

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, 2011

Management Letter





CERTIFIED PUBLIC ACCOUNTANTS

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, 2011, 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 19, 2011

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City and County of Honolulu

Current Year Comments

June 30, 2011

2011-01 Improve Accounting for Capital Assets

During our testing of the City's governmental activities capital assets as of June 30, 2011, we noted various capital assets that should have been transferred out of work-in-progress to the proper completed capital asset accounts during fiscal 2011. This resulted in an understatement of \$90.8 million and \$50.3 million in completed capital asset accounts (buildings and improvements and infrastructure) for governmental activities and the Solid Waste Fund, respectively.

Due to the sampling methodology performed in this test, \$30.2 million were known misstatements and \$60.6 million were projected misstatements based on the errors noted in the samples tested over the total work-in-progress balance of \$578.0 million.

Recommendation

We recommend that the City continue to improve its accounting for capital assets to ensure timely transfer of completed capital asset projects and recordation of depreciation expense. The City should review its work-in-progress balance for other capital projects that should be transferred to depreciable capital asset accounts and properly adjust its capital asset records during fiscal 2012.

2011-02 Period of Availability

During our testing of the period of availability of federal awards under the Workforce Investment Act ("WIA") cluster (CFDAs 17.250 and 17.260), we noted the following errors:

- There was \$6,545 of expenditures incurred subsequent to the end of the grant period of December 31, 2010 for one of the WIA grants.
- There was \$8,000 of tuition expenditures for the period August 23, 2010 to August 20, 2011 that was incorrectly charged to a different WIA grant and those expenditures were incurred subsequent to the end of the grant period.

Although we noted subsequent grants allowed the use of federal awards for the periods noted above, the City improperly recorded the expenditures to grants where the period of availability had already expired.

Recommendation

The City should stress the importance of ensuring that expenditures incurred are within the specified period of availability for the related federal awards and record expenditures to the proper grants.

2011-03 Inaccurate Timesheets and Payroll Expense

During our testing of allowable costs for federal grants under the Justice Assistance Grants ("JAG") cluster (CFDA 16.803) which included grants to the Honolulu Police Department and Prosecuting Attorney Department, we noted an employee was overpaid by 24 hours in one pay period and not paid for another pay period during fiscal year 2011 due to calculation errors in the Honolulu Police Department's payroll system. The total difference for both errors was less than \$1,500.

Prior to January 2011, a City employee spent 50% of her time on the JAG program and, accordingly, 50% of the employee's salary was charged to the JAG program. Although the employee started working full-time on the JAG program in January 2011, only 50% of the employee's salary was charged to the JAG grant, as that was the amount previously approved by the federal granting agency and pass-through entity. In March 2011, the City received approval to charge all of the employee's salary to the JAG grant retroactive to January 2011. Despite working full-time on the program from January through March 2011,

City and County of Honolulu
Current Year Comments
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the employee was instructed to continue to charge only 50% of her time to the JAG program on timesheets submitted. Consequently, the timesheets submitted did not accurately reflect the hours the employee spent working on the JAG program.

Recommendation

We recommend and the City has already made a corrective payment to the employee in question and reviewed the payroll system for other payroll errors. We also recommend that the City pay proper amounts to its employees and have employees accurately record all hours spent on programs on their timesheets. If the City is not allowed to charge a proportionate share of an employee's pay and related expenditures to the respective grant, the City should document the adjustment to the expenditure and related drawdown/reimbursement in its records.

2011-04 Documenting Inspection Extensions

During our Section 8 Housing Choice Vouchers ("Section 8") program (CFDA 14.871) testing of failed Housing Quality Standards inspections, we noted five instances where it appeared that a reinspection did not occur within the required 30 days of the failed inspection. We were informed that an informal extension was verbally granted by the City inspector in each instance.

Recommendation

We recommend that the City's Section 8 program implement procedures to ensure that granted inspection extensions are formally documented to support the proper performance of Housing Quality Standards inspections.

2011-05 Cash Management

During our cash management testing over the Community Development Block Grants ("CDBG") cluster (CFDA 14.218 and 14.253), we noted three instances in which the City disbursed the federal funds three days after the funds were received with no written justification for the time lag.

Recommendation

We recommend that the City disburse funds within three days as stated in the U.S. Department of Housing and Urban Development ("HUD") Training Guide Chapter 11, section 11.9.2 or ensure that appropriate written justification is maintained for any disbursement made more than three days after the receipt of funds.

City and County of Honolulu
Current Year Comments
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The following is the status of the prior year comments.

2010-01 and 2009-01 Improve Accounting for Capital Assets

During our fiscal 2010 testing of the City's governmental activities capital assets, 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 fiscal 2010 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 fiscal 2010 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 fiscal 2010 depreciation expense of \$1,815,000.

During the audit of the fiscal 2009 financial statements, it was noted that \$10 million of work-in-progress should have been transferred to completed capital asset accounts.

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

Status

Unresolved. The double counting of other improvements was corrected in fiscal year 2011. However, we continued to identify untimely transfers of work-in-progress during our current year testing of completed capital assets. Refer to Comment No. 2011-01. This comment will not be carried forward.

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

During our prior year 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.

Status

Resolved. No similar instances were noted in the current year. We noted that the City established procedures to ensure expenditures are properly allocated and reflected in the appropriate funds.

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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. 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 Housing Assistance Payment 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, as 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.

Status

Resolved. The City determined the interest earned on the balances in the DCS account related to the Pauahi and Revolving funds are immaterial, as the total interest earned was less than \$1,000 in fiscal 2011. Therefore, the City continues to allocate interest to the Housing and Community Development Rehabilitation Loan and Section 8 funds.

2010-04 Required Reporting to State

During our prior year 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 due by December 31st as required by the City's revolving fund loan agreements with DOH.

We recommended that the City assign an individual the responsibility to ensure that the annual reports are submitted to DOH in a timely manner. We also recommended that management monitor to ensure the reports are properly completed and submitted after appropriate review.

Status

Unresolved. The annual report was not submitted by December 31, 2010. We understand that the City is working with DOH to remove this annual reporting requirement.

2010-05 Organization of Supporting Files

During our prior year 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 the file documents.

Status

Resolved. We were informed that training sessions on proper filing procedures were conducted for all program examiners in fiscal 2011, and we did not note any missing documents or forms during our current year testing.

City and County of Honolulu
Current Year Comments
June 30, 2011

2010-06 Site Visits and Completion of Required Documents

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

- Two of the City's three subrecipients should have had site visits during fiscal year 2010, but we noted that site visits were not performed.
- Checklists were not completed 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 HUD guidelines, but the "Certification of Homeless" form could not be located.
- Although regular site visits of tenant housing were performed by the housing specialist, there were instances where the annual inspection checklist was not completed.

We recommended 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 City should also ensure that all required checklists are properly completed and filed in a timely manner.

Status

Unresolved. No changes were noted in the current year.

2010-07 Error in the Calculation of Federal Matching Requirement

During our prior year 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 subsequently corrected.

Status

Resolved. We noted that the City now ensures that an individual within the City who is familiar with the program's matching requirements performs a detailed review of the supporting schedules and calculations of the program's matching for the period.

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 until 35 days after receiving the advance due to the invoices being misplaced.

Status

Resolved. No similar instances were noted during our current year testing of other HUD funded programs. However, we noted a different cash management comment for the City's CDBG program as disclosed in Comment No. 2011-05.

City and County of Honolulu

Current Year Comments

June 30, 2011

2010-09 Improper Revenue Recognition

During our prior year 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. Consequently, the City PTS’s deferred revenue balance was understated by approximately \$825,000 as of June 30, 2010.

Status

Resolved. An analysis was performed over deferred revenue on bus passes sold and revenue was properly recorded as of June 30, 2011.

2010-10 Discrepancies Noted During Physical Inventory Observations

During our prior year 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.

- Lack of organization and consistency in the storage of inventory items. 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.

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

Status

Unresolved. The City is still working with OTS to update the year-end physical inventory counting procedures to address errors made by the individuals performing the inventory counts. We continued to identify discrepancies in the inventory counts during our June 2011 physical inventory observation.

2009-03 Improve Subrecipient Monitoring Programs

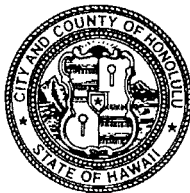
During the 2009 audit, it was noted that the City’s HOME Investment Partnerships Program (CFDA 14.239) and the Aging Cluster programs (CFDA 93.044 and 93.045) did not maintain adequate documentation to support the City’s monitoring of federal awards passed-through the City to subrecipient organizations.

Status

Unresolved. During our testing of the City’s federal awards programs, we noted instances of noncompliance with HUD requirements and the City’s monitoring policies and procedures. Refer to Finding No. 2011-5 in the City’s Single Audit Report for the year ended June 30, 2011. This comment will not be carried forward.

DEPARTMENT OF BUDGET AND FISCAL SERVICES
CITY AND COUNTY OF HONOLULU
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PETER B. CARLISLE
MAYOR



MICHAEL R. HANSEN
DIRECTOR

NELSON H. KOYANAGI, JR.
DEPUTY DIRECTOR

December 19, 2011

Mr. Edwin Young
Office of the City Auditor
1001 Kamokila Blvd. Suite 216
Kapolei, Hawaii 96707

Dear Mr. Young:

Subject: Management Advisory Report for the Fiscal Year 2010-2011

Enclosed is the response to the recommendations included in Accuity LLP's preliminary draft of the management advisory report resulting from the audit of the City and County for the fiscal year ended June 30, 2011. 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 "Michael R. Hansen", written in a cursive style.

Michael R. Hansen
Director

MRH:lt

Attachments

APPROVED:

A handwritten signature in black ink, appearing to read "Douglas S. Chin", written in a cursive style.

Douglas S. Chin
Managing Director

cc: BFS- Internal Control
BFS- Accounting

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS**
For the Year Ended June 30, 2011

CURRENT YEAR COMMENTS AND RECOMMENDATIONS

Finding No. 2011-01: Improve Accounting for Capital Assets

Audit Recommendation: We recommend that the City continue to improve its accounting for capital assets to ensure timely transfer of completed capital asset projects and recordation of depreciation expense. The City should review its work-in-progress balance for other capital projects that should be transferred to depreciable capital asset accounts and properly adjust its capital asset records during fiscal 2012.

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.

Anticipated Completion Date: June 2012

Contact Person(s): David Hanlon, Acting Chief Accountant, Budget and Fiscal Services
Luz O. Peirson, Accountant V, Accounts Payable Unit, Budget and Fiscal Services

Finding No. 2011-02: Period of Availability

Audit Recommendation: The City should stress the importance of ensuring that expenditures incurred are within the specified period of availability for the related federal awards and record expenditures to the proper grants.

Administration's Comment: The City has made the corrections and the staff have been reminded to ensure expenditures are incurred within the specified period of availability for the related federal awards and record expenditures to the proper grants.

Anticipated Completion Date: July 2011

Contact Person(s): David Hanlon, Acting Chief Accountant, Budget and Fiscal Services
Beryle Matsumura, Fiscal Officer, Budget and Fiscal Services

Finding No. 2011-03: Inaccurate Timesheets and Payroll Expense

Audit Recommendation: We recommend and the City has already made a corrective payment to the employee in question and reviewed the payroll system for other payroll errors. We also recommend that the City pay proper amounts to its employees and have employees accurately record all hours spent on programs on their timesheets. If the City is not allowed to charge a proportionate share of an employee's pay and related expenditures to the respective grant, the City should document the adjustment to the expenditure and related drawdown/reimbursement in its records.

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS**
For the Year Ended June 30, 2011

Administration's Comment: The City has revised its review procedures to ensure that timesheets properly reflect the time worked on the grants and that the expenditures are properly charged to the grants.

Anticipated Completion Date: December 2011

Contact Person(s): David Hanlon, Acting Chief Accountant, Budget and Fiscal Services
Kelli Nishimura, Accountant V, Budget and Fiscal Services

Finding No. 2011-04: Documenting Inspection Extensions

Audit Recommendation: We recommend that the City's Section 8 program implement procedures to ensure that granted inspection extensions are formally documented to support the proper performance of Housing Quality Standards inspections.

Administration's Comment: The City will modify the inspection report procedures to require the inspectors to document in writing any approved inspection extension dates.

Anticipated Completion Date: January 2012

Contact Person(s): Jayne Lee, Rental Assistance Administrator, Community Services

Finding No. 2011-05: Cash Management

Audit Recommendation: We recommend that the City disburse funds within three days as stated in the U.S. Department of Housing and Urban Development ("HUD") Training Guide Chapter 11, section 11.9.2 or ensure that appropriate written justification is maintained for any disbursement made more than three days after the receipt of funds.

Administration's Comment: City staff have been reminded to comply with the established procedures for the receipt and disbursement of federal funds and will prepare written documentation of the justification for any time lags.

Anticipated Completion Date: December 2011

Contact Person(s): David Hanlon, Acting Chief Accountant, Budget and Fiscal Services
Ann Sakurao, Fiscal Officer, Budget and Fiscal Services

PRIOR YEAR COMMENTS AND RECOMMENDATIONS

Finding No. 2010-01 and 2009-01: Improve Accounting for Capital Assets

Audit Status: Unresolved. The double counting of other improvements was corrected in fiscal year 2011. However, we continued to identify untimely transfers of work-in-progress during our current year testing of completed capital assets. Refer to Comment No. 2011-01. This comment will not be carried forward.

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS**
For the Year Ended June 30, 2011

Administration's Comment: Refer to comment 2011-01.

Finding No. 2010-04: Required Reporting to State

Audit Status: Unresolved. The annual report was not submitted by December 31, 2010. We understand that the City is working with DOH to remove this annual reporting requirement.

Administration's Comment: The City has worked with the State of Hawaii, Department of Health, regarding this submission requirement. The Department of Health has determined that the annual audited Sewer Fund financial statements provides appropriate information and this submission is no longer required. They will be removing this reporting requirement from future documents. The City will work with the Department of Health regarding the final removal of this requirement.

Anticipated Completion Date: December 2011

Contact Person: Tim Houghton, Executive Assistant, Environmental Services

Finding No. 2010-06: Site Visit and Completion of Required Documents

Audit Status: Unresolved. No changes were noted in the current year.

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

Anticipated Completion Date: June 2012

Contact Person(s): Michael Shiroma, Acting Administrator, Community Based Development Division, Community Services

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

Audit Status: Unresolved. The City is still working with OTS to update the year-end physical inventory counting procedures to address errors made by the individuals performing the inventory counts. We continued to identify discrepancies in the inventory counts during our June 2011 physical inventory observation.

Administration's Comment: The City worked with OTS to update its inventory procedures and developed a comprehensive inventory management plan to ensure that the PTS Bus and Paratransit year-end parts and supplies inventories are properly stated. The HandiVan storeroom will be reorganized when the HandiVan maintenance facility is available for use.

Anticipated Completion Date: April 2012

**RESPONSE TO MANAGEMENT ADVISORY REPORT
FINDINGS AND RECOMMENDATIONS**

For the Year Ended June 30, 2011

Contact Person(s): Wayne Yoshioka, Director, Transportation Services
Kai Nani Kraut, Deputy Director, Transportation Services
Christopher S. Ovitt, Administrative Services Officer, Transportation Services
Kellie Saiki, Internal Control Analyst, Transportation Services

Finding No. 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 HUD requirements and the City's monitoring policies and procedures. Refer to Finding No. 2011-05 in the City's Single Audit Report for the year ended June 30, 2011. This comment will not be carried forward.

Administration's Comment: Refer to Finding No. 2011-5 in the City's Single Audit Report.