



# 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, 2010

Management Letter

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Conducted by  
Accuity LLP

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, 2010, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control. However, we noted certain matters involving internal control and its operation, and are submitting for your consideration our observations and recommendations designed to help the City improve internal control and achieve operational efficiencies.

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

Very truly yours,

*Acuity LLP*

Honolulu, Hawaii  
December 30, 2010

# City and County of Honolulu

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Corrective Action Plan

**City and County of Honolulu**  
**Current Year Comments**  
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**2010-01 Improve Accounting for Capital Assets**

During our testing of the City's governmental activities capital assets as of June 30, 2010, we noted the following errors:

- There was approximately \$67,177,000 in capital assets placed in service in prior years, which were required to be transferred out of work-in-progress to completed capital asset accounts, and capital assets with incorrect in-service dates or useful lives recorded in the capital assets module of the City's financial system. This resulted in an overstatement of current year depreciation expense of \$2,218,000.
- A double counting of \$3,095,000 in other improvements, which was transferred out of work-in-progress in a prior year. This resulted in an overstatement of completed capital asset accounts and current year depreciation expense of \$3,095,000 and \$724,000, respectively.

Upon further review of its capital assets records, the City identified two other duplicate entries of capital assets previously recorded of \$5,379,000, which resulted in an overstatement of current year depreciation expense of \$1,815,000.

**Recommendation**

We recommend that the City improve its accounting for capital assets to ensure timely transfer of completed capital asset projects and recordation of depreciation expense.

**2010-02 Report Payroll and Fringe Benefits in the Proper Funds**

During our compliance testing over the Highway Planning and Construction program (CFDA 20.205), we noted approximately \$120,000 of expenditures reported on the program's Federal Grant Worksheet that were not reflected in the specific program accounts in the City's financial management system. These payroll and fringe expenditures were originally funded via the City's general fund but were not allocated to the proper program accounts in the City's accounting system.

Failure to properly allocate payroll and fringe expenditures to the appropriate Federal program understates expenditures in the respective special revenue fund and overstates expenditures in the general fund. Consequently, the expenditures in the City's financial statements are improperly classified among funds.

**Recommendation**

We recommend that the City ensure expenditures are properly allocated and reflected in the appropriate funds.

**2010-03 Allocation of Interest Earned on Federal Programs**

The City's Department of Community Services ("DCS") checking account includes balances from four different federally funded programs pooled into one account. However, cash management rules may apply differently for each federal award. Office of Management and Budget ("OMB") Circular A-110 and 2 CFR section 215.22 generally require that interest earned in excess of \$250 on federal advances to the City be remitted to the Department of Health and Human Services, Payment Management System. However, the City's Section 8 Housing Choice Vouchers ("Section 8") program (CFDA 14.871) is allowed to retain interest earned on Department of Housing and Urban Development advances in the Housing Assistance Payments ("HAP") and/or Administrative Fee reserve accounts.

**City and County of Honolulu**  
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During our testing of the propriety of the interest proration schedules prepared for the checking account, we noted differences between the City's Section 8 program calculation and our recalculation of approximately \$600 in interest earned on HAP advances.

We noted that the City prorates interest earned in the DCS account to the Housing and Community Development Rehabilitation Loan and Section 8 funds, but not to the Pauahi or Revolving funds, as the Pauahi and Revolving funds have not had any activity for several years. However, since interest is earned on the pooled cash balance (which includes the Pauahi and Revolving funds), the interest proration calculation should consider all cash balances, and the interest earned should be allocated to all four funds.

**Recommendation**

We recommend that the City properly calculate interest for the four funds pooled in the DCS checking account to ensure that each fund is allocated its share of the interest earned to avoid potential cash management issues regarding interest earned for advances received from different federal awards.

**2010-04 Required Reporting to State**

During our testing of the City's Capitalization Grants for Clean Water State Revolving Funds program (CFDA 66.458), we noted that the City failed to submit to the State of Hawaii, Department of Health ("DOH") a report required by the City's revolving fund loan agreements with DOH. The revolving fund loan agreements require the City to submit the City wastewater enterprise's revenue and expense report by December 31<sup>st</sup> of each year. Although this is not a requirement of the federal program, it is specified in the loan agreements with DOH. Failure to submit required reports to DOH may jeopardize future funding.

**Recommendation**

We recommend that the City assign an individual the responsibility to ensure that the annual reports are submitted to DOH in a timely manner. Management should monitor to ensure that the reports are properly completed and submitted by the responsible individual after appropriate review.

**2010-05 Organization of Supporting Files**

During our testing of the City's Section 8 program, we noted that the tenant files were not organized and maintained in accordance with the program's standard operating procedures. We noted multiple instances in which tenant documents were loose, not filed in chronological order, filed on the wrong side of the files, and certain forms were not filed in order. Moreover, we noted multiple instances of excessively thick tenant file folders, contributing to the lack of organization of file documents.

Although no issues of noncompliance were noted during our current year testing, inadequate maintenance of tenant files may potentially lead to missing supporting documents resulting in noncompliance with the federal program's requirements.

**Recommendation**

All tenant files should be maintained in accordance with the Section 8 "File Order" document to ensure consistency among tenant files and that source documents relating to tenant eligibility, rent reasonableness, and reporting for the Section 8 Housing Choice Voucher program are properly maintained and support the City's compliance with federal requirements.

**City and County of Honolulu**  
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**2010-06 Site Visits and Completion of Required Documents**

During our testing of the City's Shelter Plus Care program (CFDA 14.238), we noted the following issues:

- The City's internal control procedures require site visits of subrecipients every other year. Although two of the City's three subrecipients should have had site visits during fiscal year 2010, we noted that site visits were not performed.
- Checklists were not completed, although required by the City to ensure that all required documents are filed.
- An annual re-examination of income was not performed.
- Utility allowances used by various subrecipients were calculated differently.
- The prior year's utility schedule was used by some subrecipients for a portion of the year.
- A tenant was determined to be homeless in accordance with Department of Housing and Urban Development guidelines, but the "Certification of Homeless" form could not be located.
- Although regular site visits of tenant housing are performed by the housing specialist, there were instances where the annual inspection checklist was not completed.

**Recommendation**

We recommend that the City perform site visits every other year in accordance with the City's internal control procedures and maintain a tracking schedule to ensure that program personnel are aware of when site visits are required. The program should also ensure that all required checklists are properly completed and filed in a timely manner.

**2010-07 Error in the Calculation of Federal Matching Requirement**

Part 4 of the June 2010 OMB Circular A-133 Compliance Supplement states that the Shelter Plus Care program has the following matching compliance requirement, "A grantee must provide or ensure the provision of supportive services that are at least equal in value to the aggregate amount of rental assistance funded by HUD." During our testing of the matching requirement for the City's Shelter Plus Care program, we noted that there was a calculation error on one of the supporting schedules, which the City has subsequently corrected. This did not result in the City violating the matching requirement, as the grant was still on-going in fiscal year 2010 and matching is only required to be met by the completion of the grant. However, there is a risk that if proper controls are not in place to review the detailed calculation, the City will not adequately match the federal funding by the end of the grant period and will not be in compliance with the program's matching requirement.

**Recommendation**

We recommend that management assign an individual familiar with the program's matching requirements to perform a detailed review of the supporting schedules and calculations of the program's matching each period.



**City and County of Honolulu**  
**Current Year Comments**  
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**2010-08 Cash Management**

During our testing of the Shelter Plus Care program, we noted an instance where an advance of approximately \$126,000 in federal funds received by the City was not disbursed in a timely manner. Advances are required to be disbursed soon as administratively possible, but the City did not disburse these funds until 35 days after receiving the advance. This appears to be an isolated incident, where the documents related to the drawdown and related invoices were misplaced by the program accountant. Upon the discovery of the missing documents by the City, the necessary disbursements were made by the City.

**Recommendation**

To ensure that a similar situation does not occur in the future, individuals should be made aware of the importance of limiting the time between the drawdown and disbursement in accordance with federal requirements and ensure that paperwork is organized in an orderly fashion so that invoices are not misplaced.

**2010-09 Improper Revenue Recognition**

During our audit, we noted that Oahu Transit Systems, Inc. ("OTS"), which manages the City's Public Transportation System – Bus and Paratransit Operations ("PTS") had not properly recorded deferred revenue on certain bus passes sold. The PTS conforms to generally accepted accounting principles as applicable to enterprise activities of governmental units as promulgated by the Governmental Accounting Standards Board. Accordingly, revenues should be recognized when earned. However, revenues from sales of one and two year bus passes were recognized when payments were received, rather than over the period that the bus passes can be used. Consequently, the City PTS's deferred revenue balance was understated by approximately \$825,000 as of June 30, 2010.

**Recommendation**

We recommend that the City ensure that an analysis is performed on at least an annual basis and that revenue is recognized in the proper period.

**2010-10 Discrepancies Noted During Physical Inventory Observations**

Adequate physical inventory procedures are an integral component to mitigating the risk of material misstatement in the City's financial statements. During our observations of the PTS Bus and Paratransit year-end physical inventory counts of parts and supplies inventories, we noted numerous discrepancies between the amount of items counted by OTS personnel and the quantity we independently verified. The cause of such variances may be attributed to the following:

- Lack of organization and consistency in the storage of inventory items. Specifically, it was noted that Bus and Paratransit inventory items were often commingled within the same storage area without being properly identified. It was also noted that inventory items were maintained at multiple locations throughout the PTS's warehouses without OTS personnel knowledge.
- Errors made by the individuals performing the inventory counts.
- Failure to include infrequently used inventory items in the physical inventory counts.

**Recommendation**

We recommend that the City work with OTS to update the year-end physical inventory counting procedures to address the issues noted above.

**City and County of Honolulu**  
**Status of Prior Year Comments**  
**June 30, 2010**

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The following is the status of the prior year comments as identified by the predecessor auditors.

**2009-01 Improve the Accounting of Capital Assets**

It was noted that the City implemented a new accounting system that included a capital assets module in fiscal 2008. However, upon a system upgrade in February 2009, the City encountered difficulties implementing the new version of the capital assets module. This resulted in a number of errors discovered during the audit of the City's financial statements for the year ended June 30, 2009, including:

- Approximately \$33 million in costs removed from work-in-progress that were not transferred to the proper completed capital asset accounts.
- Work-in-progress of approximately \$10 million was not transferred to the completed capital assets account upon completion of projects.
- Approximately \$5 million of depreciation expense for land improvements were misclassified as depreciation expense for buildings and structures.
- An asset reclassified to infrastructure was also improperly recorded as a land improvement for approximately \$800,000.
- Work-in-progress for the Sewer Fund was overstated by approximately \$5 million for completed projects that were also recorded as completed capital assets.
- Capitalized interest for the Sewer Fund's work-in-progress was incorrectly calculated using the prior year's interest rate resulting in an overstatement of approximately \$1 million.

It was recommended that the City improve its accounting of capital assets for accuracy and proper classification.

**Status**

Unresolved. All items above were addressed in fiscal year 2010, except for the timely transfer of completed capital assets from work-in-progress (second bullet point). In addition, during our testing of capital assets for the City's governmental activities for the year ended June 30, 2010, we noted other errors. Refer to Comment No. 2010-01.

**2009-02 Review Sewer Fund Financial Statements in a Timely Manner**

During the 2009 audit, it was noted that the financial statements of the City's Sewer Fund were not prepared and reviewed for accuracy in a timely manner, resulting in certain audit adjustments and corrections to the financial statements.

**Status**

Resolved. The Sewer Fund's financial statements for the year ended June 30, 2010 were prepared and reviewed by the City in a timely manner, and no audit adjustments were required.



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**2009-03 Improve Subrecipient Monitoring Programs**

During the 2009 audit, it was noted that the City's HOME Investment Partnerships Program (CFDA 14.239) and the Aging Cluster programs (CFDA 93.044 and 93.045) did not maintain adequate documentation to support the City's monitoring of federal awards passed-through the City to subrecipient organizations.

**Status**

Unresolved. During our testing of the City's federal awards programs, we noted instances of noncompliance with the City's subrecipient monitoring policies and procedures. Refer to Comment No. 2010-06.

**RESPONSE TO MANAGEMENT ADVISORY REPORT  
FINDINGS AND RECOMMENDATIONS  
For the Year Ended June 30, 2010**

**CURRENT YEAR FINDINGS AND RECOMMENDATIONS**

**Finding No. 2010-01: Improve Accounting for Capital Assets**

**Audit Recommendation:** We recommend the City improve its accounting for capital assets to ensure timely transfer of completed capital asset projects and recordation of depreciation expense.

**Administration's Comment:** The City continues to work on improving its capital asset accounting procedures to ensure that transactions are properly classified and recorded in a timely manner. The timely transfer of work in progress projects has been an ongoing issue due to lack of timely submission of "in service" information to accounting. A report will be developed to check on the status of projects as they near completion. Also, new procedures have been implemented to prevent the duplicate recording of assets.

**Anticipated Completion Date:** June 2011

**Contact Person(s):** Nelson Koyanagi, Chief Accountant, BFS  
Michael D. Richards, Supervisor, Capital Assets, BFS

**Finding No. 2010-02: Report Payroll and Fringe Benefits in the Proper Funds**

**Audit Recommendation:** We recommend that the City ensure expenditures are properly allocated and reflected in the appropriate funds.

**Administration's Comment:** The City will revise its accounting and review procedures to ensure that expenditures are properly allocated and reflected in the appropriate funds.

**Anticipated Completion Date:** June 2011

**Contact Person(s):** Nelson Koyanagi, Chief Accountant, BFS  
Ann Sakurao, Fiscal Officer, BFS

**Finding No. 2010-03: Allocation of Interest Earned on Federal Programs**

**Audit Recommendation:** We recommend that the City properly calculate interest for the four funds pooled in the DCS checking account to ensure that each fund is allocated its share of the interest earned to avoid potential cash management issues regarding interest earned for advances received from different federal awards.

**Administration's Comment:** The audit comment is duly noted, however, the City's allocation for interest earned in the checking account is proper.

**Anticipated Completion Date:** December 2010

**Contact Person(s):** Nelson Koyanagi, Chief Accountant, BFS  
Beryle Matsumura, Fiscal Officer, BFS

**Finding No. 2010-04: Required Reporting to State**

**Audit Recommendation:** We recommend that the City assign an individual the responsibility to ensure that the annual reports are submitted to DOH in a timely manner. Management should monitor to ensure that the reports are properly completed and submitted by the responsible individual after appropriate review.

**Administration's Comment:** The City will work with the State Department of Health to ensure that appropriate annual reports are submitted to DOH in a timely manner.

**Anticipated Completion Date:** June 2011

**Contact Person:** Tim Houghton, Executive Assistant, ENV

**Finding No. 2010-05**

**Audit Recommendation:** All tenant files should be maintained in accordance with the Section 8 "File Order" document to ensure consistency among tenant files and that source documents relating to tenant eligibility, rent reasonableness, and reporting for the Section 8 Housing Choice Voucher program are properly maintained and support the City's compliance with federal requirements.

**Administration's Comment:** The Section 8 tenant files will be organized in accordance with program procedures and will be reviewed to ensure that the source documents that comply with federal requirements are maintained.

**Anticipated Completion Date:** March 2012

**Contact Person** Gail Kaito, Administrator, Community Assistance Division, DCS  
Jayne Lee, Section 8 Administrator, DCS

**Finding No. 2010-06**

**Audit Recommendation:** We recommend that the City perform site visits every other year in accordance with the City's internal control procedures and maintain a tracking schedule to ensure that program personnel are aware of when site visits are required. The program should also ensure that all required checklists are properly completed and filed in a timely manner.

**Administration's Comment:** The City will develop and adhere to a schedule of site visits to Shelter Plus Care grantees and ensure that all required checklists are properly completed and filed in a timely manner.

**Anticipated Completion Date:** June 2011

**Contact Person:** Keith Ishida, Administrator, DCS

**Finding No. 2010-07**

**Audit Recommendation:** We recommend that management assign an individual familiar with the program's matching requirements to perform a detailed review of the supporting schedules and calculations of the program's matching each period.

**Administration's Comment:** The City will perform detailed reviews of supporting schedules and calculations as it relates to the program's matching requirements.

**Anticipated Completion Date:** June 2011

**Contact Person:** Keith Ishida, Administrator, DCS

**Finding No. 2010-08: Cash Management**

**Audit Recommendation:** To ensure that a similar situation does not occur in the future, individuals should be made aware of the importance of limiting the time between the drawdown and the disbursement in accordance with federal requirements and ensure that paperwork is organized in an orderly fashion so that invoices are not misplaced.

**Administration's Comment:** The delay in disbursing the federal funds was an isolated occurrence. The staff have been reminded to follow the established procedures to monitor and limit the time lapsed between the receipt and disbursement of federal funds.

**Anticipated Completion Date:** December 2010

**Contact Person(s):** Nelson Koyanagi, Chief Accountant, Budget and Fiscal Services  
Beryle Matsumura, Fiscal Officer, Budget and Fiscal Services

**Finding No. 2010-09: Improper Revenue Recognition**

**Audit Recommendation:** We recommend that the City ensure that an analysis is performed on at least an annual basis and that revenue is recognized in the proper period.

**Administration's Comment:** The City will perform an analysis to ensure that OTS defers a portion of the revenue from the sale of one and two-year bus passes that will not be used in the current year and recognizes the revenue in the proper accounting period.

**Anticipated Completion Date:** July 2011

**Contact Person(s):** Nelson Koyanagi, Chief Accountant, BFS  
James P. Burke, Chief, Public Transit Division, DTS

**Finding No. 2010-10: Discrepancies Noted During Physical Inventory Observations**

**Audit Recommendation:** We recommend that the City work with OTS to update the year-end physical inventory counting procedures to address the issues noted above.

**Administration's Comment:** The City is working with OTS to update its inventory procedures and develop a comprehensive inventory management plan to ensure that the PTS Bus and Paratransit year-end parts and supplies inventories are properly stated.

**Anticipated Completion Date:** June 2011

**Contact Person:** Wayne Yoshioka, Director, DTS

**PRIOR YEAR COMMENTS AND RECOMMENDATIONS**

**Finding 2009-01: Improve the Accounting of Capital Assets**

**Audit Status:** Unresolved. All items listed above were addressed in fiscal year 2010 except for the timely transfer of completed capital assets from work-in-progress (Bullet point 2). In addition, during our testing of capital assets for the City's governmental activities for the year ended June 30, 2010 we noted other errors. Refer to Comment No. 2010-01.

**Administration's Comment:** Refer to comment 2010-01.

**Finding 2009-03 – Improve Subrecipient Monitoring Programs**

**Audit Status:** Unresolved. During our testing of the City's federal awards programs, we noted instances of noncompliance with the City's subrecipient monitoring policies and procedures. Refer to Comment No. 2010-06.

**Administration's Comment:** Refer to comment 2010-06.