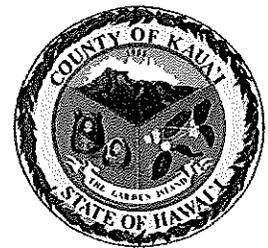


AUDIT OF CASH MANAGEMENT PRACTICES



Submitted by

Office of the County Auditor
County of Kaua'i
State of Hawai'i

Report No. 12-03
2012

PREFACE

This office determined that an audit of cash management practices was warranted based on the significant amounts of cash and short-term investments managed by the county's Department of Finance.

The courtesies and cooperation extended by employees of the Department of Finance (especially the Treasury division), as well as the Transportation Agency, the Kaua'i Police Department, the Department of Public Works and the Planning Department, who assisted us during the course of this audit are sincerely appreciated.

Ernesto G. Pasion, County Auditor

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EXECUTIVE SUMMARY

The Treasury division of the Department of Finance is responsible for monitoring the county's cash positions and immediate cash needs, as well as investing excess cash in short term investments. The total value of cash and short term investments managed by the Treasury division exceeds \$200 million. The Treasury division operates under the supervision of the County Treasurer, who reports to the Deputy Director of Finance. The Deputy Director of Finance reports to the Director of Finance.

The emphasis of this audit was on assessing compliance with Hawai'i state laws regarding the selection of depositories and short term investment of cash in excess of immediate needs. We also reviewed cash receipt processing controls at selected county department and agency locations to assess whether controls, policies and procedures are adequately designed to ensure proper safeguarding of undeposited county moneys.

Summary of Findings

- The County Treasurer does not maintain written documentation designed to demonstrate ongoing compliance with Hawai'i Revised Statute §38-2.
- The county could increase interest earnings on moneys on deposit with local banks by making greater use of the bank accounts with the highest yields.
- We are pleased to report that we found controls at each location to be adequately designed to ensure that cash receipts are properly safeguarded from initial points of collection through bank deposits. However, we noted minor opportunities for improving cash receipt processing controls at several locations. In particular, we noted that an accountant at the Transportation Agency participates in the daily bus fare counting activity and she also assists with the bank deposit process. Ideally, this accountant should not be involved in the bank deposit process.

Summary of Recommendations

- We recommend that the County Treasurer document the percentage of county moneys on deposit with each of the county's depositories on a daily or weekly basis, along with the yields offered by each depository, to demonstrate ongoing

compliance with state laws. (If the information is available.)
Currently, it is being monitored on a monthly basis.

- Consideration should be given to increasing the amount of county moneys on deposit with local bank(s) that offer the highest yields.
- We recommend that management at the departments and agencies that we visited implement the minor suggestions for improvements in cash receipt processing controls that we noted during the course of this audit. In particular, we recommend that the Transportation Agency accountant who assists with daily bus fare counts should not also be involved in the daily bank deposit process.

CHAPTER 1

Introduction

This audit was conducted pursuant to the authority of the Office of the County Auditor, as provided in the Kaua'i County Charter. The audit was included in the county auditor's annual work plan for fiscal year 2011-2012, which was provided to the mayor and the Kaua'i County Council in June 2011.

Background

The county's Department of Finance operates under the supervision of the Director of Finance, who is the chief accounting, fiscal and budget officer of the county. The County Treasurer reports to the Deputy Director of Finance, who reports to the Director of Finance. The County Treasurer supervises the activities of the Treasury and Motor Vehicle Registration division (hereinafter "Treasury division") of the Department of Finance.

The Treasury division manages county funds, including the short-term investment of cash which is in excess of immediate requirements. The Treasury section monitors the county's cash position on a daily basis and manages an investment portfolio, which exceeds \$200 million. In particular, the Treasury divisions' program objectives include:

- ensuring deposits with financial institutions are fully collateralized;
- acting as custodian of all short term investments and checking accounts;
- making short term investment decisions, such as whether to re-invest short term investments as they mature or "cashing in" investments to meet the county's cash flow needs;
- preparing bank account reconciliations; and
- coordinating and preparing all cash management, investment management and debt management reports, such as long term debt schedules, as needed to meet requirements.

The county maintains 15 bank accounts with four local banks. One general checking account, which the county opened in 1963, remains the primary account used for the majority of the county's deposits and

disbursements. Most of the other bank accounts are used for more specific purposes, such as funds held in trust for others and funds restricted for federally assisted housing programs.

State laws, primarily Hawai'i Revised Statutes §38-2 and §38-3, address the use of depositories and collateralization requirements. More specifically, HRS §38-2 (in conjunction with HRS §46-48) provides, in part, that all moneys in the county treasury be deposited in depositories with "due regard" given to depositories doing business in the state of Hawai'i. Depositories are defined by HRS §38-1 as "any federally insured national or state bank, savings and loan association, or financial services loan company; or federal or state credit union insured by the national credit union administration authorized to do business in this State." HRS §38-2(c) further provides that no more than 60 percent of moneys of the county may be deposited in any one depository. However, if the yield offered by one depository is the highest available yield in the State, then the county can legally deposit more than 60 percent of its moneys with that one depository, consistent with the safety and liquidity of the moneys.

HRS §38-2 and HRS §38-3 also address collateralization requirements for eligible depositories. Generally, moneys on deposit with depositories are collateralized when the depositories pledge or otherwise set aside qualifying securities, such as U.S. Treasury notes or bonds, in a financial institution with trust powers to be held therein for safekeeping. Collateralization provides a form of protection for the county's moneys on deposit with depositories. All county moneys on deposit must be fully collateralized.

With respect to short term investments, HRS §46-50 authorizes the Director of Finance, with the approval of the legislative body, to invest county moneys that are in excess of the amounts necessary for meeting the county's immediate requirements in short term investments (i.e., investments which are due to mature not more than five years from the date of investment). Generally speaking, HRS §46-50 limits the types of investments to bonds or notes issued by the county, the state, the US government, or agencies of the US government, as well as bank savings accounts and time certificates of deposit.

According to the County Treasurer, the following are the basic objectives of the county's investment program:

1. To conform with all applicable State of Hawai'i and County of Kaua'i legal requirements (legal);
2. To ensure the safety of public funds by protecting investment principal (safety);

3. To maintain sufficient liquidity to meet the county's operating requirements (liquidity); and
4. To attain the maximum yield possible consistent with the first three objectives.

In addition to managing the county's cash and investment portfolio, the County Treasurer is also responsible for supervising the operations of the Motor Vehicles Registration (MVR) and the MVR tellers. The MVR tellers receive and process a wide variety of payment types, including motor vehicle weight taxes and registration fees, various licensing fees, charges for sewer and solid waste disposal, and more. The county also receives payments from residents, tourists, customers, and others at a variety of locations. For example, the Records unit at the Kaua'i Police Department receives payments for copies of traffic accident reports, the Planning Department receives payments for zoning permits, and the Transportation Agency collects bus fares from riders. These payments are often made in the form of checks, currency or coins, and, for purposes of this audit, are referred to as "cash receipts."

In addition to the cash receipt payments types mentioned above, the county also receives real property tax payments, which are handled by the Real Property Tax Collections section of the Department of Finance.

More than 20 years ago, a previous County Treasurer illegally diverted county funds amounting to \$1.3 million to himself, apparently by writing checks to himself. Even though the county was being audited by outside auditors, this diversion was not detected. We noted that this control weakness has been corrected as the current County Treasurer does not have check-signing authority.

Audit Objectives

Our audit objectives were to determine whether:

- county policies and procedures for selecting banking services (depositories) are adequate to ensure compliance with state laws;
- cash management practices, including the investment of cash in excess of immediate needs are in compliance with state laws; and

- internal controls are adequately designed to ensure cash receipts are properly safeguarded from initial points of collection through bank deposits.

The county's administrative branch is responsible for creating and maintaining effective controls and by adopting methods, procedures and an organizational structure designed to ensure goals are met. Management controls include the processes for planning, organizing, directing and controlling operations, as well as systems for measuring, reporting and monitoring performance.

Audit Scope and Methodology

The scope of this audit was primarily focused on cash management and short term investment activities of the Treasury division within the Department of Finance. We also reviewed cash receipt processing controls at the county's Transportation Agency, the Buildings division of the Department of Public Works, the Records unit at the Kaua'i Police Department, and the Planning Department. Our audit evidence gathering techniques included examination of documents and records, inquiries and observations.

It should be noted that the scope of this audit did not include cash receipt processing controls relative to the county's real property tax collections or golf course fees because these receipts were covered by the annual financial statement audit, which is conducted by an external CPA firm. Similarly, cash management practices and cash receipt processing controls at the Department of Water were not covered by this audit because the DOW is also audited annually by an external CPA firm. These activities could be covered by a follow-up audit in the future.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

CHAPTER 2

AUDIT FINDINGS AND RECOMMENDATIONS

Finding 1. The County Treasurer Should Establish Documentation Procedures Regarding Ongoing Compliance with State Law Regarding Moneys on Deposit with Depositories.

Although the county maintains a number of depository accounts with four local banks, the county maintains the majority of its moneys on deposit with one large local bank. One reason for this practice is that, during the current fiscal year, the yield offered by this large local bank appears to have been higher than the yields offered by the other local banks.

State law requires that no more than 60 percent of the aggregate amount of moneys of the county available for deposit may be deposited in any one depository. However, state law also provides that if the yield offered by any one depository is greater than the yield offered by the other depositories in the state, then the county is allowed to exceed the 60-percent limitation.

From time to time, the county holds more than 60 percent of its moneys on deposit with one large local bank. In our opinion, however, it appears that the county is not in violation of state law because the yield offered by this large local bank is the highest yield available. Nonetheless, we found that the County Treasurer does not maintain documentation demonstrating that he is monitoring compliance with this state law.

We noted that the County Treasurer is aware of the law and he is also aware of the yields offered by the various local banks; accordingly, he had good reasons to assume compliance. Nonetheless, he did not formally document how the county is complying with the law when county moneys on deposit with the large local bank exceeded the 60-percent limitation.

Recommendation

- We recommend that the County Treasurer document the percentage of county moneys on deposit with each of the county's depositories on a daily or weekly basis, along with the yields offered by each depository, to demonstrate ongoing compliance

with state laws. (If the information is available.) Currently, it is being monitored on a monthly basis.

Finding 2. The County Should Consider Opportunities to Increase Interest Earnings on Demand Deposit Accounts With Local Banks.

As discussed in Finding #1, the county maintains accounts with four local banks and some of these accounts earn higher yields than other accounts. It appears that the county could increase interest earnings on moneys on deposit with local banks by making greater use of the bank accounts with the highest yields.

Recommendation

- Consideration should be given to increasing the amount of county moneys on deposit with local bank(s) that offer the highest yields.

Finding 3. Cash Receipt Processing Controls Appear to be Adequately Designed at the Locations We Visited.

We reviewed cash receipt processing controls at the Transportation Agency, the Records Unit at the Kaua'i Police Department, the Planning Department, the Buildings Division of the Department of Public Works, and the Motor Vehicles Registration section of Department of Finance. We are pleased to report that we found controls at each location to be adequately designed to ensure that cash receipts are properly safeguarded from initial points of collection through bank deposits.

An essential element of an effectively controlled organization lies in the attitude of its management. When managers and supervisors exhibit an attitude that establishing good controls and adhering to policies and procedures is essential, others in the organization will sense that and respond by dutifully observing the organization's controls, policies and procedures.

We found that management and staff at each location we visited seemed to be very conscientious about the importance of adhering to established procedures and internal controls. In fact, at several locations where we offered minor suggestions for enhancing controls, the employees took immediate action to improve controls or expressed that they would be implementing control enhancements in the near future.

Recommendation

- We recommend that management at the departments and agencies that we visited implement the minor suggestions for improvements in cash receipt processing controls that we noted during the course of this audit. In particular, we recommend that the Transportation Agency accountant who assists with daily bus fare counts should not also be involved in the daily bank deposit process.

AUDITEE RESPONSES TO FINDINGS AND RECOMMENDATIONS

The Director of Finance informed us that he agrees with our recommendations regarding increasing the amount of county funds on deposit with local banks that offer the highest yield while ensuring compliance with HRS §38-2 (and documenting such compliance on worksheets prepared by the County Treasurer).

With respect to enhancing cash receipt processing controls at the Transportation Agency, the Executive on Transportation informed us that she agrees with the recommendation and has taken corrective action.

A copy of their responses are included in this report in Appendix 1.

Bernard P. Carvalho, Jr.
Mayor



Celia M. Mahikoa
Executive on Transportation

Gary K. Heu
Managing Director

TRANSPORTATION AGENCY
County of Kaua'i, State of Hawai'i
3220 Ho'olako Street, Lihu'e, Hawai'i 96766
TEL (808) 246-8110 FAX (808) 241-6417

TO: Mr. Ernesto G. Pasion

FROM: Celia Mahikoa, Executive on Transportation *Celia Mahikoa*

VIA: Jeremy K. Lee, Program Specialist III *JKL*

Date: July 5, 2012

RE: Audit of Cash Management Practices-Transportation Agency Finding

OFFICE OF
THE COUNTY AUDITOR
COUNTY OF KAUAI

12 JUL -6 12:45

RECEIVED

Mr. Pasion,

We are in receipt of your draft audit report and have reviewed the audit finding and recommendation affecting the Transportation Agency. At this time the Transportation Agency would like to respond to the finding and recommendation.

Finding:

The accountant at the Transportation Agency participates in the daily bus fare counting activity and she also assists with the bank deposit process.

Recommendation:

The Transportation Agency accountant who assists with daily bus fare counts should not also be involved in the daily bank deposit process.

1. *Whether you agree or disagree with the audit recommendation.*

We agree with the audit recommendation.

2. *If you agree with the recommendation, please describe your corrective action plan.*

The Transportation Agency has from Friday, June 29, 2012, removed the accountant identified in the finding and recommendation from participating in the bank deposit

process. The other staff member and a member of the management team will be performing the daily bank deposit.

3. *The date you expect to implement your corrective action plan.*

The corrective action plan was implemented on Friday, June 29, 2012.

The Transportation Agency appreciates the recommendations provided to improve the cash controls at our agency.

Sincerely,



Celia Mahikoa
Executive on Transportation

From: Wallace Rezendes
Sent: Thursday, August 02, 2012 4:07 PM
To: Ron Rawls; Dave Spanski
Cc: Ernie Pasion
Subject: RE: Response to Audit Recommendations in "Cash Management Practices" Audit Report

Hello Ron:

The Department of Finance agrees with your findings relative to H.R.S. 38-2 and interest earnings. The Division of Treasury will continue to monitor treasury funds in accordance with your recommendations.

Aloha,
Wally

From: Ron Rawls
Sent: Thursday, August 02, 2012 1:28 PM
To: Dave Spanski
Cc: Wallace Rezendes; Ernie Pasion
Subject: Response to Audit Recommendations in "Cash Management Practices" Audit Report

Hi Dave.

I am sending this message to you to inquire about the status of any written response that the Department of Finance may wish to include in the final report for the Cash Management Practices audit, which was completed in June 2012.

As you may recall, we met for an audit exit meeting on June 28th and discussed the audit findings and recommendations in the draft audit report. The draft report was issued the next day, accompanied by a transmittal letter (copy attached) which requested that any written responses be provided to County Auditor Pasion by July 20th. To date, however, we have not received a response from the Finance Department.

Would you please let me know if the Finance Department intends to provide a written response to the audit recommendations included in the draft audit report? If not, we will proceed to issue the draft report as a final report (with a statement that no response was received from the Finance Department).

If you have any questions, please feel free to contact me.

Thank you.

Ron