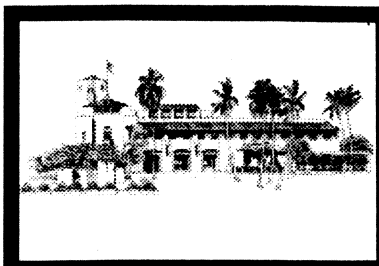

OFFICE OF THE CITY AUDITOR

City and County of Honolulu
State of Hawai'i

Financial Audit of the City and County of Honolulu State of Hawai`i

For the Fiscal Year Ended
June 30, 2003

Management Letter

Conducted by
PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS

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December 22, 2003

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

In planning and performing our audit of the basic financial statements of the City and County of Honolulu, State of Hawaii (City) as of and for the year ended June 30, 2003, we considered the City's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on the internal control. Although our audit was not designed to provide assurance on the internal control, we noted certain findings and matters involving the system of internal control and its operations, and are submitting for your consideration related deficiencies and recommendations to help the City improve the system of internal control. Our comments reflect our desire to be of continuing assistance to the City as your auditor.

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

We will be pleased to discuss any questions that you or your associates may have regarding this letter.

Very truly yours,

PricewaterhouseCoopers LLP

DMT:ky

City and County of Honolulu
State of Hawaii
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June 30, 2003

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CURRENT YEAR COMMENTS

No. 03-1: Lack of Monitoring of Subrecipient Loans

During our testing of federal grant loans between the City and its subrecipients, we noted that the City does not monitor these loans on a regular basis to ensure proper and timely payments from the subrecipients. Certain loan agreements require the subrecipients to make payments when the projects have residual receipts. Of the loans we tested which required payments based on residual receipts, we noted that no payments were made in fiscal 2003 as it appeared that the projects did not generate residual receipts. We also noted that the definition of residual receipts was not defined in the loan agreements and there were inconsistencies in the definition of residual receipts based on our review of the subrecipients' audited financial statements. We understand that although the City monitored loan payments for other subrecipient loans during the subrecipient monitoring procedures, the projects we tested were not selected for subrecipient monitoring review by the City in fiscal 2003.

Recommendation –
The City should establish procedures to ensure all subrecipients are complying with the loan agreements by making required payments on a timely basis, including residual receipt payments. Proper monitoring of these loans should be performed annually. The City should also clearly define residual receipts in the loan agreements to ensure consistency.

No. 03-2: Equipment Costs Should Be Obtained From the Contractors

During our audit of the separate Public Transportation System – Bus and Paratransit Operations financial statements, we noted that the City was unable to obtain an accurate, detailed listing of the equipment purchases for the Pearl City facility from the contractor which amounted to $4.5 million. The detail listing the City obtained from the contractor grouped similar, but not the same type of equipment, and assigned a total value. Therefore, Oahu Transit Services, Inc. personnel, who manage the City's bus and paratransit services, reviewed the assigned values and determined estimated costs for each equipment to properly manage and track the equipment.

Recommendation –
The City should request and obtain a detailed listing of the equipment costs from their contractors or vendors to ensure the assets are accurately reflected in the City's financial records.

No. 03-3: Unamortized Discount on Long-Term Debt Should Be Properly Recorded

During our audit, we noted that the City had previously recorded certain long-term debt net of the unamortized discount. The City adjusted the financial records and financial statements to gross-up the long-term debt and unamortized discount by $27 million at June 30, 2003. We also noted that since the City had not amortized the debt discount in prior years, the amortization of debt discount was overstated in fiscal 2003 by $4.9 million.

Recommendation –
The City should ensure proper recordation of future debt discounts and proper amortization of the unamortized debt discount over the life of the bonds.

No. 03-4: Adequacy of the Workers Compensation Reserve

Although the City is substantially self-insured for worker's compensation claims, we noted that the City's actuaries had assumed the City's liability for loss and allocated loss adjustment expense was limited to $1 million per occurrence in determining the City's case and incurred but not reported reserves (IBNR) as of June 30, 2003. As a result of using incorrect retention amounts, the actuarial liability may have underestimated the required reserves.

Recommendation –
The City should communicate this inconsistency with the actuaries and ensure future actuarial studies assume an unlimited self-insurance retention, which would provide more accurate estimates of case and IBNR reserves.

No. 03-5: Findings Based on Federal Agency's On-Site Monitoring

During January 2003 through February 2003, the U.S. Department of Housing and Urban Development (HUD) performed an on-site monitoring review of the City's Community Planning and Development (CPD) Programs and issued a report dated March 13, 2003 with their findings. We understand that the City has not yet provided a response to HUD.

The HUD findings included the following:

1. Designate which units are HOME units and keep the information in all Loliana project files.
2. Ensure invoices from an organization reflect that technical assistance was provided.
3. Project files must contain verification that invoices have actually been paid.
4. Ensure HOME eligible families occupy units at Kulana Nani that are rehabilitated with HOME funds.
5. There were incorrect and inconsistent clauses in project Deeds and Declaration of Land Use documents.
6. Ensure records used to verify the eligibility of low-income families are contained in the files.
7. Lack of control over project records resulted in incomplete project files.

Recommendation –
The City should ensure timely responses to HUD and proper resolution of these findings.

No. 03-6: Allowance for Extra Work Should Not Be Encumbered

During our testing of professional services contracts, we noted that a contract allotted $5,000 for the pre-stage of a project for which the scope and services had been detailed and agreed upon by the City and the consultant. An additional $45,000 had been allotted as "allowance for extra work" for the implementation of improvements determined during the pre-stage services. However, no further information was provided in the contract related to the additional $45,000. Therefore, the allowance for extra work does not comply with the City's encumbrance policy, as an encumbrance is defined as follows:

1. Encumbrances reserve an appropriation (or a portion of an appropriation) to cover obligations or commitments that have been incurred against the appropriation.
2. Encumbrances are not firm liabilities but are converted to liabilities upon performance of the acts required by the obligations or commitments (such as delivery of goods or services).
3. Encumbrance obligations or commitments are not merely anticipated future expenses, but are enforceable rights that bind the parties involved to complete a transaction based on proper performance of the acts called for by the obligation or commitment.

Based on the above definition, the allowance for extra work does not satisfy the third point as it is unclear as to what the scope of services are to ensure proper performance by the consultant.

Recommendation –
The City should not execute contracts and encumber funds for projects that provide "allowance for extra work," unless the scope of services are clearly defined and complies with the City's encumbrance policies.

No. 03-7: Noncompliance with the State Procurement Code

During our testing of the City's procurement process related to competitive sealed bidding contracts, we noted that for 6 out of 10 contracts tested, the names of witnesses during the bid opening were not recorded. The Hawaii Administrative Rules Section 3-122-30(b)(2) states that along with the name and bid price of each bidder, "the name(s) and address(es) of the required witnesses shall also be recorded at the opening." We understand that due to the numerous bid openings in December 2002, other City employees were utilized to administer some of the bid openings, who may not have been properly instructed on completing the City's standard forms and on the state procurement rules.

Recommendation –
The City must ensure compliance with the state procurement rules. The City should properly train all employees and temporary workers on the bid opening procedures.

No. 03-8: Delinquent Collections on Subsidy Agreements

During our testing of the Community Development Block Grants program income, we noted that certain tenants were delinquent in making subsidy payments based on the terms of the subsidy agreements. We understand that due to the tenants' financial difficulties, the City verbally agreed to revise payment plans. However, there was no written documentation of the revised terms.

Recommendation –
The City should either amend the subsidy agreements or maintain written documentation of the revised payment plans, which has been approved by the appropriate City personnel, in the tenant files.

STATUS OF PRIOR YEAR COMMENTS

The following represents the status of prior year comments reported in our management letter report for the year ended June 30, 2002. Comments which have not been resolved are included in the section entitled "Comments Which Are Still Applicable." Comments which have been resolved are included in the section entitled "Comments Which Have Been Resolved.

COMMENTS WHICH ARE STILL APPLICABLE

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

During our testing of federal grant loans between the City and its subrecipients, we noted that the loan agreement with Kailua Elderly Housing of $4.7 million, which was effective in February 1995, has not been formally executed. We were informed by the City that the delays are due to disputes between the City and the subrecipient regarding payment of certain fees and also due to a change in City personnel handling the execution of this loan.

We recommended that the City resolve the Kailua Elderly Housing dispute and ensure the loan agreement is properly executed. The City also needs to ensure that future loan agreements are fully executed prior to the disbursement of funds.

Status –
Unresolved. The Kailua Elderly Housing loan agreement has not been formally executed.

No. 02-4: Inclusion of Certain Funds as Fiduciary Funds

Governmental Accounting Standards Board Statement No. 34 (GASB 34) provides that fiduciary funds should only be used to report assets held in a trustee or agency capacity for others and therefore, cannot be used to support the government's own programs. The fiduciary fund category may include pension trust funds, investment trust funds, private-purpose trust funds and agency funds. The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations or other governments.

We noted that certain funds included in the City's fiduciary funds at June 30, 2002 may not meet the GASB 34 definition of fiduciary funds. Consequently, these funds should not be reported as fiduciary funds but included in another fund.

We recommended that the City determine which funds qualify as fiduciary funds under the GASB 34 definition and transfer those funds not qualifying to the appropriate funds in fiscal 2003 for financial reporting purposes.

Status –
Unresolved. Although the City identified and transferred certain funds included in the fiduciary funds to other City funds during fiscal 2003, we identified other funds that did not qualify as fiduciary funds. We noted that the City transferred additional funds in fiscal 2004.

No. 01-3: Inadequate Monitoring of Property Management Companies

In fiscal 2000, we reported this finding as a reportable condition in the separate Single Audit report. The City performed certain corrective measures to improve monitoring of the property management companies and therefore, the comment was no longer considered a reportable condition. However, we continued to recommend that the City strengthen its procedures and controls over the following areas:

1. The City should ensure that the property budgets submitted by the property management companies to the City are reviewed and approved before the beginning of the fiscal year.
2. The City should formalize the policy regarding reimbursement of general overhead costs (e.g., photocopying, office supplies, postage, etc.).
3. The City should work with the property management companies to ensure that receivables deemed uncollectible are submitted to the City for write-off.

Status –
Unresolved. We noted that the property budget approval process was not completed prior to the beginning of fiscal 2003 and 2002, the City's agreements with the property management companies do not state the City's formalized policy regarding reimbursement of general overhead costs, and the City still has not written-off significant old outstanding receivables. We continue to recommend that the City address the unresolved items.

No. 01-11 and 00-11: Information Technology Policies and Procedures Should Be Improved

During our audit, we noted that a "High-Level Security Assessment" was performed by Network Care in 2000. This report was finalized and presented to management in July 2000. The report detailed several weaknesses around the City's network. Lack of controls around the existing network could result in unauthorized access and control around the City's information assets.

Status –
Unresolved. All of the issues noted in the "High-Level Security Assessment" report have been resolved by the City, except one. We continue to recommend that the City's task force properly address this remaining issue.

No. 00-3: Accounting for Infrastructure Costs Should Be Improved

In accordance with the establishment of the Sewer Fund as an enterprise fund effective July 1, 1999, the City was required to value infrastructure costs and record them on the Sewer Fund's books. The City utilized the Geographic Information System (GIS), which included most of the sewer lines for operational purposes, as a basis for establishing infrastructure costs. However, we noted that developers often did not provide cost information to the City when projects were completed and sewer lines were dedicated to the City, which resulted in incomplete cost information. We also noted that there were delays in inputting the information into GIS by the City. Although we understand that the City had recently assessed the physical conditions of these infrastructure components, no adjustments (i.e., possible write-downs) were made to the cost estimates.

During fiscal 2002, over $200 million of capital assets, net of accumulated depreciation, were identified which should have been recorded in prior years. These errors were due to delays in inputting current information into GIS by the City and also due to certain inaccurate information already in GIS. The City did a comprehensive review of the capital assets as of June 30, 2002, which resulted in various changes to the information in GIS and adjustments to the financial records.

Status –
Unresolved. We continue to recommend that the GIS system be kept current and is accurate and complete. Periodic assessments should be performed on the infrastructure values to determine whether any write-downs are necessary. The City should also ensure that appropriate cost information is obtained from developers and recorded on a timely basis.

No. 00-10: Ensure Proper Section 8 Utility Allowances Are Utilized

In accordance with the Code of Federal Regulations (CFR) 982.517(c)(1), a public housing agency must review its schedule of utility allowances each year, and must revise its allowance for a utility category if there has been a change of 10% or more in the utility rate since the last time the utility allowance schedule was revised.

During our fiscal 2000 testing of the Section 8 housing assistance payments program monthly utility allowance schedule, we noted that the subsidy amount for a certain utility rate was understated. This resulted in less subsidy to certain tenants of approximately $600.

During our fiscal 2001 audit, we noted that the utility allowance schedule for certain utility classifications were erroneously adjusted when the current rate did not require an adjustment. Consequently, there were overpayments to 23 families which amounted to $226 and underpayments to 18 families which amounted to $483 in fiscal 2001. We also noted one instance where the utility classification exceeded the 10% adjustment threshold, but the utility schedule was not adjusted.

During our fiscal 2002 audit, we noted that the utility rates for certain classifications exceeded the 10% adjustment threshold, but the utility schedule, which was effective January 1, 2002 was not adjusted. The total estimated overpayment to 11 families amounted to $114 and underpayments to 35 families amounted to $1,280 for fiscal 2002.

Status –
Unresolved. In the current year, we noted that the utility rates for certain classifications exceeded the 10% threshold, but the utility schedule, which was effective March 1, 2003 was not adjusted until August 2003. This error resulted in an overpayment to one family. We continue to recommend that the City review the revised utility allowance schedules each year to ensure that the utility allowances are properly adjusted in accordance with federal regulations.

Changes in the Government Reporting Model

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*, dramatically changed the presentation of the City's external financial statements effective in fiscal 2002. In the GASB's view, the objective of the new reporting model is to enhance the clarity and usefulness of these financial statements to the citizenry, oversight bodies, investors and creditors.

We understand the City's current financial accounting system, CIFIS, is unable to process the required information under this new financial reporting. Therefore, the City is required to prepare manual spreadsheets to generate government-wide financials using the CIFIS reports. The City is also retrieving information from other systems that are maintained by the various departments instead of being retrieved from a central system.

Although the City implemented GASB 34 in conjunction with the preparation of its fiscal 2002 financial statements, the completion of the Comprehensive Financial Annual Report (CAFR) was not until April 2003 due to certain significant task deadlines not being met. We recommended that the City ensure that the required information and necessary resources are available for timely and accurate completion of its financial statements in fiscal 2003.

Status –
Unresolved. The City continued to experience delays in completing the CAFR as certain task deadlines were not met. We also continue to recommend that the City should determine its financial reporting system needs and invest in a long-term solution.

COMMENTS WHICH HAVE BEEN RESOLVED

No. 02-1: Findings Based on Federal Agency's On-Site Monitoring

In December 2000, HUD performed a limited on-site monitoring review of the City's Community Planning and Development (CPD) Programs and issued a preliminary report in December 2001 with their findings. The City provided written responses to HUD. We understand that the latest response from HUD was dated October 23, 2002, which indicated that certain findings were adequately addressed by the City.

The HUD findings included the following:

1. The City sold certain Ewa Villages properties at a price in excess of the documented fair market value of the property.
2. The City failed to collect Community Development Block Grant (CDBG) program income from Unity House, resulting in improper program and accounting controls over an estimated $1.2 million in CDBG program income.
3. The lack of accountability resulted in the City closing on the sale of an Ewa Villages area without Unity House's $1.7 million share of the purchase price, while allowing escrow statements to reflect that the cash was on-hand.
4. The City allowed Unity House to keep escrow interest earned on CDBG funds resulting in an approximate $24,000 loss in interest due to the U.S. Treasury.
5. Data related to the City's subrecipient loan program was questioned as a result of program management control weaknesses.
6. The City's lack of control over the Kekaulike financial management was impacting on the ability to adequately determine CDBG program income.

Status –
Resolved. The City received a letter from HUD dated November 25, 2003 which stated that all of these findings have been resolved.

No. 02-3: Classification of Outstanding Checks

During our audit, we noted $17.8 million in liabilities classified as checks payable at June 30, 2002, which were actually outstanding checks. As outstanding checks should be deducted from the City's cash balance, the $17.8 million in checks payable should have been offset against the City's cash in determining the proper asset and liability account balances as of June 30, 2002.

Status –
Resolved. The City has properly offset outstanding checks against cash balances for financial reporting purposes at June 30, 2003.

No. 02-5: Repayment of Temporary Fund Transfers

During our testing of four interfund borrowings, we noted one instance in which the City Council was not properly notified of an interfund reimbursement. Per City Ordinance 01-24 Bill 15 (2001), CD2, "The Director of Budget and Fiscal Services shall notify the Council of the reimbursement or repayment of the temporary transfer or loan as soon as such reimbursement or repayment is made. Such notification shall identify the source of funding of the reimbursement or repayment of the temporary transfer."

Status –
Resolved. The City has since notified the City Council of the interfund reimbursement. No exceptions were noted in our current year testing.

No. 01-1: Construction Contract Encumbrance Procedures Should Be Improved

The City's Charter Section 9-106 par. 3(a), *Administration and Enforcement of the Budget Ordinances*, states that "appropriations authorized in the executive capital budget ordinance or any supplementary appropriation shall be considered valid only for the fiscal year for which made and for six months thereafter, and any part of such appropriations which is not expended or encumbered shall lapse six months after the end of the fiscal year." During our 2001 audit, we noted that the City was not in compliance with its procurement policy. We noted that multiple award letters to contractors were dated in December 2000 for funds appropriated in fiscal 2000. However, the City's "Referral of Bid Abstract and Recommendation as to Award" form, which is reviewed and signed by the fiscal officer and department, was dated in January 2001 through April 2001. The City's procurement policy stipulates that the purchasing division shall "prepare, process, and **award the contract after the agency returns the completed bid referral** and contract documents."

We also noted that the City issued conditional award letters dated December 29, 2000. The final award letters were also dated December 29, 2000, but the contractors' acknowledgement of receipt of the December 29, 2000 award letters were dated in January 2001 through April 2001.

During fiscal 2002, the City amended its procurement policy to state that the Purchasing Division shall "Prepare, process and award the contract." Thus, the policy deleted the requirement to "award the contract after the agency returns the completed bid referral." During our 2002 testing, we noted that many contracts were awarded and encumbered with conditional awards as a result of this policy change. However, we noted no mention of conditional awards in the procurement and encumbrance policy. If the City's practice is to allow conditional awards to encumber funds, the City should consider amending its procurement policy to specifically include this practice in the policy.

Status –
Resolved. Although we noted that contracts were still awarded and encumbered with conditional awards in fiscal 2003, the Department of Corporation Counsel concluded that the City's practice of encumbering funds through conditional awards is legal and is consistent with the definition of encumbrance in the City's encumbrance policy.

No. 01-5: Equipment Recordkeeping Policies and Procedures Compliance

During our 2002, 2001 and 2000 audits, we noted certain equipment did not have the City's FACS or agency identification decal affixed to the equipment to facilitate inventory taking as required by the City's personal property policy and procedure manual, certain equipment was not at the site listed on the FACS system listing, an equipment was installed in 1995 but has never been used and certain storage rooms contained old unused equipment.

Improper accounting for property and equipment may result in a misstatement of equipment balances in the FACS listing and in the financial statements. Additionally, equipment may be misplaced or lost to theft without proper decal identification.

Status –
Resolved. The City has taken measures to correct the exceptions noted above. No exceptions were noted in our current year testing.

No. 01-11 and 00-11: Information Technology Policies and Procedures Should Be Improved

A. Update and Test the Disaster Recovery Plan

While the City has a formal and comprehensive disaster recovery plan, we noted that a comprehensive test has not been performed since September 2000. The disaster recovery plan has only been tested on a limited (i.e., only the system designated as critical) basis since 1999.

In the event of a disaster such as fire or flooding, the lack of a tested and proven comprehensive disaster recovery plan for the computer environment could result in severe disruption of hardware and software availability. Without the dedication of required resources for recovery, critical business processes may not be recovered and business continuity may not be assured. Furthermore, the chances for a successful recovery are diminished greatly without a coordinated recovery effort between system users and the systems support functions. By planning ahead for disaster situations, adverse business impact can be limited and exposure to financial loss from system failure can be reduced.

Status –
Resolved. The disaster recovery hot site was moved from Chicago to Kapolei, Hawaii to facilitate the testing of the recovery plan. In April 2003, the City performed a comprehensive disaster recovery test by testing all systems by module and performing back-up procedures.

B. Standardize Information Security Policies and Related Procedures

We noted standard information security policies and related procedures do not currently exist at the City. While several policies relating to security exist within the City's information technology environment, a comprehensive document to standardize procedures across all platforms does not exist. With the moves and impending moves into new technologies, policies and procedures should be documented and standardized to ensure critical applications remain secure and available.

Status –
Resolved. The City has finalized its Internet and General Information Technology Security Policies and Guidelines Manual, which includes monitoring procedures and controls over physical and network security, information access and monitoring of security incidents.

C. Implement a Help Desk Function

During our review of the help desk function, we noted that operations staff perform this function along with maintaining the computer operations for the City. Lack of a dedicated help desk function could result in inadequate support for users and inaccurate reporting of system/application problems. Although the current manual procedures for recording and tracking system/application problems is functional, it will not be adequate as the City moves to the client/server environment. Further, manual procedures make it difficult to identify trends with system/application problems. We understand the City has acquired and plans to implement problem-tracking software. This will automate the help desk function.

Status –
Resolved. The help desk function has been fully implemented in fiscal 2003.

D. Establish Standard, Formalized Service Level Agreements

We noted that documented, formalized service level agreements do not always exist between the proprietors and custodians of data. Therefore, divisions of duties are not clearly defined for system and software maintenance support, configuration and control with external vendors. Furthermore, performance measurements were not developed and reported.

We noted that the application support for the Axent remote access software has not been consistent or reliable and that the application is currently not working due to problems with integration in the City's operating environment and lack of response from the vendor.

Status –
Resolved. The City has developed and implemented a standard service level agreement for use with all City agencies. Specific performance measurements between the proprietors and custodians and the application support for remote access software have been properly addressed.

No. 00-2: Financial Statements Should Be Issued on a Timely Basis

The City generally completes and submits the CAFR to the Government Finance Officers Association (GFOA), for qualification for an award certificate, by the GFOA's deadline of December 31. However, the City's June 30, 2000 CAFR was not completed and submitted to GFOA until February 2001, eight months after the City's year end. The primary delays in completing the final combined financial statements were due to difficulties encountered by the City in establishing the account balances for two new enterprise funds (Sewer Fund and Solid Waste Special Fund) created as of July 1, 1999.

Although the City published its June 30, 2001 CAFR prior to December 31, 2001, a qualified opinion was rendered as we were unable to obtain sufficient information to support the Sewer Fund's inventories of materials and supplies of $11,983,180 and related materials and supplies expense of $12,655,949. The City's June 30, 2002 CAFR was submitted to the GFOA in April 2003, ten months after the City's year end, due to various problems and difficulties encountered by the City which contributed to the delays.

Status –
As this comment has been incorporated into reportable condition Finding No. 03-02 and 02-02 in the separate Single Audit report, this comment will not be carried forward.

No. 00-5: Fixed Assets Should Be Properly Classified

During our testing of the General Fixed Assets Account Group, we noted that three out of eight projects tested were completed at June 30, 2000, yet continued to be included in the work-in-progress account. We also noted during our testing of the Sewer Fund that a significant number of completed projects had not yet been transferred from the work-in-progress account to the fixed assets account. Reclassifications were necessary which resulted in additional depreciation expense for the Sewer Fund.

Although the City conducted a comprehensive review of the work-in-progress account and transferred completed projects or assets from the work-in-progress account to fixed assets during fiscal 2002, we noted certain exceptions during our testing. Therefore, the City subsequently investigated and corrected these exceptions.

We understand that the Purchasing Division is responsible for monitoring the FACS system, while the operating agency is responsible for the timely transfer of projects or assets from the work-in-progress account to the respective asset account in the FACS system.

We recommended that the City's Purchasing Division monitor the work-in-progress account and follow up with the operating agencies to ensure timely transfers of completed assets are performed. Timely and accurate completion dates are necessary to record and compute depreciation expense for those assets currently in the enterprise funds.

Status –
As this comment has been incorporated into material weakness Finding No. 03-01 in the separate Single Audit report, this comment will not be carried forward.

CORRECTIVE ACTION PLAN

DEPARTMENT OF BUDGET AND FISCAL SERVICES
CITY AND COUNTY OF HONOLULU
530 SOUTH KING STREET, ROOM 208 • HONOLULU, HAWAII 96813
PHONE: (808) 523-4616 • FAX: (808) 523-4771 • INTERNET: www.co.honolulu.hi.us

JEREMY HARRIS
MAYOR

IVAN M. LUI-KWAN
DIRECTOR

CHRIS A. DIEBLING
DEPUTY DIRECTOR

March 22, 2004

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

Dear Mr. Tanaka:

RE: MANAGEMENT LETTER – COMPREHENSIVE FINANCIAL AUDIT FOR THE FISCAL YEAR 2002-2003

Attached is the City Administration's response to PricewaterhouseCoopers LLP preliminary draft of the management letter findings and internal control comments resulting from the audit of the City and County of Honolulu for the fiscal year ended June 30, 2003. The response includes actions taken or contemplated, anticipated completion dates, and City personnel responsible for the corrective action.

Sincerely,

IVAN M. LUI-KWAN
Director

IMLK:al
Attachments

FORWARDED:

BENJAMIN B. LEE, FAIA
Managing Director

c: Budget and Fiscal Services- Internal Control Division

RESPONSE TO MANAGEMENT LETTER FINDINGS AND INTERNAL CONTROL COMMENTS
For the Year Ended June 30, 2003

CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Finding No. 03-01: Lack of Monitoring of Subrecipient Loans

Audit Recommendation: The City should establish procedures to ensure all subrecipients are complying with the loan agreements by making required payments on a timely basis, including residual receipt payments. Proper monitoring of these loans should be performed annually. The City should also clearly define residual receipts in the loan agreements to ensure consistency.

Administration's Comment: The Community Services Fiscal, Department of Budget and Fiscal Services (BFS), and the Department of Community Services (DCS) have established procedures to monitor the subrecipient loan payments. The BFS Post Development Monitoring staff has developed procedures to perform annual reviews of the loans. Based on recent clarification from the U. S. Department of Housing and Urban Development (HUD), the City will issue guidance to define residual receipts and the definition will be included in new loan agreements.

Anticipated Completion Date: September 2004

Contact Person(s): Jean Tanji, Federal Grants Coordinator, BFS
Randy Wong, Division Chief, DCS

Finding No. 03-02: Equipment Costs Should Be Obtained From the Contractors

Audit Recommendation: The City should request and obtain a detailed listing of the equipment costs from their contractors or vendors to ensure the assets are accurately reflected in the City's financial records.

Administration's Comment: BFS is working on establishing procedures to obtain equipment costs from the contractors and vendors to ensure that the assets are accurately classified on the City's financial records.

Anticipated Completion Date: December 2004

Contact Person(s): Charles, Katsuyoshi, Central Purchasing & Contracts Administrator, BFS
Nelson Koyanagi, Jr, Chief Accountant, BFS

Finding No. 03-03: Unamortized Discount on Long-Term Debt Should Be Properly Recorded

Audit Recommendation: The City should ensure proper recordation of future debt discounts and proper amortization of the unamortized debt discount over the life of the bonds.

Administration's Comment: The City has revised its policy to record discounts on long-term debt and will properly amortize the discounts over the life of the bonds.

Anticipated Completion Date: December 2003

Contact Person: Nelson Koyanagi Jr, Chief Accountant, BFS

No. 03-04: Adequacy of the Workers Compensation Reserve

Audit Recommendation: The City should communicate this inconsistency with the actuaries and ensure future actuarial studies assume an unlimited self-insurance retention, which would provide more accurate estimates of case and IBNR reserves.

Administration's Comment: The City has instructed the actuary to ensure that future actuarial studies for worker's compensation claims assume an unlimited self-insurance retention. The actuary has estimated that using an unlimited retention level in the June 30, 2003 IBNR study would not result in a significant change to the reserves.

Anticipated Completion Date: March 2004

Contact Person: Beverly Braun, Risk Manager, BFS

No. 03-05: Findings Based on Federal Agency's On-Site Monitoring

Audit Recommendation: The City should ensure timely responses to HUD and proper resolution of these findings.

Administration's Comment: The City is working on addressing each finding in the HUD report. A policy has been implemented to provide timely responses to HUD.

Anticipated Completion Date: September 2004

Contact Person: Jean Tanji, Federal Grant Coordinator, BFS

No. 03-06: Allowance for Extra Work Should Not Be Encumbered

Audit Recommendation: The City should not execute contracts and encumber funds for projects that provide "allowance for extra work," unless the scope of services are clearly defined and complies with the City's encumbrance policies.

Administration's Comment: The City will issue guidance to clarify the encumbrance policy requirements and specify contract provisions for the allowance of unanticipated work that may arise within the scope of the contract.

Anticipated Completion Date: June 2004

Contact Person: Chris Diebling, Deputy Director, BFS

No. 03-07: Noncompliance with the State Procurement Code

Audit Recommendation: The City must ensure compliance with the state procurement rules. The City should properly train all employees and temporary workers on the bid opening procedures.

Administration's Comment: The City implemented a new computerized bid application management system, which will record the names of the witnesses opening the bids. The City will instruct all employees and temporary workers on the proper bid opening procedures.

Anticipated Completion Date: September 2003

Contact Person: Charles Katsuyoshi, Central Purchasing and Contracts Administrator, BFS

No. 03-08: Delinquent Collections on Subsidy Agreements

Audit Recommendation: The City should either amend the subsidy agreements or maintain written documentation of the revised payment plans, which has been approved by the appropriate City personnel, in the tenant files.

Administration's Comment: The City has instituted a policy to document changes in repayment terms by executing and maintaining a revised payment plan in the tenant's file. The City is in the process of updating the tenant files.

Anticipated Completion Date: September 2004

Contact Person: Jean Tanji, Federal Grants Coordinator, BFS
Ross Miyamoto, Revenue Collections Administrator, BFS

PRIOR YEAR COMMENTS THAT ARE STILL APPLICABLE

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

Audit Status: Unresolved. The Kailua Elderly Housing loan agreement has not been formally executed.

Administration's Comment: The City has been working with the subrecipient's lawyers to finalize and execute the Kailua Elderly Housing loan agreement.

Anticipated Completion Date: June 2004

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

Finding No. 02-04: Inclusion of Certain Funds as Fiduciary Funds

Audit Status: Unresolved. Although the City identified and transferred certain funds included in the fiduciary funds to other City funds during fiscal 2003, we identified other funds that did not qualify as fiduciary funds. We noted that the City transferred additional funds in fiscal 2004.

Administration's Comment: The City has over 120 trust funds, which were properly classified as trust funds and agency funds prior to GASB 34. With GASB 34 fiduciary funds were more narrowly defined and the City identified and reclassified the funds for financial statement reporting purposes in fiscal year 2003. The City is completing the analysis of all trust and agency funds and is transferring those not qualifying under GASB 34 as fiduciary funds to the appropriate funds.

Anticipated Completion Date: June 2004

Contact Person: Nelson Koyanagi Jr, Chief Accountant, BFS

Finding No. 01-03: Inadequate Monitoring of Property Management Companies

Audit Status: Unresolved. We noted that the property budget approval process was not completed prior to the beginning of fiscal 2003 and 2002, the City's agreements with the property management companies do not state the City's formalized policy regarding reimbursement of general overhead costs, and the City still has not written-off significant old outstanding receivables. We continue to recommend that the City address the unresolved items.

Administration's Comment:
The delay in receiving the property management budgets for fiscal year 2003 was due to the implementation of a new federal budget report format. The City is working with the property management companies to ensure that their budgets are submitted before the start of the fiscal year.

The City issued a letter to the property management companies in May 2002 to inform them of HUD's policy for reimbursement of general overhead costs. The policy is being incorporated into new property management agreements.

The property management companies have submitted a list of receivables deemed uncollectible to the City.

Anticipated Completion Date: June 2004

Contact Person: Charles Woodward, Division Chief, DFM

Finding No. 01-11 and 00-11: Information Technology Policies and Procedures Should Be Improved

Audit Status: Unresolved. All of the issues noted in the "High-Level Security Assessment" report have been resolved by the City, except one. We continue to recommend that the City's task force properly address this remaining issue.

Administration's Comment: The Department of Information Technology (DIT) had difficulty identifying the issue raised above. We feel we have addressed all issues raised in the security report. In the past year, DIT has implemented the following to improve security measures: web filtering, intrusion detection system within the internal network, anti-virus on the SMTP gateway, and public key infrastructure for wireless/VPN access.

DIT has also published new Internet, system usage and e-mail policies and procedures that outline acceptable usage and penalties for violation (including revocation of network access). These polices have been approved by the administration and therefore give DIT policy enforcement and control of network access. As a management and civil service/union policy, violations are handled by senior administration at the departmental level. Changing this will require changes in Hawaii law. The City Security Office position is presently filled in DIT.

The nature of security threats requires improvements to be ongoing, subject to funding considerations.

Anticipated Completion Date: November 2003

Contact Person: Alvin Sunahara, Technical Support Division Chief, DIT

Finding No. 00-03: Accounting of Infrastructure Costs Should Be Improved

Audit Status: Unresolved. We continue to recommend that the GIS system be kept current and is accurate and complete. Periodic assessments should be performed on the infrastructure values to determine whether any write-downs are necessary. The City should also ensure that appropriate cost information is obtained from developers and recorded on a timely basis.

Administration's Comment: The Department of Environmental Services (ENV) coordinates with the Department of Design and Construction to obtain the appropriate information to update the GIS system. Write-downs of infrastructure values are recorded in the GIS system as changes in infrastructure assets occur. BFS is working with the operating agencies and developers to establish procedures for obtaining the cost information of assets dedicated to the City.

Anticipated Completion Date: March 2005

Contact Person(s): Timothy Houghton, Deputy Director, ENV
Diane Murata, Property Management Officer, BFS

Finding No. 00-10: Ensure Proper Section 8 Utility Allowances Are Utilized

Audit Status: Unresolved. In the current year, we noted that the utility rates for certain classifications exceeded the 10% threshold, but the utility schedule, which was effective March 1, 2003 was not adjusted until August 2003. This error resulted in an overpayment to one family. We continue to recommend that the City review the revised utility allowance schedules each year to ensure that the utility allowances are properly adjusted in accordance with federal regulations.

Administration's Comment: The 2003 overpayment for $30 was an isolated occurrence and has been corrected. The City will continue to perform annual reviews and adjust the utility allowance schedules in accordance with federal regulations.

Anticipated Completion Date: August 2003

Contact Person: Sandy Toma, Program Administrator, DCS

Changes in the Government Reporting Model

Audit Status: Unresolved. The City continued to experience delays in completing the CAFR as certain task deadlines were not met. We also continue to recommend that the City should determine its financial reporting system needs and invest in a long-term solution.

Administration's Comment: The City acknowledges that its current financial system, CIFIS, is costly, inefficient and unable to provide the necessary information required for financial reporting in accordance with GASB 34. However, until funding is available, the City will continue to rely on CIFIS and other cumbersome adhoc systems to meet its financial reporting requirements.

Anticipated Completion Date: The completion date is dependent on the City being able to fund the cost of acquiring and implementing a new financial system.

Contact Person(s): Nelson Koyanagi Jr, Chief Accountant, BFS
Robert Morita, Executive Assistant, BFS