

Report of independent certified public accountants in accordance with
Government Auditing Standards and Circular A-133

State of Hawaii, Department of Transportation, Harbors Division

June 30, 2004

C O N T E N T S

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	3
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Report of Independent Certified Public Accountants on
Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With *Government Auditing Standards*

To the Director
Department of Transportation
State of Hawaii

We have audited the financial statements of the Harbors Division, Department of Transportation of the State of Hawaii relating to the Public Undertaking (Harbors Division) as of and for the year ended June 30, 2004, and have issued our report thereon dated November 15, 2004, which included an explanatory paragraph describing the restatement of the 2003 financial statements. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Harbors Division's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Harbors Division's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 04-01 to 04-04.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 04-01 to 04-03 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Harbors Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Procurement Code (Chapter

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103D of the Hawaii Revised Statutes) and procurement rules, directives, and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Honolulu, Hawaii
November 15, 2004

Report of Independent Certified Public Accountants
on Compliance With Requirements Applicable to
Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133

To the Director
Department of Transportation
State of Hawaii

Compliance

We have audited the compliance of the Harbors Division, Department of Transportation of the State of Hawaii relating to the Public Undertaking (Harbors Division) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2004. The Harbors Division's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of Harbors Division's management. Our responsibility is to express an opinion on Harbors Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments and Other Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Harbors Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Harbors Division's compliance with those requirements.

In our opinion, the Harbors Division complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

Internal Control Over Compliance

The management of the Harbors Division is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Harbors Division's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

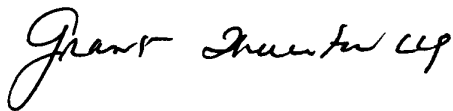
To the Director
Department of Transportation
State of Hawaii

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Harbors Division as of and for the year ended June 30, 2004, and have issued our report thereon dated November 15, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Honolulu, Hawaii
November 15, 2004

State of Hawaii
 Department of Transportation
 Harbors Division

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2004

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA number</u>	<u>Pass-through entity identifying number</u>	<u>Federal expenditures</u>
U.S. Department of Transportation - Federal Highways Administration			
Pass-through from State of Hawaii, Department of Transportation - Highways Division			
Highway Planning and Construction	20.205	FB-0300	\$ 365,918
U.S. Department of Homeland Security			
Direct Programs			
Port Security Grant Program for Critical National Seaports	97.056		<u>464,034</u>
Total Expenditures of Federal Awards			<u><u>\$ 829,952</u></u>

The accompanying note to the schedule of expenditures of federal awards is an integral part of this schedule.

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NOTE TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2004

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of State of Hawaii Department of Transportation Harbors Division and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the presentation of, the basic financial statements.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year ended June 30, 2004

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditors’ report issued: Unqualified.

Internal control over financial reporting:

- Material weakness(es) identified? Yes No
- Reportable condition(s) identified that are not considered to be material weaknesses? Yes No
- Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? Yes No
- Reportable condition(s) identified that are not considered to be material weakness(es)? Yes None reported

Type of auditor’s report issued on compliance for major programs: Unqualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? Yes No

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
97.056	Port Security Grant Program for Critical National Seaports

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

State of Hawaii
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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2004

Section II – Financial Statement Findings

Ref.

No. Internal Control Findings

04-01 Improve Management of Financial Records

The fiscal office has been challenged over the past two years mainly due to the significant issues encountered with the implementation of the financial management package of the Comprehensive Information Database System (CIDS) effective July 1, 2002 and the lack of sufficient staff resources. See Internal Control Findings 03-01, Prior Year Audit Findings. Although many improvements were noted during the current year, continued efforts in implementing additional improvements are still needed in the Harbors Division fiscal office.

The primary focus of the Fiscal Office was to stabilize CIDS and to develop and implement compensating accounting procedures in order to produce meaningful financial reports. This major task contributed to the delay in performing timely periodic reconciliation of the Harbors Divisions accounts. As a result the Harbors Division recorded numerous adjustments after the books were closed at year-end. The lack of periodic account reconciliations, including the thoroughness of subsequent review and approval of such reconciliations, could affect the accuracy of financial information provided to management and may jeopardize decisions based on such information. Furthermore, the probability that additional errors will occur and go undetected is greatly increased. Finally, when accounts have not been reviewed and reconciled during the year, attempts to perform year-end account analyses can become a time-consuming and costly process.

The statement of net assets of the public undertaking at June 30, 2003 and the statement of revenues, expenses and changes in net assets of the public undertaking for the fiscal year ended June 30, 2003 were restated to reflect the correction of certain assets, liabilities, revenues and expenses. The correction of these errors were the result of system implementation issues, lack of periodic reconciliation of the Harbors Divisions accounts in a timely manner as well as the lack of established policies and procedures to ensure proper cutoff of transactions

Recommendation

We recommend that the Harbors Division assess its control processes, procedures and resources and consider undertaking a restructuring of functions in the accounting and financial management area. The objective of the assessment will be for management to determine whether its resources are adequate to maintain proper controls weighing its risks in connection with costs and benefits. The following are important factors to consider in the assessment:

- Proper segregation of duties
- Proper authorization and monitoring of accounting functions
- Backup systems and levels of redundancy

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2004

The function of the fiscal office should be one of financial management as well as maintaining the internal control of the Harbors Division. Management should determine whether this function and objectives could be achieved with the capabilities of its current resources.

To ensure that appropriate actions steps are taken, we suggest that the Fiscal Officer direct the efforts in implementing improvements in the financial reporting process. To facilitate this process, a work plan and implementation schedule should be prepared that would detail the requirements, persons responsible for implementation and timetable. The Fiscal Officer should submit periodic assessments to management on the implementation progress of the proposed plan. This will enable management to monitor the progress of the Fiscal Office's progress and provide for greater accountability.

As part of the implementation plan, the Harbors Division should continue to improve the management of its financial records by strengthening its monitoring process to ensure that there are adequate resources and training, appropriate assignment of responsibilities, appropriate prioritization of accounting duties, establishment of appropriate fiscal procedures, and follow-through in executing fiscal procedures.

The Harbors Division should continue to update its accounting policy and procedures manual so that employees have a reference source on how they should perform any assigned tasks.

We recommend significant accounts on the statement of net assets be reconciled in a more timely manner. Timely reconciliations should be assured by establishing a realistic schedule and having completion monitored by a designated individual. A staff accounting person (rather than a supervisor) should be assigned to reconcile account balances on a routine basis. This would allow supervisors to perform review activities, thereby improving the control system in the fiscal office. In addition, all reconciliations should be reviewed by a designated individual to ensure accuracy and completeness, and to verify that reconciled items have been properly handled. This should be evidenced by having the reviewer initial the reconciliation. Although this reconciliation procedure is currently in place, greater care needs to be exercised in preparing and reviewing such reconciliations to ensure the effectiveness of such controls.

In addition, we recommend that the Harbors Division develop policies and procedures to ensure that analytical procedures are performed on the statement of revenues, expenses and changes in net assets to identify large or unusual fluctuations for investigation. These analytical review procedures could include the comparison of current year to prior year results, budget to actual results and the review of statistical reports.

04-02 Improve Monitoring of Self-Reporting Revenue

Significant portions of the Harbors Division revenues are of a self-reporting nature. The Harbors Division has formal comprehensive policies and procedures to ensure the completeness of revenues. Due to the self-reporting nature of the Harbors Division's revenues the completeness of recorded revenues should be monitored closely.

The Harbors Division has policies and procedures to perform audits of self-reported wharfage revenue, as both a detective and preventative control measure to ensure accuracy and completeness of the reported

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2004

amounts. Audit of shipping lines and agents are based on errors noted on filed reports, type of commodities reported and the dollar amount of the wharfage reported. Due to the lack of sufficient resources in the financial management office, the Harbor Division's auditors have been assisting with various accounting functions and did not perform the number of audits usually conducted.

Recommendation

We recommend that the Harbors Division continue to develop formal comprehensive policies and procedures to ensure that all revenues earned be recorded in a timely manner. Also since wharfage is the Harbors Division's largest source of revenue this should be closely monitored. We recommend that the Harbors Division schedule audits on a more frequent basis. We also recommend that the auditors adjust their audit selection criteria to include larger revenue shipping lines and shipping agents such as Matson, Young Brothers, and Horizon Lines. If staff resources are limited, the Harbors Division should consider hiring independent contractors to perform such tasks.

04-03 Allowance for Doubtful Accounts

The Harbors Division has not established a written policy for maintaining an allowance for receivables where management anticipates collectibility problems. The accrual basis of accounting requires the Harbors Division to record an allowance for probable losses on any receivables that might not be collected. Generally accepted accounting principles require that a provision for bad debt expense be estimated each year in order to properly match such expenses with related revenue and reported net of related revenues.

Recommendation

We recommend the Harbors Division establish written policies and procedures to maintain an allowance for doubtful accounts to provide for potential losses, giving due consideration to the composition and character of its receivables. The allowance should include amounts for specifically identified potentially uncollectible accounts as well as estimated amounts of the potential losses, not specifically identified, and based upon the Harbors Division's past loss experience.

04-04 Preparation of Vacation and Sick Leave Accrual

The Harbors Division prepared a summary leave schedule to determine the amount of its accrued compensated absence liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly rate. We noted the following conditions:

There were a few occurrences on the accrued vacation and sick leave summary schedule where the employee's actual hourly rates did not agree to the DPS Form 5.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2004

Recommendation

The summary leave schedule should be reviewed and validated against personnel and payroll records to ensure accuracy and completeness before reporting the balances to the State Comptroller.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

State of Hawaii
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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS

Year ended June 30, 2004

Ref.
No. **Internal Control Findings**

03-1 Improve Management of Financial Records

In past fiscal years, the Harbors Division was unable to provide timely financial reports or perform certain basic accounting tasks. To correct these deficiencies, the Harbors Division implemented the financial management package of the Comprehensive Information Database System (CIDS) effective July 1, 2002. In addition to problems from past years, new problems occurred from the conversion to the new financial system during the fiscal year ended June 30, 2003.

CIDS involved the re-engineering of the Harbors Division information systems to a single client/server system. Its comprehensive scope encompassed a range of business operation that was to be integrated in the following modules: Harbor Master (vessel management, scheduling and billing), Property Manager (contract management and billing), Parking Manager, Project Management, Agent to Accounts Receivable (electronic capture of shipper information to billing) and Financial Management package (Accounts Receivable, General Ledger, Month end, Statistical Reporting, Multi-year Forecast and Budget modules).

Various problems in the system became apparent with the use of the Accounts Receivable module, such as when accounts receivable information was posted to the general ledger; one side of the double-account-entry was lost in the system under certain conditions. This had a direct impact on testing and validating the accuracy of information postings to the general ledger. As a result, the Harbors Division was unable to use the CIDS general ledger module during the fiscal year.

In addition, accounts receivable balances imported to CIDS were transactions as of the original billed date and amount instead of the outstanding account balances as of July 1, 2002. This caused further problems and delays as the Harbors Division was required to correct the problem by performing month end closing in CIDS retroactively to April 1996, which was the date of the oldest imported transaction. The beginning accounts receivable balance for the individual accounts was not corrected until September 2003.

The General Ledger and Month End modules had not undergone data validation testing as resolution of the problems with the Accounts Receivable module was the priority. The Harbors Division considered using its previous general ledger system. However, by then, it was incompatible with the operating system. Time constraints to meet established external financial reporting deadlines were such that there was little time remaining to select, acquire and implement another general ledger system. As a result, accounting data from the State Financial Accounting and Management Information System (FAMIS) system and CIDS was compiled by a third party for the purposes of preparing a trial balance for the fiscal year ended June 30, 2003.

There were various other problems with the Harbors Division's overall management of its accounts:

- a. The aged receivable report as of June 30, 2003, was not accurate. The aged accounts receivable balances were incorrect because the Harbors Division did not apply all receipts and account adjustments to the

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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2004

aged invoices. Due to the magnitude of the problems encountered while using CIDS, the Harbors Division personnel could not attend to all the problems and was unable to apply payments. Additional temporary staff was later provided to assist the Harbor Division's personnel to focus on the priority issues and provide resources to apply payments. In addition, CIDS did not allow application of certain payments due to software programming conditions. As a result, the aged accounts receivable balances were overstated.

- b. The accounts receivable report could potentially be misstated if Harbors Division received a payment for a self-reporting fee (e.g. wharfage) and recorded it in the report period but recorded the related invoice after the report period. In the present recording process, the district offices perform all billings and the fiscal office receives and records the payments. In the case of self-reported fees, the fiscal office receives and records the payment before the district office inputs the related billing information upon notification from the fiscal office. The time lag between recording the payment and notifying the district office to record the billing could result in recording the two stages of the transaction in different report periods. The recording of the billing and receipt should be simultaneous to prevent misstating the accounts receivable report balance. Because CIDS automatically assigns the current date as the transaction date, the transaction cannot be recorded to have occurred as of a specified date to result in a more accurate historical financial report. The Harbors Division is presently considering centralizing the billing function for self-reporting fees at the fiscal office to reduce the time lag.
- c. Accounts receivable statements were not sent to harbor users during the fiscal year ended June 30, 2003. Statements have not been mailed to harbor users as of the date of this report because the Harbors Division found numerous errors in the data, which require software programming changes and data corrections.

In addition, the Harbors Division did not record or adjust its accounting records to reflect the following significant transactions and events, of which several originated in past fiscal years, in a timely manner:

- a. Constructed assets such as wharves and buildings amounting to approximately \$256 million were not recorded on the state property and inventory record as of June 30, 2003. Demolished capital assets were also not removed from the state property record.
- b. While over \$4 million of receipts were deposited in the State of Hawaii's account on a timely basis, the money was not assigned to the DOT Harbors Special fund until after the fiscal year ended on June 30, 2003. The delay in the transfer was up to five months.
- c. The accounts receivable balance included over \$3 million in past overbillings to a harbor user that originated from a dispute in rental rate that was settled in May 2000. The Harbors Division was unable to record the adjustment because the adjustment feature in CIDS was not set up.
- d. Over \$3 million of rental billings was not recorded during the fiscal year ended June 30, 2003, for a property that was previously managed by a third party. The Harbors Division could not decide whether

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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2004

to record the revenues at gross as in general practice or net of expense as reported by the third party management company in past years.

- e. Encumbrances for contracts related to services ended over five years ago remained on the accounting records.

Furthermore, the Harbors Division did not request for federal grant reimbursement in a timely manner. A reimbursement claim for approximately \$3 million for a construction project was submitted nearly five months after the end of the reimbursement report period covering 11 months. Approximately \$400,000 of additional expenditures incurred for the same project during the fiscal year ended June 30, 2003, was not claimed as of the date of this report. Approximately \$500,000 for another construction project that was completed during the fiscal year ended June 30, 2002, was not claimed as of the date of this report.

It is standard practice to record transactions in a timely manner for the preparation of timely financial reports that are essential for effective management of operation. Financial reports enable management to quickly identify problem areas or reporting errors that need corrections.

It is good business practice to collect receivables as quickly as possible to maximize cash utilization whether by financing operations or capital projects, or investing excess cash. Because the Harbors Division did not submit federal grant reimbursement claims, in a timely manner, the Harbors Division lost the opportunity to earn significant interest income from the State centralized investment pool even during times of low interest rates. If the Harbors Division had submitted reimbursement claims for the \$3 million construction project at the end of each month that the expenses were paid with the annual rate of return of 1.4 to 2.4 percent experienced during the fiscal year ended June 30, 2003, for the State centralized investment pool, the Harbors Division would have earned approximately \$40,000.

We were informed that the combined effect of vacant positions, extended personnel leave, and personnel attention diverted to the development of CIDS caused backlog in performing fiscal duties in a timely manner. Encumbrances for contracted services that ended several years ago remained on the accounting records due to lack of follow through in clearing the balances from the accounting records.

In order to effectively manage operations, timely and accurate financial information is necessary. Timely and accurate financial information can be provided with adequate resources, appropriate assignment of responsibilities and effective management.

Recommendation

The Harbors Division should improve the management of its financial records by strengthening its monitoring process to ensure that there are adequate resources and training, appropriate assignment of responsibilities, appropriate prioritization of accounting duties, establishment of appropriate fiscal procedures, and follow-through in executing fiscal procedures. The Harbors Division should also create an accounting

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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2004

policy and procedures manual so that employees have a reference source on how they should perform any assigned tasks.

Status

Although the Harbors Division has made improvements in the management of its financial records during the current year, the Harbors Division should continue its efforts to improve its financial reporting. See Internal Control Finding 04-01. Some of the improvements were as follows:

In fiscal year 2004, the Harbors Division selected and purchased a general ledger software package. Utilizing accounting data from the State Financial Accounting and Management Information System (FAMIS) and CIDS, Harbors Division personnel were able to compile a trial balance for the fiscal year ended June 30, 2004.

Unapplied credits of reconciled accounts totaled \$5 million and \$2.7 million as of June 30, 2003 and 2004, respectively. Harbors Division personnel are currently working on reconciling the remaining accounts.

During the current fiscal year, the Harbors Division Fiscal and District personnel revised its policies and procedures, including the responsibility for processing of self-reporting revenues and recognizing the cash receipts and charges in the same period.

During 2004, a report was designed using a third-party system to extract data from CIDS. Harbors personnel were then able to generate accurate monthly statements. Since then, 61% of the customers received statements.

Harbors Division personnel recorded approximately \$256 million in wharves and building on the state property and inventory record during the year. Demolished capital assets were also removed from the state property records. As of June 30, 2004, there was an unreconciled difference of approximately \$741,000.

During the current fiscal year, the Harbors Division Fiscal personnel revised its policies and procedures to ensure that cash receipts are allocated to the Harbors special fund timely. As of June 30, 2004, all payments received by the Harbors Division were deposited in the State of Hawaii's account and assigned to the DOT Harbors Special Fund, in a timely manner.

During the current year, Harbors Division personnel set up new adjustment types in CIDS with accompanying procedures. The accounts receivable subsidiary ledger was then adjusted for the \$3 million in disputed rental rate billings.

During the fiscal year ended June 30, 2004, Harbors Division personnel recorded rental billings for the property that was previously managed by a third party.

During the year ended June 30, 2004, the Harbors Division received approximately \$400,000 and \$500,000 in reimbursements for projects completed during the fiscal years ended June 30, 2003 and 2002, respectively.

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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2004

As of June 30, 2003, encumbrances for 39 contracts related to services ended over five years ago totaling \$1,515,065 remained in the accounting records. As of June 30, 2004, 27 contracts related to services ended over five years ago totaling \$1,023,013 remained in the accounting records.

03-2 Correct Shortcoming in Comprehensive Information Database System and Establish Compensating Accounting Procedures

The Harbors Division implemented the accounting function of CIDS effective July 1, 2002. Since then, the Harbors Division encountered numerous problems in using CIDS. Some of the problems were corrected by the developer and about 27 modified version changes to CIDS were released throughout the fiscal year ended June 30, 2003. Some of the problems encountered are described below.

- a. The entries recorded in the general ledger were treated as if the debit and credit entries were switched: the original debit entry was treated as a credit entry and vice versa.
- b. Accounts receivable balances, when totaled, did not agree to recorded summary balances because of rounding differences. CIDS computed invoice balances that were rounded to the nearest one-thousandth of a dollar. When totaled in dollars and cents, the balances would differ from a summary total shown in another module.
- c. CIDS was unable to account for security deposits properly as a liability account by individual accounts. To ensure the security deposit receipts were accounted for, the Harbors Division recorded security deposit receipts in the CIDS Accounts Receivable billing module, which resulted in an understatement of the total accounts receivable balance. In order to obtain the correct accounts receivable balance, the balance must be calculated by reversing the security deposits. There was no single up-to-date information system, manual or computerized, that readily provided the balance of all security deposits on hand for each harbor user as of a report date. The Harbors Division had more than one subsidiary ledger system in various stages of completeness to account for security deposits by individual accounts.
- d. Report of revenues by district generated by CIDS was not available for the fiscal year ended June 30, 2003. Due to a lack of proper design, CIDS original design did not require that operating area codes be entered for transactions originating in the Property Manager module. This information is critical to identify the revenues by district. The CIDS developer has developed corrections to this problem.

CIDS is unable to generate operational statistical information reports that meet the Harbors reporting requirements. For example, a statewide cargo summary by port reported information for only one port and excluded nine other ports.

- e. Because of the numerous problems encountered with the Harbor Master billing, Property Manager billing, Accounts Receivable, Agent to Accounts Receivable and General Ledger modules, the Harbors Division stopped posting to the general ledger and performing the month end closing as of July 2002, to

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SUMMARY SCHEDULE OF PRIOR-YEAR AUDIT FINDINGS (continued)

Year ended June 30, 2004

prevent the perpetuation of errors. Further, the Harbors Division has limited their use of the General Ledger module to include only transaction from the Accounts Receivable module. The Harbors Division continues to document CIDS problem issues and is working with the CIDS developer to correct and enable CIDS to perform fundamental accounting tasks using standard accounting practices. Since October 2003, the State Department of the Attorney General has been assisting the Harbors Division to resolve CIDS performance issues with the developer.

Recommendation

The Harbors Division should continue to work with the CIDS developer to improve CIDS and should establish compensating accounting procedures until CIDS is developed to perform fundamental tasks in conformity with general accounting practices.

Status

The priority focus of the Harbors Division has been to stabilize CIDS, establish compensating accounting procedures and to perform fundamental accounting tasks before directing resources to modify the existing system or to work on the development of a new system. During the current year the Harbors Division worked to establish compensating accounting procedures to perform fundamental tasks and reports in conformity with general accounting practices. These compensating accounting procedures include manual downloads of information to create reports to identify revenues by harbors and other required statistical information. These compensating accounting procedures allowed Harbors Division to close and balance the CIDS AR sub ledgers.

The Harbors Division is cognizant that a long-term solution to improve its financial reporting is the modification of the CIDS program source codes in conformity with general accounting practices. The Department of the Attorney General is working to obtain the release of the CIDS source codes to Harbors Division.

RESPONSE OF THE AFFECTED AGENCY



STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
HARBORS DIVISION
79 S. NIMITZ HIGHWAY, HONOLULU, HAWAII 96813
March 3, 2005

Grant Thornton LLP
1132 Bishop Street, Suite 1000
Honolulu, Hawaii 96813

Gentlemen:

Thank you for the opportunity to comment on the Office of Management and Budget (OMB) Circular A-133 Audit for the fiscal year ended June 30, 2004. We look upon this audit as a constructive process to identify areas of improving financial management and internal controls over financial reporting and operations. We appreciate the recommendations that have been made and concur with the audit's findings.

The division is still working to correct shortcomings in the Comprehensive Information Database System (CIDS) project undertaken to re-engineer its information systems under one client/server system. Critical problems encountered in the financial management module significantly affected the division's ability to perform certain basic accounting functions. Staff resources have been challenged to not only stabilize CIDS but to also manage the day to day financial operations and work on establishing compensating accounting procedures to perform fundamental accounting tasks. While considerable progress was made during the current year, we acknowledge that further improvements are still needed to achieve efficiency.

We will be working with our management staff to develop and implement corrective action plans to address these findings. An assessment of our current resources will also be done to determine if a possible restructuring of functions and responsibilities is needed.

A budget request has been submitted to the 2005 Legislature for additional funds to contract independent audits of self reported wharfage revenue. This request, if approved, will assist the division and supplement staff resources to schedule audits on a more frequent basis. The Attorney General's Office has also been working to resolve CIDS performance issues and obtain the release of the CIDS source codes.

The division recognizes the need to improve the management of its financial operations and will be working diligently on correcting the deficiencies noted. Thank you for the opportunity to provide input into the process.

Very truly yours,

A handwritten signature in black ink, appearing to read "Glenn M. Okimoto".

GLENN M. OKIMOTO
Harbors Administrator

