

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, 2009

Management Letter

Conducted by
N&K CPAs, Inc.

CITY AND COUNTY OF HONOLULU

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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 as of and for the fiscal year ended June 30, 2009, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and its compliance with major federal program requirements, but not for the purpose of expressing our opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

However, during our audit, we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this report summarizes our current findings and recommendations regarding these matters and the status of our previous audit recommendations. This letter does not affect our report dated December 30, 2009, on the financial statements of the City.

N&K CPAs, Inc.

Honolulu, Hawaii
March 16, 2010

CURRENT FINDINGS AND RECOMMENDATIONS

09-01 IMPROVE THE ACCOUNTING OF CAPITAL ASSETS

Effective July 1, 2007, the City implemented a new computerized accounting system that included a fixed assets inventory module. In February 2009, when the system was upgraded, the City encountered difficulties in implementing the new version of the fixed assets software.

We noted the following errors in the accounting of capital assets as of and for the fiscal year ended June 30, 2009:

- Six projects totaling approximately \$33 million that were removed from work-in-progress were not recorded in the respective completed capital asset accounts.
- Construction costs for completed projects amounting to approximately \$10 million for governmental activities were not transferred from work-in-progress to the respective completed capital asset accounts.
- Depreciation expense for governmental activities amounting to approximately \$5 million for land improvement was misclassified as depreciation expense for building and structure.
- The balance for work-in-progress for the Sewer Fund was overstated by approximately \$5 million for two completed projects that were also recorded as completed capital assets.
- Capitalized interest for Sewer Fund constructed assets was erroneously computed using the prior year's rate instead of the current year's rate. As a result, capitalized interest was overstated by approximately \$1 million.
- A governmental activities asset valued at approximately \$800,000 that was reclassified as infrastructure was also recorded as land improvement.

Recommendation

The City should improve its accounting of capital assets for accuracy and proper classification.

09-02 REVIEW SEWER FUND FINANCIAL STATEMENTS IN A TIMELY MANNER

The City prepares stand alone financial statements for the Sewer Fund which are reported in the City's comprehensive annual financial report as a separate fund. In addition, the financial statements are reported in the official statement for wastewater system revenue bond issue purpose.

As of and for the fiscal year ended June 30, 2009, the financial statements prior to audit adjustments had the following discrepancies:

- The amount of net assets reported in the statement of net assets was less than the amount reported in the statement of revenues, expenses and changes in net assets by approximately \$51 million.
- Five classification errors were made in preparing the statement of cash flows. As a result, seven out of fourteen activity amounts reported in the statement of cash flows were misstated by approximately \$1.5 to \$18 million.
- Amortization of bond discount amounting to approximately \$2 million was reported as amortization expense instead of interest expense as required by accounting principles generally accepted in the United States of America.

Recommendation

The City should review the Sewer Fund financial statements for accuracy in a timely manner. Timely review is a basic and effective control procedure to detect financial statement misstatements.

09-03 IMPROVE SUBRECIPIENT MONITORING PROCEDURES

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, 2009, the City passed-through approximately \$18 million in federal awards to its subrecipients.

Section .400(d) of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, states that a pass-through entity is responsible for:

1. Ensuring that subrecipients expending \$500,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133 for that fiscal year.
2. Issuing a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensuring that the subrecipient takes appropriate and timely corrective action.

Section .405(a) of OMB Circular A-133 states that the management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given.

During our testing of the HOME Investment Partnerships Program (CFDA number 14.239) and the Aging Cluster programs (CFDA numbers 93.044 and 93.045), we noted four out of six instances where adequate documentation was not on file to support whether the City complied with the requirements established by OMB Circular A-133, as described below:

- Two instances where the subrecipient's most recent audit reports were not on file. The City subsequently obtained the audit reports.
- One instance where only a portion of the subrecipient's most recent audit reports were on file. The portion of the subrecipient's audit report that documents whether there were any compliance findings or internal control deficiencies was not on file.
- One instance where management's decision on audit findings reported in a subrecipient's most recent audit report was not clearly documented and maintained on file. The subrecipient's corrective action plan was on file.

Although the City has policies and procedures designed to ensure that audited financial statements are obtained, further improvements can be made to increase the effectiveness of the City's policies and procedures. The findings noted appear to indicate that the City's program personnel can improve on their understanding of the specific OMB Circular A-133 audit and reporting requirements, including when an audit is required, the form in which the auditors' reports must be submitted and when the audit must be completed.

Without sufficient knowledge of OMB Circular A-133 audit and reporting requirements, program personnel may not be able to effectively monitor whether these requirements are being adhered to at the subrecipient level. Furthermore, without a thorough review of subrecipient audit reports, the City may not become aware of internal control deficiencies or instances of non-compliance at the subrecipient level which could impact federal programs that are funded by the City.

Recommendation

The City should ensure that all program personnel directly responsible for the monitoring of the City's subrecipients are aware of the following requirements:

- Non-Federal entities that expend \$500,000 or more in a year in Federal awards are required to have a single or program-specific audit conducted for that year in accordance with the provisions of OMB Circular A-133.
- Non-Federal entities required to conduct a single or program specific audit in accordance with OMB Circular A-133 must have their audits completed within nine months after the end of the subrecipient's audit period.
- For audits performed in accordance with the provisions of OMB Circular A-133, auditors' reports shall include a schedule of findings and questioned costs. This schedule is a summary of the auditor's results and provides information on any reportable instances of noncompliance and/or significant deficiencies in internal control noted during the audit. This schedule also identifies the specific federal programs that were audited as major programs for the audit period.

Furthermore, in the event that findings are reported in a subrecipient's audit report, the City should ensure that management's decision on audit findings are clearly documented and maintained on file within six months after the receipt of the subrecipient's audit report.

STATUS OF PRIOR AUDIT RECOMMENDATIONS

**City and County of Honolulu
STATUS REPORT
Fiscal Year Ended June 30, 2009**

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the management advisory report for the fiscal year ended June 30, 2008, dated February 25, 2009.

<u>Recommendations</u>	<u>Status</u>
<p>08-01 Improve Recordkeeping Over Capital Assets (page 4)</p> <p>The City should improve its procedures over the record keeping of its capital assets. Policies and procedures should include:</p> <ul style="list-style-type: none">▪ Timely identification and reclassification of completed construction projects and capitalizable expenses to the respective completed capital asset accounts.▪ Additional review for all manual entries into the system to detect input errors.▪ Timely deduction of related capital assets if a new record is made for the same capital assets.	<p>Partially accomplished. Refer to Finding 09-01.</p>
<p>08-02 Monitor Financial Assurance for the Waimanalo Gulch Landfill (page 6)</p> <p>The City should annually monitor the sufficiency of the financial assurance for the Waimanalo Gulch Landfill by comparing the amount of insurance coverage in combination with other acceptable financial assurance mechanisms obtained by the contractor to the amount of the estimated closure cost.</p>	<p>Accomplished. The City compares the amount of insurance coverage obtained from the contractor with the amount of estimated closure cost.</p>
<p>02-02 Loan Agreement Should Be Properly Executed (page 8)</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>Accomplished. A loan agreement was executed in December 2009.</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) 768-3900 • FAX: (808) 768-3179 • INTERNET: www.honolulu.gov

MUFI HANNEMANN
MAYOR



RIX MAURER III
DIRECTOR

MARK K. OTO
DEPUTY DIRECTOR

April 6, 2010

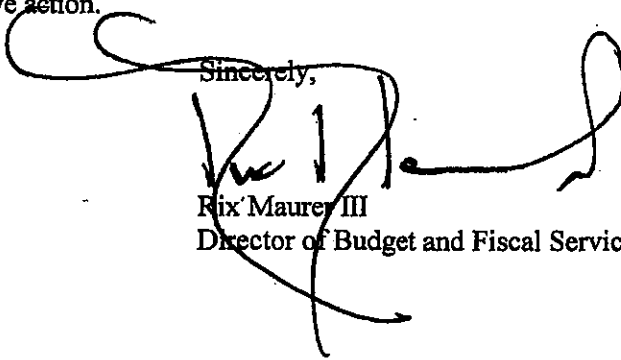
Mr. Edwin S. W. Young, Acting City Auditor
Office of the City Auditor
City and County of Honolulu
1001 Kamokila Boulevard, Suite 216
Kapolei, Hawaii 96707

Dear Mr. Young:

Subject: Management Advisory Report for the Fiscal Year 2008-2009


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, 2009. The response includes actions taken or contemplated, anticipated completion dates, and City personnel responsible for the corrective action.

Sincerely,


Rix Maurer III
Director of Budget and Fiscal Services

RM:al
Attachment

APPROVED:


Kirk W. Caldwell
Managing Director

cc: BFS – Internal Control

ICD.al.A-10-26

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2009**

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Finding No. 09-1: Improve The Accounting of Capital Assets

Audit Recommendation: The City should improve its accounting of capital assets for accuracy and proper classification.

Administration's Comment: The upgraded software included a number of defects that took months of working with the software developer to resolve. The problems encountered caused inefficiencies and delays in the processing and recording of the FY2009 capital asset transactions and likely contributed to some of the errors noted. The errors identified in the comment have been corrected and the more critical issues encountered during the implementation of the system upgrade have been resolved. The City continues to work on improving its capital asset accounting to insure that transactions are recorded accurately and classified properly. A new fixed asset section staffed with experienced accountants has been established in the Accounting Division, Budget and Fiscal Services, to centralize the accounting and recordkeeping of capital assets. New procedures to record and review capital asset transactions have been implemented and a procedures manual is being developed.

Anticipated Completion Date: June 2010

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

Finding No. 09-2: Review Sewer Fund Financial Statements In A Timely Manner

Audit Recommendation: The City should review the Sewer Fund financial statements for accuracy in a timely manner. Timely review is a basic and effective control procedure to detect financial statement misstatements.

Administration's Comment: The City will review the Sewer Fund financial statements on a timely basis to insure that they are presented accurately.

Anticipated Completion Date: June 2010

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

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2009**

Finding No. 09-3: Improve Subrecipient Monitoring Procedures

Audit Recommendation: The City should ensure that all program personnel directly responsible for the monitoring of the City's subrecipients are aware of the following requirements:

- Non-Federal entities that expend \$500,000 or more in a year in Federal awards are required to have a single or program-specific audit conducted for that year in accordance with the provisions of OMB Circular A-133.
- Non-Federal entities required to conduct a single or program specific audit in accordance with OMB Circular A-133 must have their audits completed within nine months after the end of the subrecipient's audit period.
- For audits performed in accordance with the provisions of OMB Circular A-133 auditors' reports shall include a schedule of findings and questioned costs. This schedule is a summary of the auditor's results and provides information on any reportable instances of noncompliance and/or significant deficiencies in internal control noted during the audit. This schedule also identifies the specific federal programs that were audited as major programs for the audit period.

Furthermore, in the event that findings are reported in a subrecipient's audit report, the City should ensure that management's decision on audit findings are clearly documented and maintained on file within six months after the receipt of the subrecipient's audit report.

Administration's Comment: The City will periodically review the OMB Circular A-133 audit requirements with the responsible department staff. Letters will be sent to subrecipients to document and request an audit report, including a schedule of findings and questioned costs, as required by OMB Circular A-133. The City will perform a timely review of findings reported in the subrecipient's audit report and document its decision on the audit findings.

Anticipated Completion Date: June 2010

Contact Person: Deborah Kim Morikawa, Director, Department of Community Services (DCS)