer needed. The City should also review outstanding encumbrances on an annual basis for any unnecessary encumbrances that should be cancelled.

**Administration's Comment:** The City has implemented a process to review and cancel outstanding encumbrances that are no longer needed on an annual basis. Approximately \$3.1 million outstanding purchase orders and the related encumbrances have recently been cancelled. The City will also develop a process to evaluate and terminate old outstanding contracts and cancel the associated encumbrances.

**Anticipated Completion Date:** June 2007

**Contact Person(s):** Nelson Koyanagi Jr, Division Chief, BFS

**Finding No. 06-4: Establish Written Policies and Procedures for Conditional Awards**

**Audit Recommendation:** The City should establish written policies and procedures to encumber contracts based on conditional award letters.

**Administration's Comment:** As part of its implementation of a new financial reporting system, the City will review and revise its financial policies and procedures for conditional awards as necessary.

**Anticipated Completion Date:** June 2007

**Contact Person(s):** Nelson Koyanagi Jr, Division Chief, BFS

**RESPONSE TO MANAGEMENT ADVISORY REPORT  
FINDINGS AND RECOMMENDATIONS  
For the Year Ended June 30, 2006**

**PRIOR YEAR COMMENTS AND RECOMMENDATIONS**

**Finding No. 05-1: Demonstrate Financial Assurance for Landfill Postclosure Care Costs Under State Approved Mechanism**

Audit Status: Partially accomplished. The City documented its financial assurance for landfill postclosure care costs within 180 days after the fiscal year ended June 30, 2006. Although the City requested for approval of the landfill financial assurance mechanism used, the State of Hawaii's Department of Health has not responded.

Administration's Comment: The City has provided financial assurance for the landfill postclosure costs and will continue to do so. The State of Hawaii has verbally acknowledged receiving the City's filing of financial assurance. The City will continue to submit the required documentation on a timely basis with the State of Hawaii.

Anticipated Completion Date: June 2007

Contact Person: Beverly Braun, Risk Manager, Budget and Fiscal Services (BFS)

**Finding No. 05-3: Improve Documentation of Subrecipient Monitoring**

Audit Status: Not accomplished. There continues to be inconsistencies within the City as it relates to the monitoring of subrecipients.

Administration's Comment: Refer to Comment 06-2.

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

Audit Status: Not accomplished. The loan agreement has not been executed.

Administration's Comment: The City has procedures to ensure that loan agreements are properly executed and all agreements are fully executed prior to the disbursement of funds. Negotiations to obtain a signature for the one loan agreement that was identified in the original finding is on going.

Anticipated Completion Date: June 2007

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