OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i

Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability

A Report to the
Mayor
and the
City Council of
Honolulu

Report No. 04-01
April 2004

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Submitted by

THE CITY AUDITOR
CITY AND COUNTY
OF HONOLULU
STATE OF HAWAI'I

Report No. 04-01
April 2004

Foreword

This is a report of our audit of the Department of Enterprise Services' efforts toward fiscal self-sustainability. The audit was conducted pursuant to Council Resolution 03-198, that requested the City Auditor to review economy and efficiency activities of eight departments that are primarily funded by general and highway fund appropriations. The City Auditor selected the Department of Enterprise Services to audit because it continues to require significant general fund subsidies for its operations.

We wish to acknowledge the cooperation and assistance of the Department of Enterprise Services, the Department of Budget and Fiscal Services, and others whom we contacted during this audit.

Leslie I. Tanaka, CPA
City Auditor

EXECUTIVE SUMMARY

Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability

Report No. 04-01, April 2004

This audit was conducted pursuant to Council Resolution 03-198, which requested the City Auditor to review economy and efficiency activities of eight executive departments. The City Auditor selected the Department of Enterprise Services because it continues to require significant general fund subsidies. This audit, *Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability*, assesses the department's plans to operate on a self-sustaining basis and the management of its concession and revenue-generating contracts.

Background

Established by the 1998 citywide reorganization, enterprise services' mission is to manage and market a diversity of community-oriented facilities—the Neal S. Blaisdell Center, Waikiki Shell, Honolulu Zoo, and the City's golf courses—for the public's use and benefit on a self-supporting basis. The department is unique among city agencies because its activities generate revenues that are used to offset a portion of the department's operating costs. In FY2003-04, the department's appropriated operating budget, for salaries, current expenses, and equipment, was $15,925,206, while for the same period its appropriated general fund subsidy totaled $17,336,931.

Summary of Findings

Fiscal self-sustainability, defined as having a revenue stream to cover all expenses, is an admirable goal. However, without adequate planning and oversight of its resources and contracts, this goal is difficult to attain. While total fiscal self-sustainability—that is no general fund support—may be unrealistic for the Department of Enterprise Services, the department needs to do a better job of planning and improving on its management of revenue-generating concession contracts and resources.

Finding 1: The Department of Enterprise Services lacks an adequate plan to focus and coordinate its initiatives to achieve fiscal self-sustainability

- While the general fund-appropriated subsidies fluctuate from year-to-year, the department's annual subsidies are substantial;
- The department has no comprehensive fiscal sustainability plan as reported;
- Inadequate planning will hinder significant reductions in its subsidies; and
- Enterprise services' resources for a contract planner and related costs, totaling nearly $142,000, has been expended for a program that is the primary responsibility of another City agency.

Finding 2: The department's management, oversight and enforcement of its contracts are deficient

- The department faces serious difficulties in enforcing contract compliance. One concessionaire accrued arrears in excess of $202,000 and continues to stymie the department's efforts;
- The department lacks an effective plan and procedures to ensure that concessionaires comply with the terms of their concession contracts and pay the rent owed to the City; and
- City policy on accounts receivable is not being followed and thousands of dollars owed to the City are not being collected in a timely manner. While the department has begun addressing the backlog in accounts receivable, more priority is needed.

Finding 3: Concession contract practices bypassed public bidding requirements and awarded City concession revenues to a non-City organization

- The department bypassed competitive bids in the award of a concession contract. Even though it received a sole-source exemption, the department used the "revocable permit" exemption permissible under state law for concessions on public property to bypass the City's public bidding requirement for concession contracts;

- The department has allowed a concessionaire to operate without a written contract for months at a time; and

- The practice of awarding City concession revenues directly to a non-City organization is questionable.

Finding 4: Deficient record management practices and missing official contract documents place the City at unnecessary risk

- The department has not established policies and procedures for maintaining its concession contract files;

- Concession contract files were in disarray with little evidence of monitoring or oversight efforts by department employees;

- Missing documents, spanning a 17-month period when one concessionaire's arrears skyrocketed to $155,000 could not be explained; and

- The department could not provide us with a copy of an official beach stand concession contract even though this concessionaire has sued the City.

Recommendations and Response

We made a number of recommendations to the Department of Enterprise Services to resolve deficiencies and problems identified during this audit. In summary, the department needs to establish a comprehensive long-term fiscal sustainability plan and make improvements in its management, oversight and enforcement of the department's concession contracts. In addition, the department must ensure compliance with City ordinance requiring open competitive bidding for awarding City concession contracts and cease the practices of awarding City concession revenue directly to non-City organizations. Lastly, the department needs to improve its records management practices and maintain copies of official concession contracts in its files.

We also made recommendations to the Department of Budget and Fiscal Services to address certain concerns identified during this audit. Copies of official concession contracts must be maintained in its contract files. In future requests for sole-source approval, the department should ensure that enterprise services' provides accurate information and appropriate justification prior to approval.

In its response to our draft audit report, the Department of Enterprise Services was critical of the draft report. It suggested that the report was not prepared in accordance with government auditing standards. The department reported that it generates an operating profit and is achieving its goal of fiscal sustainability and disputed the report's findings on its fiscal sustainability planning. It asserted that its general fund subsidy has been reduced over the past six years, not increased. Also, since the Mayor assigns responsibilities for the annual environmental conference to the department, the use of staff time and resources are therefore part of enterprise services' mission. The department also noted that one concessionaire is responsible for the $202,000 arrears. It stated that it is not violating City accounts receivable policy and that the amount of the outstanding fees and rents represents a small percentage compared to the Blaisdell and Waikiki Shell's annual revenues. The department identified the zoo train contract as a revocable permit pursuant to State Procurement code, not a sole-source contract, and therefore City ordinance was not violated. Furthermore, the department stated that no City concession revenues were diverted from the City Treasury. Finally, the department reported that the City maintains adequate control over all contract documents and that the concessionaire's emergency contact information is provided to City personnel. The department did not comment on whether it agreed with or would implement the audit's recommendations.

The department's response provided some clarifying points useful to us and changes, where appropriate, were made to the final report. However, overall the response and related attachments did not address some of the actual report text or change the facts we gathered during our fieldwork. In addition, the department's response included information contradictory from that provided to us in interviews and contained in the department's project files during fieldwork. Thus, we are not in a position to comment on the validity of some of the information generated by the department for its response—much of which was prepared after conclusion of our fieldwork. We incorporated certain other changes for the purpose of accuracy and clarity. We stand by the statements in our report and recommendations contained herein.

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Chapter 1
Introduction

The Honolulu City Council adopted Resolution 03-198 requesting the City Auditor to review economy and efficiency activities of a number of executive departments. The City Auditor selected the Department of Enterprise Services for review because it continues to require significant general fund subsidies for its operations.

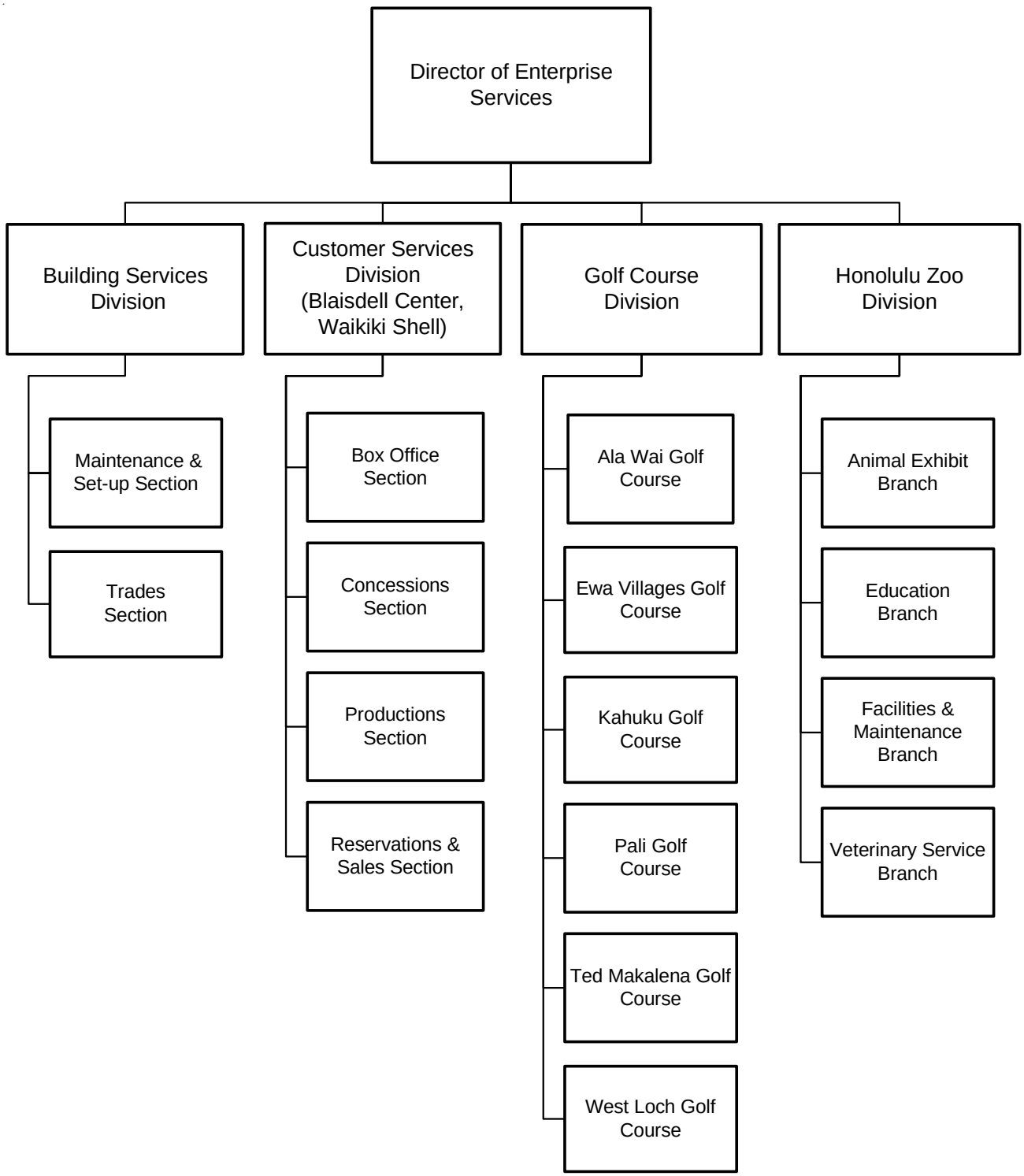
This audit, *Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability*, assesses the department's plans to operate on a self-sustaining basis and its management of concession and revenue-generating contracts.

Background

The Department of Enterprise Services was established by the 1998 citywide reorganization. It is comprised of the former Department of Auditoriums, which at that time included the Honolulu Zoo and the municipal golf course operations, and also the citywide concessions from the Department of Parks and Recreation. Enterprise services' mission is to manage and market a diversity of community-oriented facilities and services for the public's use and benefit on a self-supporting basis.

The department has four divisions, as shown in Exhibit 1.1: Building Services, Customer Services, Golf Course, and the Honolulu Zoo. As of December 31, 2003, the department had 433 employees of which 205 were permanent full-time, 22 part-time, and 206 contract employees.

Exhibit 1.1
Department of Enterprise Services' Organizational Chart



Source: Department of Enterprise Services

Functions

The **Customer Services Division** is responsible for the Neal S. Blaisdell Center and Waikiki Shell operations. Its business functions include box office, citywide concession management, production, and reservations and sales. The Blaisdell Center's venues include an Arena that can seat up to 8,800 persons, a 2,158-seat Concert Hall, a 65,000 square foot Exhibition Hall, and five meeting rooms. The Waikiki Shell has 2,400 seats and lawn area with the capacity to accommodate 6,000 additional persons. Revenues generated by the City's venues include room and equipment rentals, box office services, ushering, parking, and beverage, food and novelty sales. The division's Concessions Section administers and oversees citywide concession contracts for the department.

The **Golf Course Division** is responsible for managing, operating, planning, and improving the City's six municipal golf courses as follows: 1) Ala Wai, 2) Ewa Villages, 3) Kahuku, 4) Pali, 5) Ted Makalena, and 6) West Loch. The City's courses include five of the six most-played courses in Hawaii. In FY2002-03, a total of 611,979 rounds of golf were played on the City's courses. Golf course operations generate revenues from greens fees, tournament play, and golf club sets and cart rentals. In addition, the food, pro shop and driving range concessions located at the golf courses generate additional revenues for the City.

The **Honolulu Zoo Division** is responsible for operating, maintaining and planning for the City's 42-acre zoological park. The zoo generates revenues from admission fees, annual passes and on-site concessions. Located within walking-distance of Waikiki, the Honolulu Zoo is the seventh most popular tourist attraction in Hawaii. In FY2002-03, it attracted 498,376 resident and out-of-state visitors.

The **Building Services Division** provides maintenance, grounds-keeping, and event set-up services at the Blaisdell Center, Waikiki Shell, Honolulu Zoo, City golf courses and for all of the City's "Brunch" and "Sunset" programs since 2002. The division's operations do not generate revenues for the City. It also oversees the department's capital improvements program and manages maintenance contracts, such as tree trimming and stage lift maintenance services, for the department's facilities.

Currently, the Department of Enterprise Services manages 32 concession contracts, including four beachboy concessions along

Kuhio beach in Waikiki, the Hanauma Bay snorkel rentals, the Ala Wai Golf Course's driving range and pro shop, and the Honolulu Zoo train ride attraction. Exhibit 1.2 lists the concessions managed by the Department of Enterprise Services as of January 1, 2004, including the term and monthly rent paid to the City.

Exhibit 1.2
City Concessions Managed by The Department of Enterprise Services as of January 1, 2004

	Name of Concession	Contract Term	Monthly Rent Paid to the City
1.	Ala Moana Food Concession	2-23-00 to 2-22-05	$4,000 or 21% of gross revenues, whichever is higher
2.	Ala Wai Golf Course Food Concession	12-11-01 to 12-10-06	$6,880 or 10% of gross revenues, whichever is higher
3.	Ala Wai Golf Course Driving Range and Pro Shop	9-6-03 to 9-5-08	$20,040 or 56% of gross revenues plus 3% of Pro Shop gross revenues
4.	Beach Services Stand #1 at Kuhio Beach	month-to-month pending bid opening	$8,150 per month plus 5% of gross receipts
5.	Beach Services Stand #2 at Kuhio Beach (non-profit operator)	month-to-month pending lottery	$1,750 per month plus 10% of gross receipts
6.	Beach Services Stand #3 at Kuhio Beach	month-to-month pending bid opening	$12,001 per month plus 10% of gross receipts
7.	Beach Services Stand #4 at Kuhio Beach	month-to-month pending bid opening	$1,600 per month plus 10% of gross receipts
8.	Blaisdell Center and Waikiki Shell Food Concession	2-23-00 to 2-22-05	$22,500 or 33.31% of concession plus 17.75% of catering revenues
9.	Blaisdell Center Novelty	4-1-01 to 3-31-04	$1,500 and 25% or 60% gross revenues as applicable
10.	Blaisdell Center Parking Lot	1-1-99 to 12-31-04	$21,050 or 72.2% of gross revenues, whichever is higher
11.	Civic Center Lunch Wagon	1-24-00 to 1-23-05	$600
12.	Ewa Villages Golf Course Food Concession	8-1-03 to 7-31-04	$511 or 5% of gross revenues, whichever is higher
13.	Ewa Villages Golf Pro Shop	9-6-03 to 9-5-06	$500
14.	Hanauma Bay Food Concession	4-1-03 to 3-30-08	$21,750
15.	Hanauma Bay Shuttle Bus	9-1-02 to 8-31-03 (extended)	$3,100
16.	Hanauma Bay Snorkel	8-17-02 to 8-16-07	$65,800
17.	Hanauma Bay Gift Shop	8-17-02 to 8-16-07	10% of gross revenues
18.	Honolulu Zoo Food and Gift Shop (management contract)	1-24-00 to 1-23-10	$5,000 for the first 2 years; $10,000 for the remaining 8 years
19.	Honolulu Zoo Train	9-20-03 to 12-20-03 (extended)	40% of ticket revenues over $400 per day
20.	Kailua Beach Park Food Concession	1-26-00 to 1-25-05	$1,100 or 15% of gross revenues, whichever is higher
21.	Kapiolani Beach Center Food	12-1-98 to 11-30-03 month-to-month until 2-29-04	$800
22.	Koko Head Stable Concession	10-1-02 to 9-30-07	$2,002
23.	Pali Golf Course Food Concession	8-1-03 to 7-31-04	$1,011 or 5% of gross revenues, whichever is higher
24.	Pali Golf Course Pro Shop	9-1-01 to 8-31-04	$125
25.	Sandy Beach Food Wagon	1-15-02 to 1-14-07	$617
26.	Pouring Rights and Soft Drink Vending Machine License Agreement	11-1-99 to 10-31-04	$100 annually per machine plus 52% of gross revenues and various
27.	Ted Makalena Golf Course Food Concession	8-31-03 to 7-31-04	$511 or 5% of gross revenues, whichever is higher
28.	Tennis Concession at Central Oahu Regional Park	8-1-03 to 7-31-08	$4,000
29.	Waikiki Beach Center Food Concession	12-6-01 to 12-5-06	$11,000 or 30% of gross revenues, whichever is higher
30.	West Loch Golf Food Concession	8-31-03 to 7-31-04	$511 or 5% of gross revenues, whichever is higher
31.	West Loch Driving Range & Pro Shop	12-15-01 to 12-14-04	$100
32.	ATM Machine-Blaisdell Center	month-to-month	$1,600

Source: Department of Enterprise Services

Resources

The Department of Enterprise Services' operating budget is funded through appropriations from revenues collected in four special funds (Golf Fund, Hanauma Bay Nature Preserve Fund, Special Events Fund, and Zoo Animal Purchase Fund) and general fund subsidies. As shown in Exhibit 1.3, the department's primary revenues come from the golf and special events funds. General fund subsidies make up a significant amount of resources to the department. Such subsidies help to offset its debt service costs and other miscellaneous costs, such as employee-related and central services expenses.

Exhibit 1.3
The Department of Enterprise Services' Appropriations and General Fund Subsidies FY2001-02 to FY2003-04

Fiscal Year	Golf Fund	Hanauma Bay Nature Preserve Fund	Special Events Fund	Zoo Animal Purchase Fund	General Fund Subsidies	Total Appropriations and General Fund Subsidies
2001-02	$8,357,165	$12,177	$7,597,380	$35,000	$12,829,197	**$28,830,919**
2002-03	$8,323,700	$13,626	$7,725,509	$35,000	$12,002,676	**$28,100,511**
2003-04	$8,221,072	$13,626	$7,680,508	$10,000	$17,336,931	**$33,262,137**

Source: Executive Operating Budget, FY2001-02 to FY2003-04

Certain rent, fees and rates for the use of the City's venues and concession prices are established by ordinance. In March 2003, Ordinance 03-3 was enacted to update rental rates and fees to encourage more commercial events to be scheduled at the Blaisdell Center and Waikiki Shell. Another change increased the term of concession contracts from three years to a maximum of five years, so that concessionaires might have additional time to recover the cost of their investment in equipment used to operate the concession.

Golf Fund

The Golf Fund receives all revenues generated by City golf course operations and concessions. In FY2003-04, $8,221,072 was appropriated from the Golf Fund for the management, operations and maintenance of the City's golf courses.

Special Events Fund

The Special Events Fund receives all revenues generated from the Blaisdell Center, Waikiki Shell, and the Honolulu Zoo operations. This includes room rentals, fees, and ticket surcharges from operations at the Blaisdell Center, Waikiki Shell, and Honolulu Zoo. In addition, all department concession revenues, except for golf, tennis and Hanauma Bay concession revenues, are deposited into the Special Events Fund. In FY2003-04, $7,680,508 was appropriated from the Special Events Fund to support the operating expenses of the three venues including the department's administrative operations.

Hanauma Bay Nature Preserve Fund

The Hanauma Bay Nature Preserve Fund was established to receive all entrance and vehicle admission fees, and all revenues generated by Hanauma Bay concessions. Funds collected are specifically earmarked for the nature preserve's operation, maintenance, and improvement; education and visitor orientation programs; and studies of the preserve. In FY2003-04, $13,626 was appropriated from the fund to oversee City concession operations at the Hanauma Bay Nature Preserve.

Zoo Animal Purchase Fund

The Zoo Animal Purchase Fund was created to receive proceeds from the sale of surplus animals and donations. Expenditures are restricted to the acquisition of animals for the zoo and in FY2003-04, $10,000 was appropriated to the department from the Zoo Animal Purchase Fund for this purpose.

Objectives of the Audit

1. Assess the Department of Enterprise Services' efforts to achieve fiscal self-sustainability.

2. Assess the department's management of its concession and revenue-generating contracts.

3. Make recommendations, as appropriate.

Scope and Methodology

Our assessment of the department's efforts to achieve fiscal self-sustainability included reviewing established plans, studies, reports, applicable policies and procedures, and relevant documents. The director and division administrators were interviewed regarding their respective fiscal self-sustainability plans, efforts and initiatives.

Our assessment of the department's management of concession and revenue-generating contracts included reviewing a sample of concession and revenue-generating contracts administered by the department. Contracts chosen for review were based on concessions associated with the department's customer services, golf, and zoo divisions, rental payments in arrears, method of contract award, and significant monthly rent paid to the City. The five contracts selected were the Ala Wai Golf Course Driving Range and Pro Shop concession, Beach Stand #3 at Kuhio Beach Park, the Hanauma Bay Snorkel concession, the Honolulu Zoo Train concession and the Honolulu Symphony rental agreements for its 2003 and 2004 seasons. We reviewed concession contract files at the Department of Enterprise Services and the Department of Budget and Fiscal Services' Purchasing and Treasury divisions. We also reviewed internal control reports on enterprise services' concessions prepared by the Department of Budget and Fiscal Services.

For each of the selected contracts, we interviewed administrators and staff from enterprise services and the Department of Budget and Fiscal Services, concessionaires or contractors and their staffs. Site visits to each of the concessions were conducted to observe operations. To address the impact of Ordinance 03-3, we interviewed local promoters who use the Blaisdell Center's venues and the Waikiki Shell. We also contacted the U.S. Internal Revenue Service's Honolulu Office and the state departments of taxation and commerce and consumer affairs regarding the registration of non-profit and for-profit corporations.

We reviewed the Hawaii State Constitution, pertinent statutes and administrative rules, the Revised Charter of Honolulu, the Revised Ordinances of Honolulu, administrative rules, and the City's finance policies. We also reviewed the department's policies and procedures, its operating budget program and presentations from FY1997-98 to FY2003-04 and other pertinent documents.

Our work was performed from September 2003 to January 2004 in accordance with generally accepted government auditing standards.

Chapter 2

The Department of Enterprise Services' Weak Planning and Deficient Contract Management Practices Thwart Its Goal of Achieving Fiscal Self-Sustainability

Fiscal self-sustainability, defined as having a revenue stream to cover all expenses, is an admirable goal of any enterprise-type governmental unit. However, without adequate fiscal planning and oversight of its resources and contracts, such units are unable to attain or make significant strides in reaching this goal. While total fiscal self-sustainability—that is, no general fund support—may be unrealistic for the Department of Enterprise Services, the department needs to do a better job of planning for its self-sustainability goals and improve on its management of revenue-generating concession contracts and resources.

Summary of Findings

1. The Department of Enterprise Services lacks an adequate plan to achieve fiscal self-sustainability. While the department and its divisions have taken actions to increase revenues, inadequate planning hinders measurable progress toward reducing the need for significant general fund subsidies. In addition, and related to its lack of planning, the department used resources for a staff planner and related costs for a program that is the primary responsibility of another City agency.

2. The department's management, oversight and enforcement of its contracts is deficient. One non-compliant concessionaire has accrued arrears in excess of $202,000 and continues to stymie the department's efforts to enforce contract compliance. More priority needs to be given to collecting payments in arrears, the backlog in accounts receivable and the lack of a payment tracking system.

3. The department bypassed City ordinance in the awarding of a concession contract. In addition, the department has allowed a concessionaire to operate without a written contract for months at a time. Moreover, contract

anomalies, including the practice of awarding City concession revenues to a non-City organization, is questionable.

4. Deficient record management practices have resulted in missing official contract documents, placing the City at unnecessary risk. In addition, concession contract files were in disarray with little evidence of monitoring or oversight efforts by department employees. The department could not explain why correspondence and other documents, spanning a 17-month period, were missing from a contract file. As a result, we could not determine the sufficiency of the department's efforts during the period when the concessionaire's arrears skyrocketed to $155,000 and eventually reached $202,000.

Inadequate Planning Results in Continued Dependence on Substantial General Fund Subsidies

The Department of Enterprise Services is unique among City agencies because its activities generate revenues to help offset the cost of its operations. While fiscal sustainability is a major departmental goal, significant general fund subsidies are still required to cover its expenses. Although the department reported that it adopted a fiscal sustainability plan in FY2002-03, none was ever developed. Lacking a focused plan, departmental resources have been expended for items that appear questionable. Measurable progress toward reducing the need for general fund subsidies will depend heavily on the development of an adequate and sound fiscal sustainability plan.

Fiscal sustainability is a major departmental goal

In March 2003, the Department of Enterprise Services reported to the Council Budget Committee that it had adopted a fiscal sustainability plan to guide it toward self-sufficiency. It noted that improving revenue opportunities and reducing expenditures were major components of the department's efforts. It further expressed that department administrators and staff examined various ideas, including privatization and new marketing promotions as potential revenue opportunities. One significant initiative, the updating and revising of rental rates and fees at the Blaisdell Center and the Waikiki Shell, is beginning to produce positive results as commercial promoters are beginning to schedule more events.

The department's subsidies and combined expenses are substantial

Emphasis on increasing revenues is driven in part by the department's desire to reduce its heavy reliance on general fund subsidies. Since FY1998-99, enterprise services' number one operating budget goal has been to decrease its general fund subsidy for the Special Events and Golf funds. While the general fund-appropriated subsidies can fluctuate from year-to-year—the special events subsidy went from $4.9 million in FY2001-02 to $8.3 million in FY2003-04—the annual subsidies are substantial. The Department of Budget and Fiscal Services annually determines the subsidy amount for each of enterprise services' funds by comparing revenues and expenditures. In addition to the department's operating costs, enterprise services must also cover its debt service, miscellaneous employee-related expenses, central administrative expenses, and accounting services provided by the Department of Budget and Fiscal Services. The shortfall amount becomes the amount of the general fund subsidy.

The department's debt service expenses consist of principal and interest payments to finance the department's capital improvement projects. Funds for debt service are transferred from the department's special funds to the General Fund. Recent capital projects include the Blaisdell Center's roof repairs and energy efficiency projects, construction and renovation of zoo exhibits, and City golf course improvements. The Honolulu Zoo train was also purchased with capital funds. In FY2003-04, the department's debt service expenses totaled $13,375,818.

In addition, the department is required to cover miscellaneous employee-related expenses including retirement contributions, social security tax, health benefits, and workers' compensation. These expenses have been increasing from $3,538,580 in FY2001-02 to $4,076,514 in FY2003-04.

Exhibit 2.1 presents the Department of Enterprise Services' debt service and miscellaneous expenses.

Exhibit 2.1
The Department of Enterprise Services' Debt Service and Miscellaneous Expenses FY2001-02 to FY2003-04

Fiscal Year	Debt Service Expenses	Employee-Related Expenses	Central Administrative Services Expenses	Accounting Services Expenses
2001-02	$9,177,910	$3,538,580	$1,455,000	$115,226
2002-03	$8,032,815	$3,643,195	$1,412,637	$111,362
2003-04	$13,375,818	$4,076,514	$1,673,500	$93,780

Source: Executive Operating Budget, FY2001-02 to FY2003-04

Numerous approaches to increasing revenues have been explored

The department has identified and explored various ways to increase revenues and reduce costs. For example, in March 2003, it was successful in updating rental fees at the Blaisdell Center and the Waikiki Shell. The new rates were designed to encourage commercial promoters to use City venues, as well as offset some of the losses when non-profit groups utilize the facilities. At the zoo, the gift shop and food concession were renovated, new playground equipment was installed and a new zoo train ride attraction, pictured in Exhibit 2.2, was added to enhance visitors' attendance and increase revenues for the City.

New revenue-generating activities, including the bulk marketing of tee times and selling advertising in the Blaisdell Center parking structure, have also been examined. The department has also analyzed privatizing certain operations, such as the Honolulu Zoo, Pali Golf Course maintenance, and the Blaisdell Center. In addition, cost-saving measures, such as using composted green waste and sewer sludge to reduce expenditures for fertilizer and using non-potable water at the Ted Makalena golf course have been implemented and plans to install energy-efficient lighting and air conditioning systems at Blaisdell Center are expected to reduce electricity costs.

Exhibit 2.2
Photo of the Honolulu Zoo Train

Enactment of Ordinance 03-3 has encouraged bookings

Among the department's recent revenue-generating initiatives, amending the lease and rental policy for the Blaisdell Center and the Waikiki Shell appears to have had a positive impact in generating additional revenues for the City. Ordinance 03-3, enacted in March 2003, revised rental rates and fees to include off-season rates from September through March at the Waikiki Shell, and also reduced rental rates for all venues on low-use days (Monday through Wednesday).

The department also sought to recover a greater portion of the costs when non-profit organizations use City venues. For example, Ordinance 03-3 increased the daily non-profit rental rate of the Concert Hall from $500 to $525 dollars per day even though the estimated daily operating cost averages around $2,992. For commercial activities, rent for the Blaisdell Arena was changed from a fixed rate of ten percent of all gross receipts to a sliding percentage rent of ten percent of gross receipts up to

$150,000 and down to five percent of gross receipts in excess of $550,000.

Local promoters have reported that the revised rates make the City's venues more competitive and desirable to national promoters. One local promoter reported booking more shows at the Blaisdell Arena than before because of the new rental rates. The new seasonal rent adjustments helped another promoter schedule a major event at the Waikiki Shell in the fall of 2003, while another was pleased to learn of the new rates and expressed interest in scheduling future events there as well.

Finally, local promoters spoke favorably about the department's extra effort in scheduling events as well as its willingness to be flexible in accommodating their needs. One promoter praised the department's assistance when a severe rainstorm threatened the cancellation of an outdoor music festival at a non-City facility. With the assistance of the department's staff, the event was relocated to the Blaisdell Arena with less than a day's notice. The promoter expressed appreciation for the department's hard work and "can do" effort to accommodate the event.

While the department's efforts in providing good customer service and instituting cost-saving measures are helpful, its failure to cohesively plan and coordinate these separate initiatives hinders its progress toward fiscal self-sustainability.

The department's claims are inconsistent

The Department of Enterprise Services has expressed differing views on its fiscal sustainability goals. It reported having adopted a fiscal sustainability plan, but later said it has avoided establishing a plan. When asked for a copy of the plan, the department provided us with lists of actions and initiatives it has examined to increase revenues and reduce operating costs. Such inconsistent viewpoints indicate a lack of a formal plan and a general lack of commitment to fiscal sustainability.

In March 2003, enterprise services informed the City Council's Budget Committee that,

> "A fiscal sustainability plan has been adopted to guide the department in pursuing the goal of self-sufficiency and the immediate changes and challenges imposed by the FY 04

> operating budget. The plan consists of two major areas: Improving revenue opportunities and reducing operating costs."

However, we found that the department has never developed a comprehensive fiscal sustainability plan. Department administrators confirmed during our fieldwork that neither the department, nor its divisions had developed such a plan. Shortly after our interviews, the director sent us a memorandum explaining the department's position and attached an ad hoc list of goals and initiatives from FY1996-97 to FY2003-04. In this October 2003 memorandum, the director stated that,

> "We indicated that we do not characterize our planning efforts as 'fiscal sustainability' planning since we have elected to focus on shorter-term programs and changes to fit within an overall scheme of achieving its mission on a year-to-year basis as opposed to establishing specific longer-range objectives."

Such contradictory statements indicate a void in any serious formal comprehensive fiscal sustainability planning efforts by the department.

Fiscal sustainability planning must comply with ordinance requirements

City ordinances establish the City's policy for the lease and rental of facilities, establish fees and rates, and require the department to accommodate a variety of users, the public's interests, and to consider the financial benefit to the City. Section 28-6.8, of the Revised Ordinances of Honolulu (ROH) requires the director of enterprise services to consider these factors when scheduling events:

> "…taking into consideration the possible financial return to the city and the overall economic benefits to the people of the city; the matter of public appeal, including diversity of events and attractions to the people of the city and avoidance of oversaturation of bookings or attractions of a similar nature; possible conflicts of interests between the event or attraction of a prospective tenant and a tenant already booked; the maximum and full-time utilization of the facilities covered by this article; and other pertinent factors, all according to the best interest of the city."

The section also reserves opportunities for symphony, opera and ballet in a concert hall setting as follows:

> "…the director of enterprise services shall have full authority in scheduling events or attractions at the Neal S. Blaisdell Center Concert Hall, the director of enterprise services shall also take into consideration the need to make available and to preserve opportunities for the residents of the city to experience, on a continuing basis, performances of symphonic music, opera, and ballet in an appropriate concert hall setting."

These considerations reflect policymakers' intent to balance public interests and the need to generate resources for the City.

The department is balancing public benefit with commercial revenue opportunities

Our review of the events and organizations using the City's venues and facilities indicated that enterprise services is complying with the ordinance's intent of balance, variety and the City's financial interests. Events held at the Blaisdell Center and the Waikiki Shell during the past two fiscal years met the needs of a broad cross-section of Oahu's residents, commercial, non-profit, educational, governmental, and private users who rented or attended activities held at the City's venues. During FY2001-02 and FY2002-03, events held at the City's venues included: Disney on Ice, Super Brawl, the Honolulu Symphony, keiki hula, high school and college sporting events, commencement ceremonies, auditions, seminars, trade shows, concerts, job fairs, photo shoots, graduation parties and baby luaus. The City's golf courses also serve the public by providing affordable recreation opportunities.

Lacking a comprehensive plan, nearly $142,000 has been expended on costs for another City program

The department listed among its accomplishments the coordination of international environmental conferences and a seminar on water and sanitation management. We found that the department's participation in a series of these events consisted of the salary of a contract planner who coordinated those programs. In fact, nearly $142,000 of departmental resources has been expended to support programs of another City agency. From FY1998-99 to FY2003-04, department staff, resources and office supplies have been used to support the following events,

coordinated by the Managing Director's Office of Economic Development:

- FY1998-99: Mayor's Asia-Pacific Environmental Summit
- FY1999-00: Mayor's Asia-Pacific Environmental Summit
  Pacific Island Symposium on Environmental Issues
- FY2000-01: Mayor's Asia-Pacific Environmental Summit
- FY2001-02: Asia-Pacific Urban Institute
  International Resource Cities Partnership
  Mayor's Asia-Pacific Environmental Summit
- FY2002-03: Mayor's Asia-Pacific Environmental Summit
- FY2003-04: Mayor's Asia-Pacific Environmental Summit

The department reported that it incurred costs for the annual Mayor's Asia/Pacific Environmental Summit, but not for the other events. From FY1998-99 to FY2003-04, the department's expenses included the salary for a contract planner and various office resources totaling $141,674. Of that, $113,224 comprised the planner's salary, accumulated vacation benefit and travel expenses. Although the department's administrative staff provided support to coordinate the environmental summit, the cost of this assistance was not documented.

To ensure proper budgeting, the Department of Enterprise Services' resources should not be used for staff salary costs and related expenses of a program that is the primary responsibility of another City agency. Organizing relevant costs within appropriate budget programs is essential for accurate program evaluation and analysis of program costs. In FY2003-04, the environmental summit is listed as an economic development activity in the Managing Director's operating budget; yet for the same year the Department of Enterprise Services expended $18,422 for salary, office supplies, communication services and other costs for the environmental summit. Such expenses distort the Managing Director's operating budget and makes review by the City Council of the full cost of the environmental summit impossible. Sound budgeting practices require that program

personnel costs and related expenses be collectively grouped and reported within relevant programs.

Fiscal self-sustainability requires adequate planning

To accomplish its fiscal self-sustainability goal, the department will need to develop adequate plans to coordinate its various initiatives. Since the department already tracks revenues and costs of operations, this information can serve as the foundation for fiscal planning. With numerous fiscal planning models in the industry, the department can start by reviewing existing models. For example, the Government Finance Officers Association has identified a fiscal planning model that balances long-term goals with current economic conditions and constraints. A comprehensive, long-term financial plan should include some of the following elements:

1. Broad goals to provide overall direction and serve as a basis for decision making;

2. Specific policies, plans, programs and management strategies to define how to achieve long-term goals;

3. A financial plan and budget that advances goals within the constraints of available resources; and

4. Program and financial performance evaluations for making adjustments to ensure progress toward achieving the goals.

This model provides a general framework for sound fiscal planning. Other fiscal planning models are available—the department needs to find a model suited to its needs.

While we recognize that full self-sustainability—generating revenues to cover all expenses—may not be realistic, the department must use planning as a necessary tool to prudently and effectively manage its operations. Without a plan to guide its collective efforts, enterprise services will be unable to purposefully make progress toward fiscal sustainability or be accountable for reducing its need for general fund subsidies.

Overall Management of Concession Contracts is Deficient

The Department of Enterprise Services faces serious difficulties in enforcing contract compliance. Large arrears have accumulated with one contract, with the likelihood that the City may never collect on the amounts due. Contract management and oversight practices appear to be deficient and ineffective.

The department is not fully complying with policies and procedures for collecting outstanding fees and rents and thousands of dollars owed to the City are not being collected in a timely manner.

Enterprise Services is responsible for monitoring and enforcing concession contracts terms

By City finance policy, the Department of Enterprise Services is responsible for managing citywide concession contracts. The policy also guides the department in its management because separate policies and procedures for monitoring and enforcing concession contracts have not been developed. The concession officer of enterprise services is responsible for administering and enforcing the terms of the City's concession contracts in accordance with City policy. Specific duties of the position include:

- Monitoring the concessionaires' day-to-day operations;
- Ensuring compliance with contract conditions as well as compliance with applicable rules, regulations and statutes;
- Conducting periodic inspections of concessions;
- Reviewing compliance with contract specifications including adequacy of sales registration equipment and record keeping procedures;
- Follow-up with concessionaires to address non-compliance, delinquency and non-payment issues;
- Enforcing concession contract terms;
- Receiving and transmitting the concessionaires' annual sales audit reports and forwarding them to the

Department of Budget and Fiscal Services' Internal Controls Division; and

- Coordinating with the Internal Controls Division to perform concession closeout audits or reviews of concessionaire accounting controls.

Under City policy, the Department of Budget and Fiscal Services' Treasury Division and not the enterprise services' concession officer is responsible for the collection of rental payments from concessionaires.

Budget and Fiscal Services is responsible for collecting concession rental payments

Sound fiscal management practices highly recommend that responsibility for the oversight of contracts be separated from the function of collecting payments. This practice, commonly referred to as "separation of duties," is intended to strengthen the internal controls of an agency and reduce the risk of fraud. In accordance with these practices, City finance policy assigns the concession rental collection function to the Department of Budget and Fiscal Services. Specifically, the Department of Budget and Fiscal Services' Treasury Division is responsible for concession rental payments as follows:

- Receiving payments from concessionaires;
- Processing and documenting payments;
- Maintaining accounting records for rentals and gross receipts by posting transactions;
- Reviewing and ensuring concessionaires' gross receipt statements comply with contract specifications;
- Recording gross receipts not reported and percentage fees not paid;
- Assessing penalty and interest on concessionaires' delinquent accounts; and
- Preparing and sending collection/delinquency letters to concessionaires, enterprise services, and budget and fiscal services' Purchasing Division.

Concessionaire's longstanding non-compliance stymies the department's questionable collection efforts

Concession operations that primarily deal in cash transactions warrant close scrutiny by the department. This is of special concern when manually generated sales receipts issued by concessionaires are used as proof of payment for rentals and services. While most concessionaires appear to comply with the terms of their contracts, we found that one beach stand concessionaire stymied the department's weak efforts to enforce the terms of the concessionaire's contract and collect rent due the City. In spite of difficulties with this concessionaire, the department continues to lack effective policies and procedures to limit arrears and enforce contract terms with non-compliant concessionaires.

Concessionaire eventually accrued over $202,000 in arrears

There were early indications that the concessionaire in question warranted concern. In February 1999, the concessionaire's bid of $12,001 for fixed rent and the required ten percent of gross revenues won the right to operate the beach stand concession beginning in May 1999. Prior to executing the contract, the concessionaire's tax clearance forms revealed unpaid taxes and that it had entered into agreements to make installment payments on federal and state tax arrears. The concessionaire's first rent check for June 1999 was returned for insufficient funds, but it paid its fixed rent plus interest a week later. In August 1999, the Treasury Division notified City Administration that the concessionaire had not submitted its gross receipts, nor paid any percentage rent since it took over the beach stand. By the end of the first year of its three-year contract, a track record of non-compliance was established.

From October 2000 to May 2002, the concessionaire underpaid its base rent by as much as $9,001 each month. While the concessionaire also submitted payments for its percentage rent, the actual percentage rent could not be accurately determined because the concessionaire never submitted verifiable statements of gross receipts.

Enterprise services' management efforts were questionable

Our review of enterprise services' contract files for this concession revealed an absence of any documented management or enforcement efforts from December 2000 to April 2002. In October 2002, the City's internal auditors reported that the concessionaire had accumulated over $200,000 in arrears for

fixed and percentage rental payments. The auditors noted that the City will never know the true amount of the total arrears for the beach stand's percentage rental payments based on gross receipts because of poor recordkeeping. The situation was so serious that the internal auditors advised the Department of Enterprise Services to take steps to resolve the outstanding balance and remove the concessionaire from operating. In their report, the auditors stated:

> "Our conclusion is that the concessionaire is not in compliance with the business records and income accountability provisions; does not have adequate detailed records to support the gross income reported; and the gross income reported is not accurate. In addition, based on the concession fee provisions and documented interim fee reductions, the concessionaire owes the City in excess of $200,000."

The internal auditor's attached a schedule of the concessionaire's payments to this report identifying arrears of $202,230.55.

At the same time, the department had no plans to deal with persistently delinquent concessionaires and no threshold to limit the City's losses. According to the current director, steps should have been taken to proactively work with the concessionaire.

Since the monitoring efforts of the department were ineffective in containing the arrears, the department determined that it had two options: 1) collect nothing if it closed the beach stand, or 2) allow the concessionaire to operate on a month-to-month basis on the condition that it pay its monthly fixed rent of $12,001, on-time and in full. The department chose to permit the concessionaire to operate on a month-to-month lease until the City put the beach stands up for bid and awarded the concessions to new operators.

In September 2003, the City's beach stand concessions were put out to public bid. When the concessionaire's October 2003 rent was late, the department terminated the concession contract and moved to evict the concessionaire. However, the concessionaire sued the City and now the department has decided to allow the concessionaire to continue operating on a month-to-month basis until February 2004.

The director of enterprise services acknowledged that the department has experienced difficulty compelling concessionaires to comply with contract terms and terminating concession contracts. For now, this beach stand concessionaire continues to operate even though the budget and fiscal services department, the City's contracting authority, has disqualified it from bidding on future City beach stand concessions until the arrears are paid in full. This "worst case" situation demonstrates the need for an effective plan and procedures to ensure that concessionaires comply with the terms of their concession contracts and pay the rent owed to the City. Such a plan should include monitoring and enforcement procedures by department personnel and minimizing the loss of concession revenues by setting limits on the total dollar amount of arrears and/or number of payments in arrears before contracts are terminated to protect the City's financial interests more effectively.

Simplifying rental agreements is a good strategy

The Department of Enterprise Services is implementing changes to its future beach stand concession contracts by requiring only fixed rent contracts rather than a percentage of gross sales-type contracts. This will alleviate the need to verify concessionaires' statements of gross receipts and eliminate the concession officer's need to collect daily sales receipts from each concessionaire.

Concession officer's monitoring efforts were of questionable benefit

The concession officer's oversight and monitoring efforts of the beach stands were of questionable benefit. The department directed the concession officer to conduct unannounced visits to the beach stands and observe the operations and collect the previous day's receipts. Reportedly, the daily visits were intended to keep tabs on the operations and performance of the concessionaires. However, this daily effort was of questionable value since the officer simply accumulated many stacks of receipts dating back to 1999. For the most part, the receipts were unverifiable as proof of rental transactions and gross revenues because they only identified the date, the item rented, and the rental fee. The handwritten receipts originated from a generic receipt book and could have been generated by anyone at any time because the receipts lacked the company's name, customer's name, form of payment, or the beach stand manager

or employee who processed the transaction. While the concession officer maintained a log of the dollar value of the beach stand's receipts, there were no explanatory notes or chronology of events accompanying the receipts in the beach stand's contract file. There was no documentation in the contract file as to whether or not the officer instructed the concessionaire to properly document the transactions on its receipts. Maintaining a record of the officer's discussions with the concessionaire and subsequent follow through in chronological order would be useful evidence in documenting the department's monitoring efforts in any contract non-compliance effort by the City.

We also found that the concession officer's interpretation of his roles and responsibilities differed from the City's finance policies. This may have contributed to the collection problems of the City because the officer believed he was responsible for monitoring and overseeing the City's concession contracts, not for enforcement. The concession officer later acknowledged responsibility for preparing enforcement actions for the director's approval, such as written notification/warning letters, assessing penalties, terminating contracts, and evicting the concessionaire. In order to maximize monitoring and collection efforts, the department director must ensure the concession officer fulfills the duties and responsibilities of the position.

Collecting outstanding fees and rents needs more attention

The department's Customer Services Division has placed high priority on scheduling more events at the Blaisdell Center and Waikiki Shell to generate more revenue for the City. However, this has been accomplished at the expense of collecting unpaid rent and fees. We found that the division is not following City policy on accounts receivable follow-up and the referral of selected delinquent accounts to collection agencies, and fiscal responsibilities for collections have been dispersed among three separate offices. However, we do note that the division has taken some initial steps to address the backlog, but more attention is needed to collect the arrears.

City policy on accounts receivable is not being followed

City policy on accounts receivable is designed to maximize collections in a cost effective manner and to provide a method for adequate follow-up. The accounts receivable follow-up policy states:

> "**First Reminder Notice**. If a payment is not received after 30 days from the billing or invoice date, a first notice shall be mailed.
>
> **Second Reminder Notice**. If a payment has not been received after 60 days from the billing or invoice date a second notice shall be mailed.
> **Phone Contact**. Phone calls are important and must be an integral part of the collection effort. Phone calls must be made in a conjunction with the mailing of both the first and second notices."

We found that only one invoice and *no* reminder notices were being sent to tenants with delinquent accounts.

Further, the policy requires that delinquent accounts be referred to a collection agency:

> "**Referral to Collection Agency**. If payment or a promise to pay has not been received after 90 days from the billing or invoice, all delinquent accounts, regardless of the amount, shall be referred to the collection agency, approved by the Director of Finance for collection."

The division administrator indicated unfamiliarity with the follow-up procedures even though this policy was established in 1994.

Backlog in accounts receivable needs more priority

Most users, with a few exceptions, are required to pay for the use of the facility and any set up prior to the day of the event in order to use City facilities. However, if users request last minute changes, for additional services, equipment, furniture, etc., the department documents whether additional fees or credits are applied to the tenant's contract after the event. The Customer Services Division is responsible for assessing and collecting these fees soon after the event is completed. Pursuing these fees soon after the event closes maximizes the likelihood of collecting the full amount.

The division's fiscal sustainability efforts have focused on increasing revenues by restructuring rental rates to increase bookings and reduce expenditures. While we found that the

division is beginning to address this backlog, more needs to be done. As of June 2003, the accounts receivable for 88 tenant contracts totaled $90,534; in November 2003, the accounts receivable for 89 tenant contracts totaled $74,503 of which $44,183 was over 90 days past due. Limited staff resources, emphasis on booking more events, and the lack of a formal department policy on accounts receivable were reasons provided for the on-going backlog.

Although enterprise services entered into an agreement with a collection agency in August 2003, only seven delinquent accounts met the department's criteria, such as commercial accounts and a cost-effective dollar threshold, for referral to a collection agency, as of January 2004. Delays in pursuing delinquent accounts receivable diminishes the likelihood of collecting these amounts owed to the City. In addition, the department is not complying with City policy for following up on accounts receivable by referring selected delinquent accounts according to enterprise services' criteria, rather than *all* eligible delinquent accounts over 90 days past due. Thus, the department is pursuing only seven delinquent accounts totaling $8,831 instead of the 49 eligible non-City or special handling delinquent accounts totaling $36,196.

Fiscal responsibilities have been distributed among different offices

Due to attrition and retirement, the responsibility for collecting accounts receivable has been delegated to staff from offices in the Customer Services Division and the Department of Budget and Fiscal Services. For the past year, the division's Sales Office has been responsible for following up on accounts receivable and its Production Office has been responsible for mailing invoices to users. In addition, a budget and fiscal services accountant is responsible for preparing the invoices and printing accounts receivable reports for the Customer Services Division. The Sales Office works on accounts receivable as time permits because its primary responsibility is booking events. The Sales Office claims that it is much busier than before, leaving little time to follow up on accounts receivable from the Blaisdell Center and Waikiki Shell tenants.

A Honolulu Symphony $15,833 rental payment was 55 days overdue

City ordinance establishes the requirement for advance payment by tenants renting the Blaisdell Center and Waikiki Shell facilities. However, the director has the discretion to allow certain tenants to pay their rent on a payment schedule. Section 28-6.5, ROH states that,

> "All charges shall be paid in advance of an event except for charges that cannot be determined in advance. The applicable rent shall be paid upon execution of the rental agreement, except that at the discretion of the director of enterprise services the rent may be paid on a payment schedule."

Under this provision, the department allows the symphony to pay its rent in three installments. However, the Customer Services Division does not have a policy or procedure to track rent paid in installments.

During our review of contract files we found that one of the symphony's rental payments of $15,833 was nearly two months past due and the symphony had not requested a payment extension. The Sales Office uses the division's event-tracking software to manually track payment due dates or overdue payments. This method appears to be workable, but is not foolproof. Shortly after the division notified the symphony of the overdue payment, it delivered the payment to the department. The division needs to establish a procedure to formally track payment schedule due dates to ensure that tenants pay their rent on time.

Concession Contract Practices Bypassed Public Bidding Requirements and Awarded City Concession Revenues to a Non-City Organization

City policy establishes public bids as the preferred method of awarding concession contracts, except in specific circumstances. Through public bidding, the City seeks the best price for the service through an open competitive process. However, we found that the department bypassed competitive bids in the award of one concession contract. Even though the department received a sole-source exemption to award this contract, the department used the "revocable permit" exemption permissible under state law. In addition, we found other contract practices

with another contract that appear to be questionable and a cause for concern.

Background on the City's concession contract for the new zoo train

At the behest of City administration, the department expended $61,806 in capital project funds to purchase a replica train for the zoo. The City was hopeful that a new ride attraction would increase attendance at the Honolulu Zoo, thus generating additional concession revenues for the City. However, since the train was put into operation in June 2003, its impact on zoo attendance appears to be modest at best. Exhibit 2.3 presents a three-year comparison of zoo visitor attendance by month, including data for time periods before and after the train began operating. Since operations began, the train concession has not generated any revenue for the City.

Exhibit 2.3
Honolulu Zoo Attendance By Month
Calendar Year 2001 to 2003

Month	2001	2002	2003
January	48,175	38,072	42,226
February	41,896	47,999	43,969
March	59,630	53,120	49,289
April	44,076	39,621	34,524
May	37,237	37,787	37,487
June	49,858	46,332	48,297*
July	60,158	57,291	54,432*
August	59,412	48,163	48,344*
September	31,728	28,357	28,866*
October	34,920	32,172	34,407*
November	31,961	30,819	32,728*
December	40,400	42,590	43,807*
Total Attendance	**539,451**	**502,323**	**498,376**

*Zoo train in operation.

Source: Department of Enterprise Services

Sole-source contract award was sought by the department

All of the Department of Enterprise Services' concessions except one were awarded through competitive sealed bids. While the train was purchased through competitive bid, the concession to operate the train at the Honolulu Zoo was initially sought and approved for award as a sole-source contract. However, by ordinance, concession contracts must meet one of the special conditions in order to be awarded as sole-source.

Section 28-3.3, ROH provides nine specific exceptions when concessions may be awarded without bidding:

1. An activity without charge;
2. Concessions operating for periods of two days or less;
3. Concessions operated by handicapped or blind persons;
4. A governmental subdivision operating the concession;
5. A non-profit beachboy concession;
6. Zoo, cultural park and botanical garden concessions operated by support groups which are incorporated as nonprofit corporations;
7. Coin-operated vending machines;
8. Pay telephones; and
9. Hans L'Orange baseball facility.

Although, the zoo train concession failed to meet any of the nine ordinance exceptions for procurement under sole-source, the department's request was approved by the City's procurement office.

Information to justify sole-source approval may have been misleading and questionable

Departments are required to obtain the City's Procurement Administrator's approval to procure services on a sole-source basis. Information required by the administrator includes:

1. Description of the services' unique features, characteristics or capabilities;

2. Description of how the service is essential for the agency to accomplish its work; and

3. Identification of other possible services that were investigated and the reason why they did not meet the department's needs.

In its sole-source justification, the Department of Enterprise Services stated that the vendor must have experience in operating and maintaining a diesel-powered train, as well as provide a back-up train if the City-owned train was not available. However, the Honolulu Zoo train is not a diesel train, but rather a John Deere garden tractor covered with a fiberglass shell painted to resemble a locomotive, as shown in Exhibit 2.4. It is a trackless vehicle that shares the zoo walkways with pedestrians.

Exhibit 2.4
Close-up of the John Deere Tractor

In addition, the zoo train did not require any specialized training for staff to operate the vehicle. According to the concessionaire's staff, the manufacturer did not require or provide any specialized training to the concessionaire's staff to operate the tractor since it operates like a riding lawn mower. A local John Deere tractor dealer confirmed that the model purchased by the City is a garden tractor and does not require specialized training.

Merely describing the zoo's new ride-attraction as a diesel train was misleading and questionable. Moreover, enterprise services' contract files and the Purchasing Division's contract files failed to document whether clarification was sought regarding the *train*.

Furthermore, enterprise services used an inappropriate factor to describe the unique features, characteristics and capabilities of the sole-source request as essential for the agency to accomplish its work. The department wrote that:

> "This is an immediate requirement and only (*company name*) is able to immediately operate and maintain the train as well as provide back-up trains as required."

Even though the Deputy Director of the Department of Budget and Fiscal Services approved the department's sole-source request, it is curious to note that the City's Purchasing Administrator informed us that for sole-source contract awards, time, such as an impending deadline, should not be a justification for not going out for bids. Project documents indicate that the urgency appeared to be related to the City's plans to dedicate the zoo train on June 2, 2003. Since this concession contract was not publicly advertised for bid, it is not known whether other businesses might have been interested and capable in operating this concession.

It is doubtful that the zoo train is "essential" to accomplishing the Honolulu Zoo's mission. According to enterprise services, the zoo train was not a department or Honolulu Zoo initiative, but a City administration initiative. None of the information provided on the sole-source request met the ordinance requirements for awarding a concession contract, and in our opinion, should have been offered to the public for bids. This award is even more questionable when the chronology of the

zoo train's purchase (Exhibit 2.5) and the more than sufficient time that was available to the department to obtain public bids for the train concession are considered.

Exhibit 2.5
Chronology of the City's Train Concession at the Honolulu Zoo

Date	Event
January 24, 2000	City concession contract grants the Honolulu Zoo food and gift concessionaire the exclusive right to operate all rides at the Honolulu Zoo.
December 7, 2001	The zoo food and gift concessionaire submits its proposal to operate a train at the Honolulu Zoo. The City would purchase the train and pay the concessionaire $25,000 per year to provide a driver, operate the train, and rides would be provided free of charge.
September 26, 2002	City executes contract to purchase a customized passenger train for $61,806.
November 18, 2002	City proposes that the concessionaire be responsible for the cost of operations, train maintenance, and zoo visitors could ride the train for free.
January 17, 2003	Zoo train is delivered to the Honolulu Zoo.
March 13, 2003	Upon declining the City's proposal, enterprise services requests the food and gift concessionaire to issue a waiver letter giving up its exclusive right to operate a train at the zoo. The director stated: "The City will be offering the opportunity for operation of the train to any interested entity through public solicitation."
April 11, 2003	The future zoo train concessionaire submits a "CONFIDENTIAL" proposal, "Operations of the Train at the Honolulu Zoo and Other City and County Events" to the City and County of Honolulu.
April 24 to May 5, 2003	The Department of Enterprise Services posts "Notice of Intent to Make Sole Source Award".
May 7, 2003	The Department of Budget and Fiscal Services approves the sole-source award.
June 2, 2003	Train dedication ceremony is held at the Honolulu Zoo.
June 19, 2003	Revocable permit contract executed for a 3-month term, starting June 20, 2003.
June 20, 2003	**First day of zoo train operation. Train rides are free that day.**
December 9, 2003	The zoo train concession contract extension is executed for a three-month term, starting September 20, 2003. A new provision requires concessionaire to pay 25 percent of ticket revenues from rides offered at Honolulu Hale during the Honolulu City Lights program to the Honolulu City Lights Association.
December 20, 2003	Zoo train contract extension expires.
December 21, 2003	The department has a verbal agreement, but no written contract, with the concessionaire to continue operating the zoo train. The department plans to advertise for bids to operate the zoo train concession for a three-year contract.
January 29, 2004	Concessionaire pays $4,876.25 to the "Friends of the Honolulu City Lights" for zoo train revenues from offering rides at Honolulu Hale during the Honolulu City Lights program.

Source: Department of Enterprise Services and Department of Budget and Fiscal Services

Revocable permit exception used by the City

State law also establishes competitive bid as the preferred method for awarding concessions on public property in Chapter 102 of the Hawaii Revised Statutes (HRS). In addition, the law provides for eleven statutory exceptions to public bidding for awarding concessions on public property. One such exception is Section 102-2(b)(7) which reads:

> "The bidding requirements…shall not apply to concessions or space on public property set aside for the following purposes:
> …(7) For operation of concessions on permits revocable on notice of thirty days or less; provided that no such permits shall be issued for more than a one year period;"

Throughout fieldwork, enterprise services reported to us that the zoo train contract was awarded on a sole-source basis. There was no mention that the contract was awarded using the revocable permit exemption for concessions under state law. The first mention of the zoo train concession's award as a revocable permit occurred when we began our review of the Purchasing Division's concession files. We were informed by the purchasing division's Goods and Services Section Head that the zoo train concession was awarded as a revocable permit, *not* as a sole-source contract. Yet, upon reviewing enterprise services' zoo train concession files, there were no documents indicating that the approved sole-source request was voided in lieu of the revocable permit waiver for concessions.

While the department was legally able to bypass the need for public bids, the revocable permit is only a short-term solution (no more than one year) for the concession. The department will have to eventually go out to public bid to secure a long-term contractor to operate the zoo train concession.

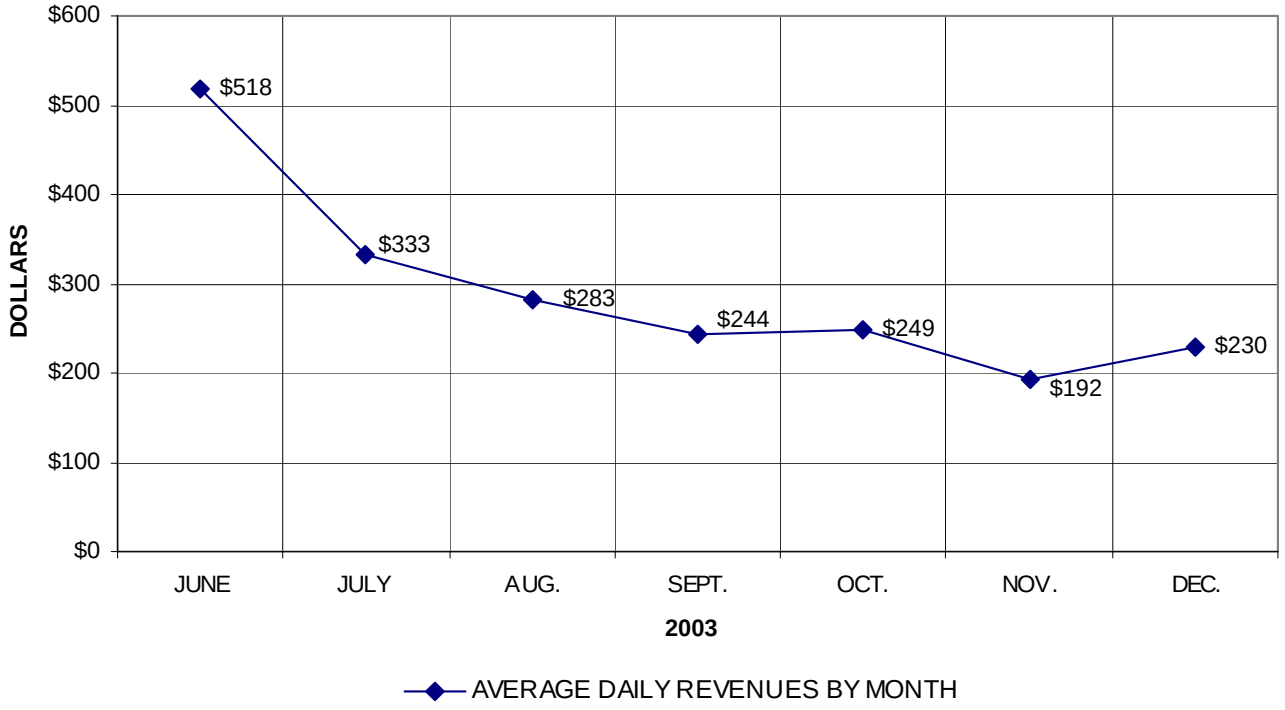
City administration suspected that the zoo train would not be profitable

City administration, the department, and the concessionaire suspected that the zoo train could not generate sufficient funds to cover its costs, especially under the terms required by the City. However, the City was adamant that the cost of a train ride

be no more than one dollar. To ensure that the concessionaire would always be paid the contract minimum amount of $400 per day, enterprise services and the Managing Director spearheaded a fund raising campaign in June 2003 to obtain funds from corporate donors. This campaign received $29,000 in corporate pledges, but collected only $18,000 from the donors. To ensure ready access to the donated funds, the City allowed corporate donations to be deposited into the concessionaire's bank account.

The department structured its payment agreement more to preserve the donated funds than to collect concession revenue for the City. The department approved the computation of concession revenues owed to the City on a monthly basis rather than daily. From June 20, 2003 to December 28, 2003, the zoo train has achieved the guaranteed minimum of $400 per day only nine times at the zoo. Had the department required the concessionaire to remit payments to the City on a daily basis, the zoo train would have generated about $856 for the City from June 2003 to December 2003. However, since the City's share of the concession revenues is based on the net monthly overages and shortages to the minimum base of $400 per day, the City has yet to earn a single dollar on train operations at the zoo. Exhibit 2.6 presents the zoo train's average daily revenues by month from June 2003 to December 2003.

Exhibit 2.6
Average Daily Revenue by Month From Train Operations at the Zoo
June 2003 to December 2003



Source: Department of Enterprise Services

In Exhibit 2.6, the average daily revenue for five days of operation at the end of June was $518. For the concessionaire's monthly revenue cycle, June 20, 2003 to July 20, 2003, the average daily revenue totaled $420. However, the concessionaire owed no revenue to the City because the concessionaire was allowed the average daily minimum of $400 for the first day of operation and rides were free on the first day of operation.

Furthermore, the contract states that no City funds are to be used to pay for train operations. However, the City has paid $1,021 for the train's speaker system, fuel, and parts for the train. When the concessionaire submitted a check for $324 to the City for the City's share of revenues from the zoo train at a Kapiolani Park event in July 2003, enterprise services instructed the Treasury Division to process the check as a reimbursement for zoo expenses, and not as concession revenue. Thus, the zoo

train concession has yet to generate any revenue at all for the City, even after six months of operation.

Concessionaire is currently operating the zoo train without a written contract

Contracts must be executed in a timely manner and before a concessionaire begins operations to protect the City's interests. However, two contract extensions have been executed late and left the concessionaire to operate the City's train without a written contract for months each time. Such delays and informal contract practices expose the City to unnecessary risks.

The original zoo train concession contract term ended on September 20, 2003. While the City and concessionaire had a verbal agreement that the City would issue a three-month contract extension to the original contract, the extension was not executed until December 9, 2003, just 11 days before the extension term expired on December 20, 2003. The department plans to publicly offer a long-term zoo train concession; however, as of March 1, 2004, bid documents had not been finalized. Until then, the department and concessionaire have another verbal agreement that the concessionaire will continue operating the zoo train under another contract extension from December 21, 2003 through March 2004. Allowing a concessionaire to operate the City's train at the Honolulu Zoo or other locations without a written contract is risky and should be suspended until the department executes a written contract extension with the concessionaire.

Practice of awarding City concession revenues to a non-City organization is questionable

City ordinance establishes that City concession revenues are to be deposited into the designated funds. Section 6-53.2, ROH establishes that there shall be deposited into the Special Events Fund,

> "All revenues generated by the department of enterprise services, including rents, concession fees, user fees, and miscellaneous revenues generated from operations at the Neal S. Blaisdell Center, the Waikiki Shell and the Honolulu Zoo".

However, a new provision in the zoo train's first contract extension directed the concessionaire to pay the City's portion of revenues generated from operating the train at the Honolulu City Lights function to a non-City organization. The contract states:

> "The Concessionaire shall also have the right to use the Train at Honolulu City Lights with the approval of the Honolulu City Lights Association.
>
> a. The City will be one of the sponsors of the Train.
>
> b. The Honolulu City Lights Association shall receive 25 percent of the proceeds of the Train ride, which shall be deemed the City's portion."

Moreover, directing City concession revenues to a non-City organization can be interpreted as an appropriation of City funds and therefore subject to City Council approval. In accordance with the City Charter, appropriations to fund activities of the executive branch are to be made only through the annual budget ordinances for the executive branch, subject to public review and adoption by City Council.

City concession revenues were earmarked for an unregistered, non-City organization

Corporations representing themselves as a non-profit organization when soliciting donations commonly register with the state Department of Commerce and Consumer Affairs. However, the Honolulu City Lights Association is not a registered for-profit business or non-profit organization in Hawaii; nor is it a registered non-profit organization or business entity with the state Department of Taxation or the federal Internal Revenue Service. During our review, we found that another organization with a similar name, "Friends of Honolulu City Lights," was registered with the state Department of Commerce and Consumer Affairs as a domestic non-profit corporation and may be registered with the federal Internal Revenue Service as a 501(c)3 non-profit organization.

Neither enterprise services' nor the Purchasing Division's contract files had any information about the Honolulu City Lights Association or the association's officers despite the fact that City concession revenues would be awarded to a non-City organization. The City's Purchasing Administrator would not comment on this practice, nor express any knowledge of the Honolulu City Lights Association. The administrator stated that the Department of Enterprise Services is responsible for

verifying the existence of an organization cited in its contracts, not the Department of Budget and Fiscal Services.

Questionable contract practices

The enterprise services department is responsible for managing citywide concession contracts under its programs. Yet, enterprise services' staff denied involvement and refused to comment on the zoo train's contract extension. We were informed that the zoo train contract extension was handled by the director of the Department of Customer Services. While this director denied any knowledge of a provision in the zoo train contract directing City concession revenues to the Honolulu City Lights Association, the concessionaire reported that the director of customer services personally handled the details of the contract extension. This director's involvement was highly irregular and circumvented the Department of Enterprise Services' role and oversight responsibilities for citywide concession contracts under its program purview.

Demand for train rides on the grounds of Honolulu Hale during the Honolulu City Lights in December 2003 was good and generated sizeable revenues. In addition to operating the zoo train, the concessionaire also operated two other ride attractions on the grounds of Honolulu Hale. Rides on the City's zoo train cost $3 and tickets for the concessionaire's rides cost $2. Altogether, the rides generated over $19,505 in revenue during the Honolulu City Lights, with the City's portion estimated at $4,876. Unfortunately, the concessionaire did not maintain separate revenue records for the zoo train and the other ride attractions. While the concessionaire submitted the revenue report to the Department of Customer Services, it was not submitted to the Department of Enterprise Services. On January 29, 2004, the concessionaire wrote a check for $4,876, the City's portion, to the Friends of the Honolulu City Lights even though the contract identified the "Honolulu City Lights Association" as the organization to receive the City's portion of the concession revenues.

There are numerous concerns about the propriety of the zoo train concession contract, from the department's attempt to use the sole-source method to award the contract and provisions in the contract's extension. The role of the director of the customer services department including the awarding of City concession revenues to a non-City organization, are serious matters that the

Council might want to pursue. Furthermore, the Council may wish to consider examining the role and responsibilities of the Department of Budget and Fiscal Services in approving sole-source requests and the formulation of contract extensions that permit City concession revenues to be awarded to a non-City organization.

Revenue collection and payment procedure may have been circumvented for the beach stand concessions

City concession policy establishes the Treasury Division as the agency responsible for receiving payments from concessionaires. One reason for this policy is to protect against fraud. Separating the responsibilities for monitoring versus collecting payments decreases the risk that concession revenues might be misappropriated. During our audit, we identified the possibility for the circumvention of this policy over the collection of rental payments from the beach stand concession.

On October 26, 2000, the directors of Enterprise Services and Budget and Fiscal Services agreed to have the concession officer collect delinquent rental payments from beach stand concessionaires, rather than have concessionaires deposit the payments directly into the City Treasury. This agreement circumvented the policy and weakened the controls over the collection of rent payments of concessionaires. While the concession officer denies ever collecting any concession payments from any of the beach stands, he noted that there were other instructions regarding the collection of rental payments from beach stand concessionaires. However, we found no such instructions in the department's files, nor were any provided to us during our review. Furthermore, the Treasury Division's deposit records for the beach stand did not identify who deposited the concessionaire's rental payments, and the beach stand's concessionaire declined to comment as to whether or not rent payments were made directly to the concession officer.

Poor Record Management Practices Place the City at Unnecessary Risk

Our review of concession contract files revealed a pattern of poor record management practices and a lack of control over concession contract documents. The department has no written policy or procedures for maintaining concession contract files. Concession contract files were disorganized and official contracts were misplaced or lost. Poor control over official

contract documents places the City's interests at unnecessary risk, especially if a lawsuit is filed against the City.

The department misplaced or lost official contracts

During our review, the Department of Enterprise Services could not provide us with a copy of the official Beach Stand #3 concession contract or a copy of the zoo food and gift concession contract. The director indicated that the department should have a working copy of all of its concession contracts, but it does not need an official contract because the department is primarily concerned with the contract terms, conditions, and amendments. Shortly after this discussion, the department provided a copy of the zoo food and gift concession contract.

Official contract of concessionaire suing the City is missing

When the department apparently could not locate its official contract for the beach stand concession, the concession officer directed us to the Department of Budget and Fiscal Services' Purchasing Division. However, the Purchasing Division's concession contract files also lacked an official concession contract, and the Purchasing Division administrator could not identify where the division maintains its official concession contracts. This is even more troubling since the concessionaire in question has since sued the City. Lost or misplaced official contracts expose the City to unnecessary risks.

No policies or procedures exist for concession contract files

Contracts are binding legal documents between the City and concessionaires. To date, the department has yet to establish official policies and procedures for maintaining its official concession contract files. Further, the department had not taken steps to secure a copy of one of the missing contracts for its own files. According to the director, the department's practice is to make available the official contract, but *not* let it leave the premises. He was surprised to learn that the Department of Budget and Fiscal Services did not have an official copy of the beach stand's concession contract either.

Concession contract files are disorganized and lack key information

Enterprise services' concession contract files we reviewed were disorganized and lacked basic information about the concessionaires and their operations. There were no records documenting the concession officer's monitoring visits,

observations, issues or verbal agreements discussed with the concessionaire. Some files contained email communications and written correspondence. There was no checklist of information required for insertion in the concession contract folders. The files also lacked any indication of the chronology of key events over the course of a concession contract. We found that the department maintained files of pertinent information on the concessions, such as complaints, separate from the concession files. This should have been noted in the contract files. Such disorganization can only hinder the City's effort to readily access and document the department's monitoring and oversight of concessions in preparation for a lawsuit.

Besides disorganized files, we found problems with missing documents for the beach stand concession. From December 2000 to April 2002, there were no documents in the department's beach stand contract files for that 17-month period. Yet, during that time period, the concessionaire's arrears to the City skyrocketed to $155,000 and eventually reached $202,000. There was no evidence of documentation, such as official correspondence, site visits, issues, concerns, discussions or agreements with the concessionaire in the files. In the absence of an index or information from other sources, we were not able to determine whether the department's course of action during that 17-month period was appropriate.

The concession officer needs to disseminate emergency contact information to certain City personnel

During our fieldwork, we conducted site visits to each of the concessions we reviewed and spoke with City personnel at the concession sites. City administrators and staff reported that the concession officer did not provide them with information on the concessionaire, the concession's authorized staff, or emergency contact phone numbers. When needed, the City personnel obtained this information directly from the concessionaires. This is a concern, since City personnel should be able to contact the concessionaire or the concession's on-site manager in case of problems or emergencies.

Since concession staff may be responsible for the operation and/or maintenance of motorized equipment such as the Hanauma Bay Shuttle Bus and the zoo train, City personnel at the respective City concession location should have emergency contact information readily available. For example, at the

Hanauma Bay snorkel concession, there has been an on-going problem with rude and inappropriate behavior by concession employees, prompting complaints to City employees working at the Hanauma Bay Nature Preserve. Based on these complaints, the City arranged for a seminar on Hawaiian hospitality and customer service for the snorkel concession's staff in fall 2002. Additional incidents and complaints prompted the concessionaire to arrange company-sponsored training for the snorkel concession staff in January 2004. As a result of these problems, the concessionaire agreed to provide his personal cell phone number to the park administrators.

Zoo administrator needed emergency contact information when a concession employee came to work intoxicated

Another more serious incident shows the need to provide City staff with the concessionaire's emergency contact information. During our site visit to the Honolulu Zoo, a potentially serious situation happened. A zoo employee reported smelling alcohol on a zoo train concession employee's breath. Because the concession officer and the director of enterprise services were on leave, the zoo director had to call the director's secretary for the concessionaire's phone number. The zoo director immediately went to investigate to ensure that the intoxicated employee was not driving the zoo train. Fortunately for the City, the employee in question was not driving the zoo train, and was later dismissed for the day by the owner of the concession. Later, the director noted that the zoo did not have a list of the concessionaire's authorized employees, nor the concessionaire's emergency contact phone number. The Department of Enterprise Services should ensure that City personnel co-located with City concessions have emergency contact information.

Conclusion

The Department of Enterprise Services is responsible for managing and marketing the Blaisdell Center, Waikiki Shell, the Honolulu Zoo and the City's golf courses on a self-supporting basis. Although its activities, including citywide concessions, generate revenues to help offset the cost of the department's operations, the department continues to require significant subsidies. To reduce the need for subsidies, the department has examined ways to increase revenues and reduce expenditures. Its effort to update rates for the use of City facilities already

appears to be having a positive effect by increased bookings. Local promoters spoke favorably of the department's staff regarding the extra effort and flexibility in accommodating their needs. Enterprise services is accommodating a variety of users and providing some financial benefit to the City as required by City ordinance.

However, the department lacks a comprehensive plan to focus its efforts toward achieving fiscal self-sustainability. In the absence of a coordinated plan, the department has expended substantial funds for programs and staff-time unrelated to its mission. While total fiscal self-sustainability may be unrealistic, the department must use planning to manage its operations and begin to make measurable progress in reducing the need for substantial general fund subsidies.

In addition, the department's management, oversight and enforcement of its concession contracts are deficient. Excessive arrears reaching $202,000 were allowed to accumulate, jeopardizing the collectability of amounts due. The department currently lacks a plan to effectively enforce contract terms with concessionaires that persist in violating the terms of their contractual agreements, as well as a plan that sets limits on the total amount of arrears before contracts are terminated. The department has not been complying with City finance policy for collecting outstanding fees and rents. As a result, there is on-going backlog in accounts receivable and thousands of dollars owed to the City by Blaisdell Center and Waikiki Shell tenants. While the department has made some improvements in its recent collection efforts, priority must be given by the department to maximize collectability in a timely manner.

Furthermore, the department bypassed City ordinance that requires concession contracts to be awarded through competitive public bids. In addition, we found other contract practices that awarded City concession revenues to a non-City organization, and named an unregistered non-City organization in the contract.

Finally, the department's poor records management practices that stem from its failure to establish policies and procedures for its contract files are troubling. Official contracts have been misplaced or lost, including one for a concessionaire that has sued the City. Concession contract files were disorganized and

lacked evidence of the concession officer's monitoring and oversight efforts. Poor control and management over the department's contract files exposes the City to unnecessary risks.

Recommendations

1. The director of enterprise services should:

   a. Establish a long-term fiscal sustainability plan that incorporates all initiatives into a comprehensive plan. The plan should unify its various efforts so that it can make purposeful progress toward accomplishing its mission.

      This plan should:

      - Clearly identify whether all of its operating costs and departmental expenses, such as debt service, will eventually be fully funded by the department;
      - Address the department's financial goals and fiscal constraints that balance the needs of the public, non-profit, and commercial activities;
      - Identify goals and objectives to reduce the need for the General Fund subsidy for the department's Golf Fund and Special Events Fund; and
      - Incorporate evaluation to assess progress and take corrective action when needed;

   b. Develop an effective plan to enforce contract compliance with non-compliant concessionaires and limit the City's financial losses if a concessionaire begins to accumulate arrears. Also needed is an effective strategy to terminate contracts of non-compliant concessionaires;

   c. Continue and expand recent efforts to reduce the accounts receivables backlog to ensure that fees and rent are paid to the City in a timely manner;

d. Comply with City finance policy for billing, collections, and follow-up on accounts receivable. It should also include procedures to track rental payment due dates and overdue payments;

e. Comply with City policy requiring open competitive bidding for awarding City concession contracts and better scrutinize sole-source contract requests;

f. Cease the practice of awarding City concession revenues to non-City organizations. It should also ensure that all City concession contracts require all revenues to be deposited in the City Treasury;

g. The department should not allow concessionaires to operate City concessions until written contracts are executed;

h. Establish policies and procedures for the management of its concession contracts and ensure that official contracts are safeguarded from loss. Contract files should be organized in a consistent manner, site visits should be documented, a chronology of key events, agreements, and problems should be maintained. Concession information maintained elsewhere should be noted in the concession contract file;

i. Obtain a copy of the official Beach Stand #3 concession contract for the department's concession files; and

j. Establish a procedure to provide emergency contact information to City personnel co-located with City concessions.

2. The director of budget and fiscal services should:

a. Locate the official copy of the Beach Stand #3 concession contract and ensure that concession contract files have official copies of all official contracts; and

b. Ensure that the Department of Enterprise Services provides accurate information and appropriate justification on future requests to award sole-source concession contracts.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Enterprise Services on March 18, 2004. A copy of the transmittal letter is included as Attachment 1. At our exit conference with the department, we informed the director that they would have seven to ten calendar days to prepare its written response to the draft report. In view of a public holiday during the intervening period, the City Auditor granted enterprise services 11 calendar days, thus extending the department's deadline to March 29, 2004. On March 19, 2004, the department requested additional time so that City administration could review the department's response. The City Auditor granted a one-day extension to March 30, 2004. The response of the department is included as Attachment 2. Accompanying the response was a number of attachments, totaling over 180 pages. The attachments to the department's response were too lengthy to duplicate, and as such, are available to the public for viewing at the Office of the City Auditor.

In its response, the Department of Enterprise Services was critical of the draft report, disagreeing with most of the findings and making no comments on some of the findings and the recommendations contained in the report. The department noted that "the report contains numerous inaccuracies, innuendos and misleading statements that throw into question the credibility, objectivity and management effectiveness of the audit report." Further, the department concludes that the audit report does not meet the City Charter requirements that the audit be performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). The department, in one of its attachments, included a memo from the Department of Budget and Fiscal Services' Internal Control Division administrator who concludes, "that your audit report appears deficient in meeting the GAGAS audit standards."

The department's response provided some clarifying points useful to us for the final report, and changes, where appropriate were made to the final report. However, overall the response and related attachments did not address some of the actual report text or change the facts as we gathered during our fieldwork. In addition, the department's response included information contradictory from that provided to us in interviews and contained in the department's

project files during fieldwork. Thus, we are not in a position to comment on the validity of some of the information generated by the department for its response, much of which was completed after conclusion of our fieldwork. We address the department's comments herein.

The department suggested that the audit was not performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). It arrived at this notion through the Internal Controls Division administrator's critique of the draft report. However, this administrator is obviously unfamiliar with government auditing standards, since such conclusions cannot be reached through a simple read of a draft report and a quick review of documents and assertions made by the auditee. To determine whether a report complies with GAGAS requires an extensive review, commonly referred to as a "peer review." Such a review requires a comprehensive check against all of the government auditing standards—namely the *general*, *fieldwork* and *reporting* standards of GAGAS. In addition, the reviewer must assess the audit policies and procedures of the audit organization and review the working papers for the respective audit project. This review requires that it be conducted by trained evaluators, independent of the audit organization. Thus, it is impossible to assess an audit report for GAGAS compliance by a simple read of the draft report and a review of documents and assertions made by the auditee.

Furthermore, the City Auditor and his staff have extensive experience with the peer review process, both as reviewers of audits conducted by other government audit organizations across the nation as well as successfully undergoing the peer review process every three years in their previous employment at the State Auditor's Office. The City Auditor is an authority on GAGAS, having issued over 180 GAGAS audit reports in his previous job as Deputy State Auditor. In addition, the City Auditor has served as an evaluator on peer review teams that evaluated the state audit offices of New York, South Carolina, Nevada, and Kansas. Thus, the City's Internal Control Administrator's conclusions are premature, misinformed, and without merit. There is *no* doubt that this audit was properly planned, conducted and reported in accordance with government auditing standards.

Information from the executive operating budget ordinances on the department's appropriations, subsidies, debt service and other expenses was provided for informational purposes only. We do not

understand why the department would react with a misinformed discussion about deficits and "operating profit" in response to a table of information from the Executive Operating Budget ordinances for the three most recent fiscal years. The department's discussion of debt service restructuring and provisional costs is a fundamental misunderstanding of the discussion about fiscal sustainability for which appropriations, expenses and subsidies pertaining to the department's operations and activities are identified. Furthermore, the director's statement that those items are budgeted in the Department of Budget and Fiscal Services is irrelevant and misleading.

The director in his response represents again that enterprise services has a fiscal sustainability plan, citing the various planning documents that the department prepares. However, not only did the director's October 2003 memorandum to the City Auditor state that it has avoided preparing such a plan, but other documents and interviews serve as our basis for concluding that the department has never established a comprehensive fiscal sustainability plan. The department commented that the City Auditor found its fiscal sustainability planning inconsistent. The draft report text clearly states that the inconsistency is with the department's statement to Council that it had developed a fiscal sustainability plan and its memo to the City Auditor stating that the department did not prepare such a plan.

We agree with the department's response that the Mayor's Asia-Pacific Environmental Summit (MAPES) program is an official City-sponsored event and funded by the City Council. In addition, we recognize the Mayor's authority to assign new duties and functions to various departments and that enterprise services' expenditures for the annual environmental summit are allowed. However, we disagree that the MAPES program is a core function of the department. Since the department generates a substantial portion of its operating revenues from golf course fees and auditorium revenues, we believe that the position for the contract planner and related costs should be budgeted and expended for in the City department primarily responsible for the MAPES program. Related to this practice, the department expressed its misunderstanding of sound budgeting practices. Program costs, such as personnel and related costs, should be collectively grouped and budgeted within relevant programs. Information on the department's program activities and expenditures should be clearly identified in budget submissions to the Council so that it can evaluate funding priorities

among the department's activities. We still conclude that the contract planner position and related costs should have been budgeted for and expended out of the Managing Director's budget—the City agency primarily responsible for the MAPES program. Our final report will focus this finding from a budget development/execution framework.

While the draft report text clearly identifies that *one* beach stand concessionaire accrued excessive arrears, the department noted that "concessionaires' " implies more than one concessionaire accrued excessive arrears. The inadvertent placement of the apostrophe was corrected in our final report.

The department discussed problems with the beach stand concessionaire in various locations in its response. For purposes of clarity and continuity, the various points are addressed here. A careful reading of the report text reveals that the report does not "blame the confusion" in determining the amount of the arrears owed by the beach stand concessionaire on poor bookkeeping. Likewise, the problems in the department's strategy for dealing with non-compliant concessionaires is the issue that needs to be addressed, contrary to the department's extraneous point that Council has or has not approved funding to hire an outside attorney to determine the arrears. Specifically, we believe that the department should carefully evaluate what changes to its existing practices are needed to improve compliance as well as limit excessive arrears. Indicating that the department's plan is to seek legal remedies overlooks its own responsibilities for concession contracts. While enterprise services plans to simplify its beach stand contracts by requiring fixed rental payments only, it also needs to strengthen the department's strategy should a similar situation occur in the future. Since the department could not provide us with a copy of the official Beach Stand #3 concession contract, as well as documents spanning a 17-month period when the concessionaire's arrears skyrocketed to $155,000, we do not know what actions the department carried out to monitor the contract.

The department stated that the concession officer did not collect or receive any concession payments because the word "collection" was used in a prior email message. The email instruction from Caroll Takahashi (*the former budget and fiscal services director*) to the Treasury Division administrator stated,

"I met with (*Enterprise services' concession officer*) and Alvin Au (*the former Director of Enterprise Services*). This is what we decided.

1. Treasury will notify (*concession officer*) when a concessionaire is delinquent in payment. Treasury's role will be limited to notification.

2. (*Concession officer*) will then notify the concessionaire in writing of the delinquency and will collect the payment.

3. If Treasury should receive payment after notifying (*concession officer*), Treasury will notify (*concession officer*) accordingly."

We believe this clearly indicates that the director's of Enterprise Services and Budget and Fiscal Services instructed the concession officer to personally collect delinquent rental payments from the beach stand concessionaire.

The director states that the current outstanding accounts receivable balance represents only two percent of the Blaisdell and Waikiki Shell revenues and is an insignificant amount by "standard business practices". We believe the department's efforts to increase revenues should also include efforts to collect revenues already owed to the City. While our report recognizes some of the positive efforts of the department to collect on receivables, the department should maximize its collection efforts. For purposes of clarification, this policy states that special handling accounts, such as government agencies, should be given priority and reviewed first. The policy establishes telephone contact as the primary means for follow-up on overdue payments and does *not* specifically exclude the use of a collection agency for such delinquent accounts.

The report text states that the responsibilities for collecting on past due accounts are *dispersed* among three different offices, to note the impact of vacant positions on this aspect of enterprise services' operations. For clarity, we changed the word from "dispersed" to "distributed" in our final report.

The director's statement that the Honolulu Symphony's late payment was due to cash flow difficulties and not due to the department's negligence is contrary to the information provided to us during

fieldwork. We stand by the original statements made to us by the symphony as presented in the report.

The department argues at length about the zoo train concession. We maintain that the zoo train concession should have been publicly bid in accordance with City ordinance and City concession policy. Moreover, the department's practice of awarding concession revenues to a non-City organization is questionable. During fieldwork, departmental personnel informed us that the zoo train concession contract was awarded as a sole-source contract. We were only made aware of a "revocable permit" status of the zoo train concession contract during our interview with budget and fiscal services' administrators. Since the revocable permit exemption under the state's concessions on public property law appears to legally permit the department to bypass the public bidding requirements of the City, the focus our finding, while not altered, is clarified in our final report.

In addition, we are skeptical of the newly revealed agreement between the Friends of Honolulu City Lights and the concessionaire that was signed on January 12, 2004, eight days after the Honolulu City Lights program concluded, and in light of the executed contract extension that specifically instructed the concessionaire to pay 25 percent of the revenues to the ***Honolulu City Lights Association***. Yet, we found no information in the department's concession files on either organization nor the existence of two train contracts being negotiated as the department now claims. Ultimately, the concessionaire wrote its check to the "Friends of Honolulu City Lights" and *not* the Honolulu City Lights Association as required by the contract. In addition, the department stated in its response that our report incorrectly claims that the Friends of Honolulu City Lights in not a registered non-profit organization with the state. However, our report clearly states that the Honolulu City Lights Association (the organization named in the contract extension) as the non-City organization that is not registered with the state and the federal Internal Revenue Service. We stand by our original statements. Decision makers may wish to clarify whether the practice of awarding City concession revenues directly to a non-City organization without City Council approval is appropriate.

The department further contends that a verbal agreement is sufficient to protect the City's interests as it allows the concessionaire continue operations without a valid contract. We disagree. A properly executed contract is a binding legal document,

whereas a verbal agreement reached after the contract's term has expired has no legal standing. As a motorized operation that transports children at the Honolulu Zoo and other locations, the department must safeguard the City's interests by only permitting the zoo train to operate only when there is a written contract. We changed the word "valid" to "written" in the final report for accuracy and clarity.

Furthermore, we stand by our findings regarding the deficient record management practices encountered during fieldwork. The department's statements by the Purchasing Administrator and the Procurement and Specifications Section Chief are contrary and misrepresent their *actual* statements made in interviews that took place on November 24, 2003 and on December 17, 2003.

Also, we believe the information provided by the zoo director at the time the incident occurred is accurate, contrary to the department's more recent claim that City personnel had emergency contact information. The department indicates that as a general practice, the concession officer arranges and attends introductory meetings with the City facility manager and the concessionaire. However, in the case of the zoo train, the identities and responsibilities of the concessionaire's authorized staff were unknown to the zoo director.

In addition, the director did not comment on our findings that we noted in our report acknowledging the positive efforts of the Department of Enterprise Services, and did not comment on our recommendations. Reporting the department's positive efforts provides balance and objectivity to the report. We added a recommendation that the department should insure that its contracts are properly executed before allowing concession operations to proceed and deleted a recommendation regarding the recovery of City concession revenues to a non-City organization. Finally, some other minor and grammatical changes were made to the final report for the purpose of accuracy and clarity.

ATTACHMENT 1

OFFICE OF THE CITY AUDITOR
CITY AND COUNTY OF HONOLULU
1000 ULUOHIA STREET, SUITE 313, KAPOLEI, HAWAII 96707 / PHONE: (808) 692-5134 / FAX: (808) 692-5135

LESLIE I. TANAKA, CPA
CITY AUDITOR

March 18, 2004

COPY

Mr. Barry Fukunaga
Director
Department of Enterprise Services
777 Ward Avenue, 2nd Floor
Honolulu, Hawaii 96814

Dear Mr. Fukunaga:

Enclosed for your review are two copies, numbers 4 and 5 of our confidential draft audit report, *Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability*. If you choose to submit a written response to our draft report, your comments will generally be included in the final report. However, we ask that you submit your response to us no later than 12 noon on March 29, 2004.

For your information, the Mayor, Managing Director, and Council Chair have also been provided copies of this confidential draft report.

Finally, since this report is still in draft form and changes may be made to it, access to this draft report should be restricted to those assisting you in preparing your response. Public release of the final report will be made by my office after the report is published in its final form.

Sincerely,

Leslie I. Tanaka, CPA
City Auditor

Enclosures

DEPARTMENT OF ENTERPRISE SERVICES
CITY AND COUNTY OF HONOLULU
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GOLF COURSE DIVISION • HONOLULU ZOO • NEAL S. BLAISDELL CENTER AND WAIKIKI SHELL

'04 MAR 30 P12:45
C & C OF HONOLULU
CITY AUDITOR

JEREMY HARRIS
MAYOR

BARRY FUKUNAGA
DIRECTOR

LYNETTE CHAR
DEPUTY DIRECTOR

March 29, 2004

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

Dear Mr. Tanaka:

RE: Draft Audit Report, Review of the Department of Enterprise Services' Efforts Toward Fiscal Self-Sustainability

Thank you for the opportunity to comment on your Draft Audit Report, *Review of the Department of Enterprise Services' Efforts toward Fiscal Self-Sustainability*, which we received on March 18, 2004.

We realize that audit reports, by their very nature, are critical and focus on negative or problem areas of a program. However, we are disappointed that the report contains numerous inaccuracies, innuendos and misleading statements that throw into question the credibility, objectivity and management effectiveness of the audit report. For the report to be useful to the public, the City & County of Honolulu, in general, and the Department of Enterprise Services, in particular, we urge you to correct the identified inaccurate statements and we ask that you revise the misleading statements; and eliminate the unsubstantiated allegations and innuendos from your audit report.

We are also disturbed that your audit report does not meet the City Charter requirements that the audit be performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). The standards require that "The report should be timely, complete, accurate, objective, convincing, clear and as concise as the subject permits." Attached to this letter is a memo from the City's Chief Accountant of Budget and Fiscal Services – Internal Control Division stating that your audit report appears deficient in meeting the GAGAS audit standards.

This letter summarizes the major findings to be corrected, incomplete statements to be revised and unsupported allegations to be eliminated, which are described in detail in the attached analysis of your findings and related exhibits.

Department generates an annual $1.3 million operating profit, achieving its goal of fiscal sustainability

1. **Department generates an annual $1.3 million operating surplus.**

   Your report misstates our goal of fiscal sustainability and makes it appear as though the operating budget of the Department is in a deficit situation. In fact, the Department's revenues exceed its operating costs. As shown in the following table, the Department is estimated to generate a $1.0 million operating profit in FY 2004 and is budgeted to have an operating surplus of $1.3 million in FY 2005. Due to potential appropriation expenditure lapses, the surpluses could be expected to be larger in FY 2004 and FY 2005 than estimated when the year ends.

Enterprise Services
Annual Operating Profit (Loss)
FY 2004 and FY 2005

	FY 2004 Estimated	FY 2005 Budgeted
Operating Revenues (1)	$16.9	$17.1
Operating Expenses	($15.9)	($15.8)
Net Operating Profit (Loss)	$1.0	$1.3

(1) Adjusted to eliminate Hanauma Bay concession revenues.
Source: City & County of Honolulu, Operating Budget, FY 2005

2. **Fiscal Self-Sustainability is based on generating revenues to meet the current operating costs of a department.**

   There are no ordinances that prescribe that Enterprise Services needs to generate sufficient revenues to cover its respective operating costs and fixed costs. The goal of fiscal self-sustainability was established by Mayor Harris. The Mayor's goal for self-sustainability is for the City's revenue-generating departments, like Enterprise Services and Planning & Permitting, to generate sufficient revenues to meet their operating costs. For Enterprise Services, the intent was not to pay for prior construction costs incurred by the Department of Parks and Recreation Services many years ago.

   Further, debt service and provisional costs are budgeted in the Department of Budget & Fiscal Services and not in the operating departments.

3. **Fiscal Sustainability Plan consists of a series of planning activities and documents.**

   Your report incorrectly claims that a fiscal sustainability plan was never developed and, thus, the Department lacks a focused plan. The Department's fiscal sustainability planning efforts includes a series of planning activities documented by separate planning documents. The Department annually updates the sustainable planning activities and the related planning documents. These planning documents include: Department's Responsibilities, Goals and Activities; Six-Year Revenue Enhancement Strategies; and Annual Implementation Plans, which are attached.

4. **Budget and Fiscal Services' General Fund Subsidy for prior years construction debt service and provisional costs has been <u>reduced</u> by $4.0 million or 25% over the past 6 years – not increased.**

   Your report is incorrect in claiming that the Department has increased the General Fund subsidy for past construction debt service and for provisional costs in Budget & Fiscal Services from $4.9 million in FY 2002 to $8.3 million in FY 04. In reality, the General Fund Subsidy for prior construction debt service and provisional costs in Budget & Fiscal Services declined $4.0 million or 25% from FY 1998 (when the Department was reorganized) to FY 2003, the last year of actual costs and revenues.

   As shown in the following table, the General Fund subsidy for prior debt service and for provisional costs in Budget & Fiscal Services, adjusted for the inclusion of the Honolulu Zoo debt service from FY 1998 to FY 2002, declined $4.0 million or 25% from $16.0 million in FY 1998 to $12.0 million in FY 2003. For FY 2004, the fiscal year is still in progress and it is too premature to estimate the amount of General Fund subsidy for prior debt service and provisional costs in Budget & Fiscal Services for the current year. Thus, contrary to your report's claim that the "special events subsidy increased," the General Fund subsidy for the prior years debt service and for provisional costs in Budget & Fiscal Services has substantially declined.

General Fund Subsidy of Historical Debt Service and Provisional Costs in Budget & Fiscal Services Special Events and Golf Funds FY 1998 to 2003

Fiscal Year	Special Events Fund	Golf Fund	Total Subsidy	Adjusted Total Subsidy (1)
1998	$13,626,697	-	$13,626,697	$16,030,296
1999	$11,436,069	-	$11,436,069	$13,766,447
2000	$2,837,076	$7,339,310	$10,176,386	$12,449,944
2001	$5,745,594	$7,291,259	$13,036,853	$15,312,666
2002	$4,906,547	$7,922,650	$12,829,197	$15,082,285
2003	$6,881,270	$5,121,406	$12,002,676	$12,002,676

(1) Adjusted to include Honolulu Zoo debt service from FY 1998 to FY 2002.
Source: City& County of Honolulu, Operating Budgets and Budget & Fiscal Services

Your analysis is also intentionally misleading because it compares FY 2004 to two prior years, when the City's debt restructuring actions by Budget & Fiscal Services reduced the City's debt service costs for those years. In FY 2001, the City restructured its outstanding debt to reduce its debt service costs in the two succeeding years through the use of Tax Exempt Commercial Paper. The major debt service savings occurred in FY 2002 and FY 2003.

Your analysis is also misleading because it excludes the Honolulu Zoo debt service from FY 1998 to FY 2002. The debt service for the Honolulu Zoo was not allocated to the Department until FY 2003. Thus, prior fiscal years understated the actual debt service for the Department.

Taking these two misleading issues into consideration, the debt service declined from $13,958,598 in FY 2001; to $11,430,998 and $8,032,815 in FY 2002 and FY 2003, respectively; and then returned to $13,375,818 in FY 2004. After the two years of refinancing savings had been realized.

5. **Department annually updates and revises its fiscal sustainability goals, initiatives and implementation plan as part of the City's annual budget submittal to the City Council.**

Your report incorrectly claims that the Department is inconsistent with its sustainability planning. As part of the City's Annual Budget Process, the Department annually updates, reviews and revises its sustainability plans, initiatives and implementation actions. Attached are the annual updates for the past five years. These plans are annually reviewed by Budget & Fiscal Services and by the Office of the Managing Director as part of the annual preparation of the City's Operating and Capital Budgets.

6. **MAPES Program is an official City sponsored event, assigned by the Mayor, and funded by the City Council and, therefore, within the mission of the Department.**

Your report incorrectly claims that the MAPES program is an "unrelated" program. The MAPES program is part of the mission of the Department. As provided by Section 4-201 of the City Charter, the Mayor assigned the logistics of this program to the Department because of the Department's expertise in organizing conferences and exhibitions.

Section 4-201 of the City Charter provides the Mayor with the authority to assign new duties and functions to the City departments, except those departments that report directly to the Mayor. Under this authority, the Mayor assigned the oversight of MAPES to the Department because of the Department's expertise in organizing conferences and exhibitions. Similarly, the Mayor assigned the responsibilities of Homeland Security to the Oahu Civil Defense Agency.

Further, Corporation Counsel has opined that the use of the Department's resources for the MAPES Conference is a proper expenditure. Attached is the Corporation Counsel opinion.

In addition, the six-year costs of $141,647 are relatively insignificant amounts and represent less than 1/10 of 1% of the Department resources. On an annual basis, these costs average less than $24,000 per year compared to the Department's annual operating budget of $15.8 million in FY 2004.

Other City departments also actively support the MAPES conferences. Department of Facility Maintenance transports tables, chairs and umbrellas to the different events. Office of Culture & Arts provides decorations and assists in the sound system. City Directors and Deputies greet arriving delegates and transport them to and from their hotels. Department of Parks & Recreation provides potted plants. Department of Environmental Services, the Board of Water Supply and Department of Transportation Services arranges tours of their facilities. Customer Service Department prints the programs and related conference materials. Department of Information Technology provides computer support and assistance.

7. **Section 13-120 of the City Charter encourages the City departments to cooperate and coordinate their work to eliminate the duplication and overlapping of functions in terms of the use of employees, land, buildings, facilities and equipment.**

   Section 13-120 provides for departments to undertake multi-departmental programs to increase the City's efficiency in delivering public services and programs. Under this section of the City Charter, interdepartmental cooperation on City sponsored events, like MAPES, is common at the City. Major events, such as Honolulu City Lights, Homeland Security and the Inauguration of the City Council, are generally budgeted in one department and use the resources of a number of supporting departments, including:

   a. **Honolulu City Lights** - Although budgeted in the Customer Services Department, Honolulu City Lights utilizes the resources of almost every department in the City to stage this annual holiday event. Each department budgets their participation in this annual event within their own department operating budgets. Department of Parks and Recreation assembles the exhibits and assists in decorating City Hall. Department of Facility Maintenance lights the Christmas Tree and installs the lighting for City Hall. Honolulu Fire Department, Department of Facility Maintenance and Department of Parks & Recreation string Christmas tree lights on the trees surrounding the Civic Center grounds. Finally, most of the departments are involved in decorating a Christmas tree in the courtyard and/or participating in the Honolulu City Electric Light Parade.

   b. **Homeland Security** – The Oahu Civil Defense Agency is primarily responsible for coordinating the City's security efforts and the costs of Homeland Security are budgeted in Oahu Civil Defense Agency. However, other City departments are

also involved in this multi-agency effort to secure the City from terrorism and these costs are budgeted in those respective departments. These agencies include the Honolulu Police Department for public safety, Honolulu Fire Department for public protection and hazardous threats, Emergency Services Department for medical protection, Facilities Maintenance for public building security, Board of Water Supply for water supply security, and others.

c. **City Council Inauguration** – This Legislative function involved numerous City agencies. The Department of Parks & Recreation provided potted plants; Department of Enterprise Services provided tables, chairs and stages; Department of Facility Maintenance transported the tables, chairs and stages to and from City Hall; and Office of Culture & Arts assisted with the decorations and the sound system.

   The upcoming National Association of County Officials (NACO) conference in 2005 will utilize the same types of services even though the conference is to be funded out of the City Council's operating budget.

d. **Revised Ordinances of Honolulu, Article 18 prescribes the form of the Executive Operating Budget by "function" and not by "program."**

   Your report claims, "Sound budgeting practices require that program costs be collectively grouped and reported within relevant program" in order that the City Council can review the entire cost of a program. Consistent with Section 13-120 of the City Charter requiring City departments to cooperate, ROH Section 2-18.2 prescribes that the Budget Ordinance appropriate monies to activities in specified functions performed by executive departments. Monies are appropriated to executive departments. Attached is a memo from the City's Director of Budget & Fiscal Services stating that funds are budgeted by departments and not by projects.

The cited deficiency in concession management refers to only one Beachboy concession contract that is in arrears. The Department referred the past due amount to the Corporation Counsel for collections over a year ago. The City Council has stymied the collection of the past due bill, by its repeated refusals of the Corporation Counsel's requests to hire expert counsel to pursue collection of the past due amount.

1. **Your report implies that numerous concessions are in arrears. In fact, the cited deficiency refers to only one concessionaire that is in arrears. This non payment arose from a dispute with the City on the impact of the Kuhio Beach improvements on the concessionaire's operations.**

Your report incorrectly claims, "Concessionaires' longstanding non-compliance stymies the department's questionable collection efforts." The Department manages 29 concession contracts but your conclusions are based on only one concession contract that is in arrears. This concessionaire in arrears is a result of a dispute about the impact the Kuhio Beach improvements on its operations. During the period of construction, the City reduced the beach concessionaire rentals to reflect the impact of construction on potential customers. For a seventeen-month period following the completion of construction, this concessionaire continued to pay the reduced amount instead of returning to the full rental amount each month. The underpaid monthly rents amount to $202,000. While this unpaid balance is in dispute, the concessionaire is currently paying its full monthly rent on a timely basis.

The Department issued a Notice of Delinquency and then referred the matter to the Corporation Counsel for resolution and restitution. The Corporation Counsel then issued two more demand letters and undertook attempts to resolve the amounts in dispute. Finally, the Corporation Counsel twice requested that the City Council approve the hiring of a legal counsel with expertise in bill collection to pursue the collection of the account. The City Council failed to approve the Corporation Counsel's requests on both occasions.

2. **One concessionaire accounts for all of the $202,000 in arrears.**

Your report fails to disclose that the $202,000 in arrears is related to one concessionaire. In fact, your report repeatedly cites this one past due account resulting in the belief that numerous concessionaires have past due amounts. The amount in arrears for this single concessionaire is a result of a dispute about how the Kuhio Beach improvements may have impacted its operations. During the period of construction, the City reduced the beach concessionaire rentals to reflect the impact on potential customers. For a seventeen-month period following the completion of construction, this concessionaire continued to pay the reduced amount instead of returning to the full rental amount each month. The concessionaire is currently paying its full monthly rent on a timely basis.

3. **The City Council has repeatedly not allowed the Corporation Counsel to hire outside counsel to determine and collect the amount in arrears.**

Your report blames the confusion in determining the amount in arrears on poor bookkeeping rather than the City Council's repeated refusal to allow the Corporation Counsel to hire an outside attorney to determine and collect the amount in arrears. The Corporation Counsel has repeatedly told the City Council that it does not have the expertise and resources to pursue the collection of this bill. The City Council has twice denied the Corporation Counsel's request, on behalf of the Department, to hire a collection attorney to collect the monies in arrears.

4. **Non- collection of outstanding fees and rents is exceedingly small considering that they represent only 2% of annual rental revenues, and many of the outstanding fees are money the City pays itself.**

Your report incorrectly claims that the Department's Customer Services Division has been neglecting the collection of past due fees and rents. However, as shown in your report, the outstanding accounts receivable balance for rental fees has declined from $90,534 as of June 30, 2003 to $74,503 as of November 30, 2003. The outstanding balance has further declined in 2004. As of January 31, 2004, the outstanding accounts receivable balance has declined to $61,218.82. The current outstanding accounts receivable balance represents only 2% of the revenues of the Blaisdell Center and the Waikiki Shell, an insignificant amount by standard business practices.

It should also be noted that City and other Government agencies represent over 41% of the outstanding accounts receivable balance. Generally, City agencies settle their outstanding amounts at the end of the fiscal year and schools pay their outstanding amounts when they return from vacation.

5. **The department's plan to collect amounts in arrears is to seek legal remedies.**

Your report incorrectly claims that the department has no plans to manage delinquent concessionaires. When the rent becomes past due and negotiations to collect the amounts fail, the Department refers the matter to the Corporation Counsel for legal action. In this case, the Department referred the matter to the Corporation Counsel and the Corporation Counsel obtained City Council approval to sue the concessionaire for collection. However, the City Council twice denied approval for the Corporation Counsel to hire an outside collection attorney to file the suit.

6. **Department is not violating City policy in processing its accounts receivable.**

Your report misunderstands the City's policy to refer all delinquent accounts to a collection agency. The City policy states that all delinquent accounts should be referred to a collection agency <u>except</u> for "government agencies, large companies and accounts with special payment plans with the Corporation Counsel." These accounts are to be handled through telephone inquires. The vast majority of these accounts not referred to a collection agency are from organizations such as Ethics Commission, Honolulu Police Department, Department of Human Resources, Department of Environmental Services, Office of Economic Development, Neighborhood Board, Department of Community Services, Department of Parks and Recreation, Board of Water Supply, HUD, US Immigration and Naturalization, Waipahu Intermediate School, Chaminade University and Hawaiian Airlines. The remaining accounts require a final notice to be mailed in accordance with the City policy. It obviously makes no sense for the City to hire a collection agency to collect money from itself. Once again, the policy is for City agencies to settle their outstanding amounts at the end of the fiscal year and for schools to pay their outstanding amounts when they return from vacation.

Past Due Accounts Receivable
As of January 31, 2004

Account Category	Number	Outstanding Balance
City/Government	22	$25,333.79
Large Corporation	30	$25,163.00
Final Notice Pending	14	$2,584.24
Total	66	$53,081.03

7. **Fiscal responsibilities have been segregated, not disbursed, in keeping with internal control principles.**

   The fiscal responsibilities have been segregated to ensure good internal control and not disbursed as you claim. As noted on page 20 of your report, "Sound fiscal management practices highly recommend that responsibility for the oversight of contracts be separated from the function of collecting payments. This practice, commonly referred to as "separation of duties," is intended to strengthen the internal controls of an agency and reduce the risk of fraud."

   In accordance with these principles, the Department of Budget & Fiscal Services' Treasury Division is responsible for the preparation and issuance of all statements and receipt of payments from concessionaires. Enterprise Services is responsible for follow up collection activities with concessionaires and tenants to address delinquency and non-payment issues.

   For delinquent tenants, the Sales Office and the Production Office are both part of the Department's Customer Services Division and handles different functions of the collection process. The Sales Office follows up on past due accounts because these accounts are established by the Sales Office. The Production Office mails all invoices and notices for the Customer Services Division.

8. **Late Honolulu Symphony payment was due to cash flow difficulties of the Honolulu Symphony and not due to Department negligence.**

   Your report implies that the Department was negligent in allowing a bill for the Honolulu Symphony to remain outstanding for 55 days. The Department's Sales Office had been tracking the outstanding bill and had granted a payment extension because the Honolulu Symphony's ticket sales funds held by the Department exceeded the outstanding bill amount. The Honolulu Symphony paid the first of three installments of its bill and sought an extension for the second payment because it was encountering cash flow difficulties at that time and needed additional time to raise funds to pay the bill. The Honolulu Symphony subsequently paid its entire bill in full.

9. **Existing polices are clear with respect to the Department's duties.**

   Your report incorrectly states "the department continues to lack effective policies and procedures to limit arrears and enforce contract terms with non compliant concessionaires" and "because separate polices and procedures for monitoring and enforcing concession contracts have not been developed." These statements are incorrect. The policies for concession contracts and for billing and for follow up on accounts receivable are uniform for all departments. These policies are sufficiently clear with respect to the Department's duties. Contrary to your statements, no new policies need to be developed. The Policy for Services and Follow-up on Accounts Receivable and the Policy on Concession Contracts are attached to the Budget & Fiscal Services memo.

The Zoo Train Concession did not violate any City or State procurement laws. The contract was awarded not on a sole-source basis but as a revocable permit in accordance with HRS Section 102-2(b)(7). Your report incorrectly states on numerous occasions that the contract was awarded on a sole-source basis.

1. **The objective of the Zoo Train is to provide an amenity for children and parents and not to generate additional revenue.**

   Your report misleadingly claims that the Zoo Train has not generated any revenue for the City. The Zoo Train was not intended to generate any new revenues to the City. Instead, it is to provide an additional amenity for the enjoyment of children and families who come to the Zoo. In zoos throughout the country, trams, carousels and play equipment are provided as amenities to make a visit to the zoo a more enjoyable experience for both children and their parents.

2. **The concession for the Zoo Train was awarded not on a sole source basis but as a revocable permit in compliance with HRS Section 102-2(b)(7).**

   Your report incorrectly claims on numerous occasions that the awarding of the Zoo Train concession violated City Ordinance because it was awarded on a sole source basis. It was not. The Zoo Train concession was awarded not on a sole source basis but as a revocable permit and, thus, did not violate any City ordinance or State law. In fact, the Corporation Counsel specifically drafted the contract so that the contract would comply with all applicable law. In consultation with the Corporation Counsel, the concession contract was awarded as a revocable permit in compliance with HRS Section 102-2(b)(7). As a revocable permit, the contract can be awarded without competitive bid as long as the permit may be terminated within a 30-day notice and is no longer than a one (1) year in duration. The Zoo Train concession contract complies with all of the requirements for a revocable permit under HRS Section 102-2(b)(7).

3. **The Zoo Train concession is in full compliance with HRS Section 102-2(b)(7).**

   Your report incorrectly claims that the Zoo Train concession violated State procurement laws. State procurement rules were not violated. The contract was issued as a revocable permit and not as a sole source contract. The Zoo Train concession contract complies with all of the requirements for a revocable permit under HRS Section 102-2(b)(7). As noted in your report, the Zoo Train concession contract may be terminated on 30 days or less and is for no more than a one-year period. Because of these conditions, the contract is in compliance with State law as a revocable permit. Attached is the Corporation Counsel opinion.

   Your confusion may come simply as a result of the form that was used. The Zoo Train contract was originally drafted on a "Revocable Permit" form. Since it was necessary to include more detailed provisions in the Zoo Train contract than those found in the City's Concession "Revocable Permit" form, the Corporation Counsel believed that the City's Concession Agreement format was more appropriate to use. However, the Corporation Counsel wrote the contract as a revocable permit. The substantive effect of any contract is dictated by its content and terms. All applicable laws were complied with in respect to the Zoo Train contract.

4. **The City sought sponsorships to reduce the price per ride for children from $2.00 to $1.00 a ride.**

   Your report incorrectly claims that the City knew the Zoo Train would be unprofitable and sought grants to underwrite its cost of the Zoo Train. The City sought corporate sponsors to reduce the cost of a ride for children from $2.00 to $1.00 a ride. For your information, during the month of March 2004, the cost of all rides has been $2.00 a ride and the Zoo Train has operated with no other funds.

5. **The Department and the Zoo Train concessionaire had verbally agreed to continue operating the Zoo Train under the same concession contract terms and the contract has been executed.**

   Your report is incomplete in its claim that the Zoo Train is currently operating without a valid contract. The Department and the concessionaire have verbally agreed to continue operating the Zoo Train under the same concession contract terms and the contract has been executed. The contract will extend up to June 4, 2004, and the contract will be revocable upon thirty (30) days notice so that it can be terminated when the Zoo Train concession bid is awarded.

6. **No City concession revenues were diverted because the concessionaire was required to pay 25% of its proceeds to the Friends of Honolulu City Lights in order to allow the Zoo Train to be operated at Honolulu City Lights.**

   Your report incorrectly claims that City revenues have been improperly diverted to the

Friends of Honolulu City Lights. No City concession revenues were diverted. The Department sought to promote and market the Honolulu Zoo at the City's popular Honolulu City Lights event by using the Honolulu Zoo Train instead of the concessionaire's train. The Friends of Honolulu City Lights required the concessionaire to pay them 25% of train ride revenues in order to operate a train at Honolulu City Lights. In accordance with the contract, the concessionaire paid 25% of the Zoo Train proceeds to the Friends of Honolulu City Lights in order to use the Zoo Train at Honolulu City Lights.

The Zoo Train was used for four nights at Honolulu City Lights and the proceeds paid to the Friends of Honolulu City Lights amounted to $560, money that was used to reduce City costs for Honolulu City Lights.

7. **Friends of Honolulu City Lights is a registered non-profit entity.**

   Your report incorrectly claims that the Friends of Honolulu City Lights is not a registered non-profit organization with the State of Hawaii. The Friends of the Honolulu City Lights is a duly registered entity with the State Department of Commerce and Consumer Affairs as a domestic non-profit corporation and is registered with the Federal Internal Revenue Service as a 501(c)(3) non-profit organization.

8. **Customer Services Director was involved in negotiating a separate agreement with the Zoo Train concessionaire for a trackless train at Honolulu City Lights.**

   Your report has confused the Customer Services Department Director's involvement with the negotiations of the second Zoo Train concessionaire contract because there were two train contracts being negotiated at approximately the same time. This situation occurred because there are two trains: Xtreme Fun's train and the City's Zoo Train. During the fourth quarter of 2003, the Friends of Honolulu City Lights was negotiating an agreement with Xtreme Fun to continue to operate its train at Honolulu City Lights. At the same time, the Enterprise Services was negotiating with Xtreme Fun to operate the City's Zoo Train at Honolulu Zoo. The Customer Services Department Director was involved in the negotiations of the use of Xtreme Fun's train at Honolulu City Lights and not the operation of the Zoo Train.

9. **No circumvention of revenue collection occurred and the Concession Officer has not collected or received any concession payments and has repeatedly advised the City Auditor of such.**

   Your report incorrectly claims that the concession officer instead of the City's Treasury Division receives concessionaire payments because the word "collection" was used in a prior e-mail to describe the Department's efforts to reduce outstanding receivables. No circumvention of revenue collection has occurred. Your staff was repeatedly advised that the Treasury Division of the Department of Budget & Fiscal Services receives all concession payments. According to Budget & Fiscal's Policy on Concession Contracts,

Index Code 2.1, Section E.2, page 4, Budget & Fiscal's Treasury Division is to "Receive payments from concessionaires." Based on this policy, no confusion exists within the City that the Treasury Division receives all payments.

City maintains adequate control over all contract documents.

1. **Budget & Fiscal Services, not the Department, maintains the "official" copies of concession contracts and the contract was not lost.**

   Your report incorrectly claims that the Department has misplaced the official beach stand concession contract. Your auditor was advised that Budget & Fiscal Services' Purchasing Division maintains all official or executed contracts and that the Department only maintains a "working" copy of the contract. Agencies are not allowed to maintain the official contracts in order to eliminate the possibility of misplacing an official document.

2. **Purchasing Division clearly knows that it maintains the "official" concession contract copies and where they are filed.**

   Your report incorrectly claims that the Budget & Fiscal Services' Purchasing Division Administrator could not identify where the official concession contracts are filed. The Purchasing Administrator did not speak to your Auditor and was not contacted by your Office. The Purchasing Administrator clearly knows that the Purchasing Division maintains all official contracts and knows where they are filed and maintained.

3. **Purchasing Division Section Chief of Procurement and Specifications was using the subject concession contract and the contract was not missing.**

   Your report mistakenly claims that the Purchasing Division's concession contract files lacked an official copy of the subject concession contract. The Purchasing Division's Section Chief of Procurement and Specifications was using the official contract and the contract was not "lost" or "missing." Your Auditor made no inquiry of the location of the subject contract and incorrectly assumed that it was missing.

4. **Emergency concessionaire information is provided to City personnel.**

   Your report incorrectly claims that City personnel do not have contact phone numbers to reach a concessionaire in case of an emergency. The concession officer has provided the phone numbers to appropriate City personnel. As a general practice, the concession officer arranges and attends introductory meetings with the concessionaire and the City Facility Managers to acquaint each other and to obtain each other's phone numbers in case of an emergency. These meetings were held for both Hanauma Bay and the Honolulu Zoo.

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We hope that this information will be helpful to you in drafting an audit report that is accurate, objective and complete.

Sincerely,

BARRY FUKUNAGA
Director