Management and Financial Audit of Hawai‘i Tourism Authority's Major Contracts

A Report to the Governor and the Legislature of the State of Hawai‘i

Report No. 09-02
January 2009

THE AUDITOR
STATE OF HAWAI‘I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai‘i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.

7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.

8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.

9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai‘i’s laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

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OVERVIEW

Management and Financial Audit of Hawaiʻi Tourism Authority's Major Contracts

Report No. 09-02, January 2009

Summary

This is the second audit of the Hawaiʻi Tourism Authority (HTA) and its major contractors, which we conduct every five years as required by Section 23-13, Hawaiʻi Revised Statutes. The audit focused on three multi-year contracts, each exceeding $15 million over the life of the contract, awarded by the HTA to the Hawaiʻi Visitor and Convention Bureau (HVCB), Hawaiʻi Tourism Japan (HTJ), and SMG, the marketer and operator of the Hawaiʻi Convention Center. We reviewed the authority's processes and controls that guide contractor performance and ensure compliance with applicable laws. We also contracted with a consultant to perform an agreed-upon procedures audit of the HVCB.

We found that the authority's year-to-year approach to planning and program implementation hinders its ability to strategically manage the long-term growth of Hawaiʻi's visitor industry. We also found that the authority no longer has a functional strategic plan of its own, and its annual budget, the only plan it has, provides no long-term strategies to fulfill the goals of the Hawaiʻi Tourism Strategic Plan: 2005 - 2015, the State's overall tourism road map. By choosing to map out their strategy and appropriate funds on a year-to-year basis, HTA officials have returned to the approach to tourism promotion that it was created to replace.

Chief among the authority's responsibilities is to create a vision of Hawaiʻi' tourism and develop a strategic plan of its own that should serve as a roadmap for the organization and its partners. In the five years since our last audit, the HTA has spent nearly $270 million in state funds or 90 percent of its marketing funds to attract visitors from North America and Japan and operate and market the Hawaiʻi Convention Center through its major contracts with the HVCB, HTJ, and SMG. Without a strategic plan that maps out the long-term goals and processes to assess the accomplishments of its major contractors, the authority's board of directors is unable to demonstrate that the promotional dollars have been spent purposefully and effectively. By failing to define its own strategies and account for its efforts, the authority has not fulfilled its leadership role to manage Hawaiʻi tourism in a sustainable manner during times of economic decline or prosperity. The authority's failure to establish clear objectives and account for its own activities extends to its major contractors.

We found the HTA's role as the lead entity and advocate of the tourism industry is significantly weakened by its inability to provide measurable results for its major marketing contractors. The only stated goal of the authority in the major contracts we reviewed refers to an "overall goal" of *Ke Kumu*, the HTA's strategic plan, which was phased out in 2004. For example, specific to the HVCB and HTJ contracts, references are made throughout to "HTA's stated goal and objectives" but nowhere

in the contracts are these clearly defined. Essentially, the authority relies on the contractors to set up their own contract terms, deliverables, and even the means by which performance will be evaluated. Lacking objective measures, benchmarks, and documentation, the authority is unable to demonstrate the effectiveness of its oversight process. In previous reports, we raised the issue of the need for HTA to develop measures that could demonstrate the effectiveness of its activities and programs. Industry experts attest to the complexity and difficulty in assessing the effectiveness of tourism development efforts such as promoting brand awareness. But absent objectively determined results, the effectiveness of taxpayer funds spent on promoting Hawaiʻi's most important industry cannot be demonstrated. The tourism industry has begun to embrace performance management practices. For example, in the handbook *Standard CVB Performance Reporting*, the Destination Marketing Association International has developed best practice methods for performance reporting on marketing destinations and convention centers.

In the opinion of N&K CPAs, Inc., with whom we contracted for an agreed-upon procedures audit, the HVCB's management has taken a stronger role in enforcing current policies and procedures. Despite better oversight by HTA to reduce risk in contract management, weaknesses and opportunities for improvement remain, primarily in the administration of the contracts with HTJ and SMG. Informal deviation from contractual terms, including the waiver of independent audits, serious errors in contractual documents, and contractor's failure to adhere to expenditure procedures are some of the issues we identified during our audit.

Recommendations and Response

We recommended that HTA's board of directors exercise the leadership necessary for the development of an action plan that gives a clear picture of the authority's long-term direction and expected outcomes from its activities in terms that can be objectively measured. We also recommend that objectively measureable outcomes be incorporated in the contractual agreements, annual plans, evaluations, and renewal deliberations relating to HTA's major contractors.

The Hawaiʻi Tourism Authority replied that it is in the process of developing an operational plan to address the audit's findings and recommendations and intends to "also explore the need to develop a longer range plan of its own which would also be aligned with the [Hawaiʻi Tourism Strategic Plan]." The authority provided information to clarify a number of points raised in our audit, which neither contradicts nor changes our findings and recommendations. However, the authority's response and clarifications do not appear to fully embrace one of the report's important points—that HTA's plans lack quantifiable, objective benchmarks linking the activities and resources spent to pre-determined outcomes in a format that does not rely on or require industry expertise.

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Management and Financial Audit of Hawai‘i Tourism Authority’s Major Contracts

A Report to the Governor and the Legislature of the State of Hawai‘i

Conducted by

The Auditor
State of Hawai‘i
and
N&K CPAs, Inc.

Submitted by

THE AUDITOR
STATE OF HAWAI‘I

Report No. 09-02
January 2009

Foreword

This is our second management and financial audit of the Hawaiʻi Tourism Authority (HTA) and its major contractors conducted pursuant to Section 23-13, Hawaiʻi Revised Statutes. The Office of the Auditor is required to conduct such an audit at least every five years to determine if the authority and these contractors are in compliance with all relevant programmatic and financial requirements. We focused on three multi-year contracts, each exceeding $15 million over the life of the contract, awarded by the HTA to the Hawaiʻi Visitors and Convention Bureau (HVCB), Hawaiʻi Tourism Japan, and SMG, the marketer and operator of the Hawaiʻi Convention Center. We contracted with N&K CPAs, Inc., to perform an agreed-upon procedures engagement of the HVCB.

We wish to express our appreciation for the cooperation and assistance extended to us by officials and staff of the Hawaiʻi Tourism Authority, its major contractors, and others whom we contacted during the course of the audit.

Marion M. Higa
State Auditor

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Chapter 1
Introduction

Every five years, beginning in 2003, the Office of the Auditor reports on the Hawai‘i Tourism Authority (HTA) and its major contractors, as required under Section 23-13, Hawai‘i Revised Statutes (HRS). The purpose of the management and financial audit is to determine if the authority and its major contractors are in compliance with all relevant programmatic and financial requirements. For a contract to be classified as "major," its financial terms must be in excess of $15 million. In our audit, we included multi-year contracts in which the total exceeded $15 million over the life of the contract, since this is within the authority's powers. This is our second audit of HTA and its major contractors performed under Section 23-13, HRS.

Background

Throughout much of the 1990s, Hawai‘i faced serious economic challenges. A 1991 recession, which had been triggered by the first Gulf War, eventually stretched into nearly a decade of economic stagnation. Unlike the boom-and-bust cycles of Hawai‘i's recent past, this economic stagnation took on "structural characteristics," as companies continued to downsize and restructure long after the initial economic shock.

In October 1997, the Legislature and the governor joined with key leaders in the private sector to form the 26-member Hawaii Economic Revitalization Task Force, which focused on "bold, fundamental, and strategic actions" to kick-start the state's economy. Since tourism accounted for one in every three jobs in Hawai‘i and more than 25 percent of the economic activity at the time, the task force put a high priority on addressing the industry's short- and long-term needs.

The Department of Business, Economic Development and Tourism (DBEDT) reported that since the early 1990s, Hawai‘i's visitor arrival growth had suffered an abrupt and prolonged decline—an almost 18 percent drop in the U.S. market from 1990 to 1996. The task force concluded that the maturing of Hawai‘i's visitor product and the rise of competing destinations together with the erosion of Hawai‘i's competitive position in the U.S. market were largely responsible for this precipitous fall.

To help remedy these developments, the task force recommended the creation of the Hawai‘i Tourism Authority, funded by an increased transient accommodations tax "to assure that promotion dollars are effectively expended." Previously, the Office of Tourism, within

DBEDT, was the agency responsible for promoting, marketing and developing the tourism industry, which included managing the contract of the Hawai‘i Visitors and Convention Bureau (HVCB). At the time, HVCB was the state’s sole tourism promotional organization and received its appropriations annually from the state general fund and the Legislature, a process considered unpredictable and impossible for long-term planning.

In 1998, the Legislature adopted the recommendation of the task force and established the HTA under Chapter 201B, HRS. Responsibility for tourism policy development, marketing, and market development, product development, and impact monitoring shifted from the Office of Tourism to the HTA. In July 1999, the HTA began operations, which included managing the only contract for promoting Hawai‘i worldwide, held by HVCB. In 2002, the HVCB was responsible for an approximately $39 million worldwide promotional budget.

Following our first *Management and Financial Audit of the Hawai‘i Tourism Authority’s Major Contracts,* Report No. 03-10, June 2003, which focused exclusively on the contract with HVCB, the authority split up the marketing responsibilities for its five major market segments, North America (U.S. West and U.S. East as well as Canada), Japan, Asia (concentrating on China, Korea, and Taiwan), Europe (primarily Germany, United Kingdom, and Ireland), and Oceania (Australia and New Zealand). In addition to HVCB, the authority awarded, effective January 2004, separate multi-year contracts for each marketing segment to Hawai‘i Tourism Japan, Hawai‘i Tourism Asia, the Mangum Group operating as Hawai‘i Tourism Europe and the Walshe Group operating as Hawai‘i Tourism Oceania.

Following our *Audit of the Convention Center Authority*, Report No. 00-08, an executive order from the then-governor transferred ownership and oversight responsibilities of the Hawai‘i Convention Center to the HTA. Until 2002, the marketing contract for the convention center was held by the HVCB’s corporate meetings and incentives branch. In January 2003, the authority’s contract with the center’s operator, SMG, was expanded to add the sales and marketing functions in compliance with a legislative mandate.

Operations, Organization, and Funding of the Authority

The Hawai‘i Tourism Authority is governed by a 16-member, policy-making board of directors, which must include 12 public, voting members and four non-voting ex-officio members, represented by DBEDT, the Hawai‘i State Foundation on Culture and the Arts, and the Departments of Transportation and Land and Natural Resources. The current DBEDT representative on the board is the governor’s tourism liaison officer. The authority is attached to DBEDT for administrative purposes only.

At least six of the public members are required to have expertise in visitor industry management, marketing, promotion, transportation, retail, entertainment, or attractions. One member position is reserved for a person with expertise in Hawaiian cultural practices. In addition, all four Hawai‘i counties must be represented on the board. In developing tourism policy recommendations, the HTA board is organized into various standing committees as shown in Exhibit 1.1.

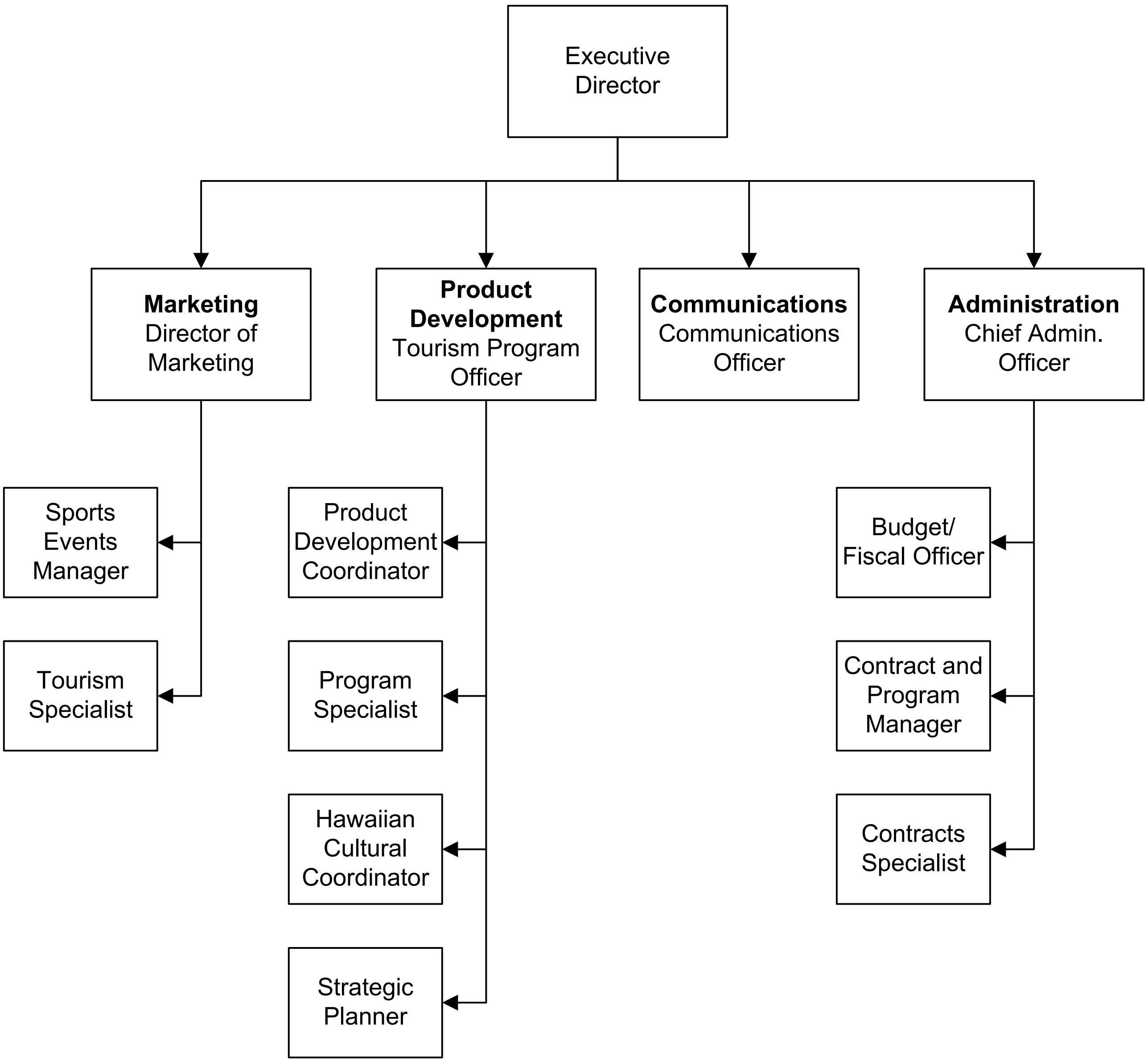
Exhibit 1.1
Hawai‘i Tourism Authority Board Committees

Administrative standing committee	Makes policy recommendations related to the evaluation of the executive director and the administration of HTA.
Budget and audit standing committee	Develops policies to ensure the financial integrity of the HTA through the proper allocation and expenditure of funds in a manner consistent with the board's policies and objectives, and ensures that funds are properly expended under a budget previously approved by the Board.
Marketing standing committee	Makes policy recommendations on initiatives that relate to promoting the visitor industry.
Strategic planning standing committee	Makes policy recommendations relating to the research and planning areas.

Source: Hawai‘i Tourism Authority website

The authority, which has a staff of 23, is organized into four functional divisions—administration, product development, marketing, and communications—as shown in the organizational chart in Exhibit 1.2. The chief administrative officer and director of marketing are responsible for management of all the marketing contracts awarded by the authority. The authority's president/executive director reports to the board, oversees the organization's day-to-day operations, and represents the authority in communications with the governor and the Legislature.

Exhibit 1.2
Organizational Chart of the Hawai‘i Tourism Authority



Source: Hawai‘i Tourism Authority

The mission of the authority is:

> To strategically manage Hawai‘i tourism in a sustainable manner consistent with our economic goals, cultural values, preservation of natural resources, community desires and visitor industry needs.

The authority is responsible for:

- Promoting, marketing, developing and conducting research for the tourism industry, and contracting for related research;
- Creating a vision and developing a long-range, strategic plan for tourism;
- Reviewing contractors' expenditures of public funds by any visitor organization to perform tourism promotion, marketing, and development of tourism; and
- Submitting an annual report on its activities and expenditures, including descriptions and evaluations of programs funded, to the Legislature and the governor.

To carry out these responsibilities, the authority, which is exempt from the Hawai‘i Public Procurement Code, may enter into contracts and agreements for periods of up to five years, and ten years if relating to contracts for the Hawai‘i Convention Center. The authority, however, must notify the Senate President, House Speaker, and governor when it enters into contracts or agreements valued at $25,000 and over.

The Legislature established three special funds administered by HTA to support its mission. The Tourism Special Fund, the Convention Center Enterprise Special Fund, and the Tourism Emergency Trust Fund receive revenues collected from a portion of the transient accommodations tax (TAT) as provided by Chapter 237D, HRS. The TAT is a 7.25 percent tax levied on gross rental income from hotel rooms, suites, condominiums, and vacation houses. Generally, the TAT applies to rentals by non-residents for less than 180 consecutive days. It is collected in addition to state general excise taxes.

Exhibit 1.3 summarizes HTA's audited revenues and expenditures for all funds for the past three fiscal years. The authority's financial statements are comprised of the transactions contained in the Tourism Special Fund and the Convention Center Enterprise Special Fund.

Exhibit 1.3
Hawai‘i Tourism Authority Revenues, Expenditures, and Fund Balances FY2004-05 Through FY2006-07*

	FY2004-05	FY2005-06	FY2006-07
Revenues			
Transient Accommodations Tax**	$96,334,000	$102,404,000	$106,087,000
Conference Center Operations	7,733,000	12,018,000	10,568,000
Interest	531,000	1,024,000	2,089,000
Other	2,000,000	185,000	981,000
Total Revenues	$106,598,000	$115,631,000	$119,725,000
Expenditures			
Contracts	68,746,000	74,451,000	76,819,000
Debt Service (Convention Center)	26,436,000	26,434,000	26,434,000
Personnel	1,570,000	1,950,000	2,093,000
Administrative	550,000	775,000	895,000
Transfer to DBEDT for Research	1,310,000	1,269,000	1,399,000
Convention Center Capital Fund Exp.	2,000,000	0	0
Total Expenditures	$100,612,000	$104,879,000	$107,640,000
Excess of Revenues Over Expenditures [Total Revenues – Total Expenditures]	$5,986,000	$10,752,000	$12,085,000
Fund Balances as of June 30 Year-end			
Tourism Special Fund	$17,926,000	$25,914,000	$31,973,000
Convention Center Enterprise Fund	$1,126,000	$3,891,000	$9,917,000

*Rounded to the nearest thousand.
**Note that these totals comprise the amounts for both the Tourism Special Fund and the Convention Center Enterprise Special Fund.

Source: Hawai‘i Tourism Authority audited financial statements

The Tourism Special Fund

The Tourism Special Fund receives 34.2 percent of the TAT collected annually, supplemented by income from investments, gifts, grants, or other receipts the authority generates from its authorized activities. At least $1 million of these funds must be made available to support and protect Hawai‘i’s natural environment—the authority actually funded nearly twice this amount in FY2006-07. Administrative expenditures are limited to 5 percent by law. In addition, 0.5 percent must be held in a sub-account to fund a safety and security budget provided for the Hawai‘i Tourism Strategic Plan. For FY2006-07, the authority reports that $71.5 million was available to pay for its operations and $2.9 million for other purposes as shown in Exhibit 1.4.

Exhibit 1.4
Assignment of Tourism Special Fund Revenues FY2006-2007 for HTA Operations and Other Purposes

Total revenues, Tourism Special Fund	$74,422,866
Expenditures for environmental purposes	<$1,984,490>
Expenditures for security and safety budget	<$963,645>
Revenues available for HTA operations	$71,474,731

Source: Hawai‘i Tourism Authority

The Convention Center Enterprise Special Fund

The Convention Center Enterprise Special Fund receives 17.3 percent from the TAT. Any amount of TAT revenues collected in a calendar year that exceeds $33 million is deposited into the state’s general fund. Additional revenues are derived from the operations of the Hawai‘i Convention Center, any interest earned on unspent cash balances, contributions, or appropriations. Expenditures for the Hawai‘i Convention Center include the cost of operating, marketing, and promoting, as well as debt service charges on the outstanding principal balance of the general obligation bonds raised to finance the facility, approximately $290 million. According to authority financial reports, revenues for the Convention Center Enterprise Special Fund were $40.5 million, $45.2 million, and $45.2 million for fiscal years 2004-05, 2005-06, and 2006-07, respectively.

Tourism Emergency Trust Fund

The Tourism Emergency Trust Fund, which was established effective July 1, 2007, provides for up to $5 million to the HTA board of directors for use in the case of emergencies as determined by the governor, such as conflicts or disasters that disrupt commerce and affect tourism. The emergency fund money comes from TAT revenues remaining after deposits have been made to the Tourism Special Fund for tourism promotion and visitor-industry research.

Hawaiʻi Tourism Strategic Plan: 2005 – 2015

In 2003, the Hawaiʻi Tourism Authority was in the process of revising its tourism strategic plan, *2002 Ke Kumu*, when it realized the need for a more comprehensive and inclusive plan that addressed the needs as well as identified the responsibilities of all Hawaiʻi's visitor industry stakeholders. The authority contracted with a team of private consultants, PBR Hawaiʻi, to develop a ten year plan "intended to guide all stakeholders in working together to attain the state's vision for a Hawaiʻi that is the best place to live, work and visit." Adopted in 2004, the Hawaiʻi Tourism Strategic Plan: 2005 – 2015 (TSP) is the State's tourism roadmap, providing an overall vision for Hawaiʻi tourism in the year 2015. The plan, which is organized into nine different initiatives, provides strategic directions, specific goals, and responsible and supporting partners for achieving that vision. The HTA is tasked with the development and coordination of the Hawaiʻi Tourism Strategic Plan, but the primary responsibility of monitoring each initiative rests with the lead partners identified in the plan. "In addition to this plan, the HTA, as the State tourism agency, [would] update its own plan—*Ke Kumu*—to identify specific action and implementation strategies consistent with the framework of the TSP."

The Hawaiʻi Tourism Authority's Major Contractors include HVCB, HTJ, SMG, and the NFL

The major contractors, the Hawaiʻi Visitors and Convention Bureau (HVCB), Hawaiʻi Tourism Japan (HTJ), SMG for the marketing and operations of the Hawaiʻi Convention Center, and the National Football League (NFL) were awarded $15 million or more over the life of their multi-year contracts and fall under the authority's marketing program.

Between July 2003 and June 2008, the Hawaiʻi Tourism Authority has spent nearly $270 million alone to attract leisure and business travelers from North America and Japan through its major contracts with the HVCB, HTJ, and SMG. Exhibit 1.5 shows the annual marketing funds allocated to these three contractors for the period from the previous audit to FY2007-2008.

Exhibit 1.5
Annual Marketing Funds Allocated to Major Contractors for July 2003 to June 2008

Calendar Year	HVCB	Hawai‘i Tourism Japan	Fiscal Year	SMG, Hawai‘i Convention Center		Total
				Operating Budget	Marketing	
			2003-04	$13,396,000	$5,800,000	**$19,196,000**
2004	$23,780,300	$7,796,000				**$31,576,300**
			2004-05	$15,145,322	$6,500,000	**$21,645,322**
2005	$24,960,664	$8,085,912				**$33,046,576**
			2005-06	$16,590,825	$6,500,000	**$23,090,825**
2006	$25,892,503	$8,838,342				**$34,730,845**
			2006-07	$18,200,000	$6,500,000	**$24,700,000**
2007	$27,169,736	$8,903,996				**$36,073,732**
			2007-08	$18,586,279	$6,500,000	**$25,086,279**
2008						
(half year)	$16,140,832	$4,136,615				**$20,277,447**
Total	**$117,944,035**	**$37,760,865**	**Total**	**$81,918,426**	**$31,800,000**	**$269,423,326**

Source: Office of the Auditor

Hawai‘i Visitors and Convention Bureau

In 2007, the HVCB received a four-year contract extension for the calendar years 2008 through 2011 to manage program planning and marketing strategies for leisure tourism for the North American market (United States and Canada) and corporate meetings and incentives domestically and internationally. State funding to HVCB for the calendar years 2006 and 2007 was $25.9 million and $27.2 million, respectively, as shown in Exhibit 1.5. The marketing funds allocated in 2007 to all the major market segments and SMG for marketing the Hawai‘i Convention Center is shown in Exhibit 1.6.

Exhibit 1.6
2007 Major Market Segments Budget Allocations

2007 Major Market Segment	Contractor	Budget Allocation
North America (Leisure)	HVCB	$22,363,000
Corporate meetings and incentives	HVCB	$2,564,000
Hawai‘i Convention Center	SMG	$6,500,000
Sporting Events	(e.g. PGA, Pro Bowl)	$7,700,000
Japan	HTJ	$7,810,000
Asia	Marketing Garden	$1,070,000
Europe	The Mangum Group	$883,000
Oceania	The Walshe Group	$900,000

Source: Hawai‘i Tourism Authority

Hawai‘i Tourism Japan

In July 2003, the HTA board of directors accepted a proposal from Dentsu Inc., Japan’s largest comprehensive advertising agency, to promote Hawai‘i in Japan. Dentsu established Hawai‘i Tourism Japan (HTJ) to meet the needs of HTA—its sole client. On December 31, 2003, HTA and HTJ signed a four-year contract. The organization’s Tokyo office began operations on January 5, 2004, with an executive director and six staff members, all of whom were Dentsu employees. The equipment was leased from Dentsu, which also charged a 10 percent service fee. A liaison office in Honolulu was opened the same month as the Tokyo office.

On March 1, 2007, the authority board of directors extended the term of the marketing contract with HTJ for another four years (2008-2011). The funding provided under HTA’s contract with HTJ for the calendar years 2004 through 2011 ranges from $7.8 million to $8.9 million per year, a total of $66 million for the eight-year contract period. In addition, a separate amount, approximately $390,000 per year, $3.1 million over the life of the contract, is allocated for a consumption tax imposed on business transactions in Japan. This tax is recoverable under Japanese law and refunded each year to HTA after receipt.

SMG (formerly known as Spectacor Management Group)

The authority contracts with the management, marketing and development firm SMG to manage, operate, and market the Hawai‘i Convention Center. A partnership headquartered in Philadelphia, Pennsylvania, SMG is the nation's largest provider of services in management, marketing, and development of convention centers, stadiums, arenas, and theaters. The company reports that it manages more than 10 million square feet of exhibition and convention space throughout the world, which were visited by more than 30 million people.

Compensation to SMG is in the form of an annual management and marketing fee, $397,023 and $412,904 for FY2005-06 and FY2006-07, respectively. The contract provides for annual fee increases matching the Honolulu Consumer Price Index up to 4 percent. In addition, SMG is reimbursed for the actual costs of marketing, managing, and operating the Hawai‘i Convention Center, subject to a budget approved by the authority's board of directors. The original 1996 contract, effective through 2003, has been extended several times. The current contractual term began in January 2003, with an extension option exercised in September 2005, which runs through 2011. The funding approved by the authority's board of directors for operations and marketing under the current term is shown in Exhibit 1.7.

Exhibit 1.7
State Funding for the Hawai‘i Convention Center, FY2003-04 Through FY2007-08

Fiscal Year	Center Operations	Sales and Marketing	Total
2002-03	$13,737,658	$2,215,000*	$15,952,658
2003-04	13,396,000	5,800,000	19,196,000
2004-05	15,145,322	6,500,000	21,645,322
2005-06	16,590,825	6,500,000	23,090,825
2006-07	18,200,000	6,500,000	24,700,000
2007-08	18,586,279	6,500,000	25,086,279
Total	$95,656,084	$34,015,000	$129,671,084

*Half year 1/1/03 through 6/30/03

Source: HTA, SMG contract and supplemental agreement 1 through 28

National Football League—Pro Bowl

The authority's contract with the National Football League (NFL) provides for a fee paid to the NFL to hold its annual Pro Bowl game in Hawai'i, as well as for commitments to activities promoting community involvement, the State of Hawai'i, and the game itself. According to a survey report commissioned by the HTA, the 2007 Pro Bowl attracted an estimated 28,000 tourists to the game, most of whom were repeat visitors to the state. In 2005, the NFL received $4.75 million for its services. Thereafter, the contract provides $4 million per year until 2009 for a total of $20.75 million.

Previous Audits' Recommendations

We issued two reports on the Hawai'i Tourism Authority. Our first, *Management Audit of the Hawaii Tourism Authority*, Report No. 02-04, February 2002, was initiated because of legislative concerns about inadequate explanations for the authority's actions, especially the spending of moneys seen as critical to the state's economic well being. The second, released in June 2003, *Management and Financial Audit of the Hawai'i Tourism Authority's Major Contracts*, Report No. 03-10, was the initial audit, and precursor of the current audit, required by Section 23-13, HRS.

The first audit report identified an array of deficiencies stemming from a lack of management and operational leadership and inadequate internal controls to ensure that the authority account for its activities and those of its contractors. Among our recommendations to the HTA board of directors were:

- To ensure that it achieves its mission by implementing a process to develop a comprehensive strategic plan; and

- To ensure that future contracts are properly documented and supported, and clearly tie contractors' remuneration to measurable deliverables, and eliminate questionable contract clauses.

Weaknesses identified in our first audit were borne out in our 2003 audit of the authority's major contractors, which focused primarily on the HVCB.

Our recommendations in the previous audit to the authority board of directors and its executive director included:

1. Improve contractor accountability by:

  - Holding contractors accountable for complying with their own internal policies and procedures;
  - Conducting periodic audits of contract expenditures;
  - Placing a limit on the amount of state funds that can be used for contractors' administrative expenditures;
  - Placing a limit on the amount of state funds that can be used for contractors' personnel expenses;
  - Prohibiting contractors from using contract funds for legal expenses that are unrelated to the contract; and
  - Requiring contractors to:
    - Record expenses in accordance with generally accepted accounting principles;
    - Limit state-funded expenditures to contract-related purposes;
    - Establish an adequate contract management system that includes appropriate controls and policies and procedures over contract procurement, filing and documentation, amendments, monitoring, and evaluation;
    - Provide specific information on the amount of state funds spent on personnel costs, overhead, and other administrative expenses; and
    - Implement and enforce appropriate policies and procedures over the use of state funds for travel and entertainment expenses.

2. Enforce all contract provisions;

3. Improve its contract language to specific graduated penalties for non-compliance and deadline dates for submission of reports, and to require the submission of reports that contain relevant and reconcilable information that ties contractor performance to measurable objectives and outcomes specified in the contract; and

4. Maintain and apply contracting policies and procedures and continue to conduct performance evaluations of its contractors.

Authority officials described our audits as tools for improvement, acknowledging their responsibilities to ensure contractor compliance, minimize the State's liability, and optimize expenditures for tourism promotion. In our 2004 Annual Report, the authority reported that a major effort was underway in implementing the recommendations, including hiring consultants to assist with strengthening its oversight over contractor spending and compliance with contractual obligations.

Objectives of the Audit

1. Assess HTA's planning process to guide its activities and those of its contractors.

2. Evaluate the adequacy of HTA's measures of effectiveness in providing a basis for performance assessments and an assurance that taxpayers receive value for the funds invested.

3. Determine HTA's effectiveness in ensuring that its major contractors' activities are in accordance with applicable laws, rules, and terms of each contract.

4. Determine the degree to which recommendations of past audits have been implemented.

5. Make recommendations as appropriate.

Scope and Methodology

The audit focuses on the major contracts awarded to HVCB, HTJ, and SMG. We did not review a fourth major contract (the NFL's Pro Bowl football game), because it does not require the scrutiny of contractor expenditures once the funding decision is made. Our audit procedures included a review of the authority's processes and controls that guide contractor performance and ensure compliance with applicable laws and the major contractors' adherence to their contractual obligations.

Our assessments covered the five-year period since Report No. 03-10 with emphasis on recent operations and expenditures in FY2007-08. We also reviewed the agency's implementation of recommendations of prior audit reports that were relevant to our objectives. Our audit was performed between January and August 2008.

Audit procedures included interviews with appropriate board members, managers, and staff of the HTA and its major contractors. Audit procedures also included examinations of applicable strategic and operating plans, policies and procedures, reports, contracts, and other relevant documents and records to assess the authority's oversight over contractor effectiveness and compliance with their agreements and pertinent law. We reviewed contractors' general ledgers, journals, invoices, and other supporting documentation to determine appropriateness of financial transactions. We also interviewed individuals and examined relevant documents of other agencies and the private sector.

We contracted with N&K CPAs, Inc., to perform an agreed-upon procedures engagement of the HVCB.

This audit was conducted according to the Office of the Auditor's *Manual of Guides* and 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.

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Chapter 2
The Hawai‘i Tourism Authority Practices an Approach to Tourism Promotion That It Was Designed To Replace

Introduction

The creation of the Hawai‘i Tourism Authority (HTA) in 1998 more than doubled the amount of tourism promotional dollars available to the state from $25 million to $60 million, providing an immediate boost to the industry. State officials believed that by guaranteeing funding from the transient accommodations tax, tourism planners would finally have the opportunity and flexibility to do the kinds of long-term, strategic planning that could address some of the industry’s structural problems. A March 1998 publication, entitled *Hawaii’s Economy/Special Edition*, predicted that: “A dedicated source of funding, coming primarily from the tourism industry itself, will assure the kind of long-term planning that will make every promotional dollar count.”

Ten years and hundreds of millions of dollars later, the HTA cannot demonstrate to the Legislature, tourism stakeholders, and taxpayers that state tourism promotional dollars do indeed count. In the last decade, the fortunes of Hawai‘i’s tourism industry have ebbed and flowed with the tides of global events. In the last five years, the authority has allocated to the Hawai‘i Visitors and Convention Bureau, Hawai‘i Tourism Japan, and SMG, nearly 90 percent of its annual marketing funds to attract visitors from North America and Japan and operate and market the Hawai‘i Convention Center. Because the authority has failed to develop a long-term, strategic plan with clearly defined outcomes and mechanisms to account for results, it is unclear what effects the authority’s worldwide efforts to promote Hawai‘i have had on the long- and short-range development of Hawai‘i’s tourism product and the economy in general.

Summary of Findings

1. The HTA’s short-range approach to tourism policy hinders its ability to strategically manage the long-term growth of Hawai‘i’s visitor industry.

2. The HTA’s role as the lead entity and advocate of the tourism industry in Hawai‘i is significantly weakened by its inability to provide measurable results for its major marketing contractors.

3. Despite better oversight to reduce risk in contract management, weaknesses remain.

A Short-Range Approach to Tourism Promotion Hinders the HTA's Ability To Strategically Manage the Long-Term Growth of Hawai'i's Visitor Industry

In this audit, we found that the authority's year-to-year approach to planning and program implementation hinders its ability to strategically manage the long-term growth of Hawai'i's visitor industry. We also found that the authority no longer has a functional strategic plan of its own, and its annual budget, the only plan it has, provides no long-term strategies to fulfill the goals of the Hawai'i Tourism Strategic Plan: 2005 – 2015 (TSP), the state's overall tourism roadmap. The authority's budget plan also provides little guidance to HTA's major, multi-year contracts, since it lacks performance goals and targets that can be compared against actual accomplishments. Instead, the authority's planning process is driven by many different pieces, working in tandem—the Hawai'i Tourism Strategic Plan, the authority's annual budget, the multi-year marketing contracts with the Hawai'i Visitors and Convention Bureau, Hawai'i Tourism Japan, and SMG, and the annual tourism marketing plans submitted by these major contractors to HTA.

In the past five years since our last audit, the HTA has spent nearly $270 million in state funds through its major contracts with the Hawai'i Visitors and Convention Bureau (HVCB), Hawai'i Tourism Japan (HTJ), and SMG, the operator and marketer of the Hawai'i Convention Center. Without a strategic plan of its own that maps out the long-term goals and processes to assess the accomplishments of its major contractors, the authority's board of directors is unable to demonstrate that the promotional dollars have been spent purposefully and effectively.

Without a long-term focus, HTA's strategic plan is strategic in name only

Public officials' responsibility to account for their use of public resources is described in the federal Government Accountability Office's *Government Auditing Standards* as key to the governing process. Government managers are responsible for providing reliable, useful, and timely information to stakeholders, including legislators and the general public, to demonstrate that public resources were used properly. Moreover, there should be evidence that the entity has achieved objectives and desired outcomes, and that services were effectively and efficiently provided.

The Hawai'i Tourism Authority has multiple and complex roles in the development, coordination, and implementation of state policies and directions for tourism and related activities. Chief among the authority's responsibilities is to create a vision of Hawai'i tourism and develop a strategic plan of its own that should serve as a roadmap for the organization and its partners. The HTA also plays a central role in the management of the TSP, the state's overall tourism road map, which identifies a shared vision for sustainable tourism in 2015. Finally, with an annual budget of more than $70 million in state funds, much of it spent on marketing efforts, HTA is itself an active partner in tourism promotion. In short, the HTA is tasked with addressing Hawai‘i tourism's short-term needs while maintaining a focus on the long-term planning and development of the industry and the community around it.

In our audit, we found that by failing to define its own strategies and account for its efforts, the authority has not fulfilled its leadership role to manage Hawai‘i tourism in a sustainable manner during times of economic decline or prosperity. Similarly, in our first *Management Audit of the Hawaii Tourism Authority*, Report No. 02-04, February 2002, we had found that the board of directors failed to incorporate the elements of a comprehensive tourism strategic plan to carry out its mission. We also noted that performance indicators for the tourism industry, such as statewide visitor spending, were insufficient measurements given the problems raised by other states. Our findings were based on a review of the authority's strategic plan at the time, *Ke Kumu*. Instead of developing a long-range strategic planning process to monitor progress using performance measures that ensure accountability, the authority's board of directors slowly phased out *Ke Kumu* in favor of a budgetary approach to planning and program implementation, which is centered around annual budgets and action plans. While *Ke Kumu* had its deficiencies, it did have the potential to serve as a foundation for an effective strategic plan, featuring a multi-year span, an attempt to identify performance measures capable of serving as benchmarks, and a means to account for outcomes. These key elements are absent from HTA's current budget plans.

The authority's FY2007 budget utilizes the operational framework of the TSP by listing its nine initiatives (access, communications and outreach, Hawaiian culture, marketing, natural resources, research and planning, safety and security, tourism product development, and workforce development) and describing HTA's activities for each initiative. Under the marketing initiative section of the budget, we reviewed a five-page document that lists the TSP marketing goal, the TSP objectives, total budget allocations for leisure marketing and business marketing, and the marketing projects and allocations for each project. The marketing contractors selected for multi-year contracts for all the major segments—effective January 1, 2004—are identified in the 2007 budget as shown in Exhibit 1.6 in Chapter 1.

The budget provides little to no detail on how activities performed will accomplish the marketing goal of the TSP. Specific activities are not outlined within the contracts, but instead the contracts specify that an annual tourism marketing plan should be prepared by each contractor for each geographic segment and approved by the authority. There are no specific objectives to measure performance in the annual tourism marketing plans for HVCB and HTJ.

According to the Urban Institute's "Making Results Based State Government Work," a 1998 guide to state government performance management practices, strategic plans should cover a number of years beyond the budget period—three years at a minimum—and should include appropriate analyses of background information, alternatives, costs and benefits, and role specification for the various institutions or agencies that will be involved in implementation. The guide also points out that "strategic planning has too often been done primarily by holding some form of retreat for key government officials, rather than being based on extensive and thorough in-depth analysis of alternative strategies." The Hawai'i Tourism Authority holds such a retreat. Every winter, the board of directors and management staff discuss tourism industry issues and activities for the coming year. The budget is eventually formulated, based in part on the results of the retreat.

The HTA contends that its strategic directives are achieved through its annual budgetary process. However, these one-year spending plans provide no details on the long-term growth and development of Hawai'i's tourism industry. For instance, the authority's budget includes a breakdown of spending for leisure marketing, business marketing, the Hawai'i Convention Center, PGA Tour, Pro Bowl, and other marketing projects and sporting events. Missing from the one-year budget plan are performance measures and benchmarks to gauge the authority's progress. There is no basic process outlined, nor does it relate how activities or programs will fulfill the TSP's goal of the marketing initiative, which is "to develop marketing programs that contribute to sustainable economic growth."

The authority's planning focuses on merely implementing programs and activities, not achieving desired results

The authority's monthly variance reports compare actual money spent versus budgeted amounts to evaluate contractors' success in the month. These reports account only for actual spending as compared to budgeted amounts—providing no indication of progress toward planned outcomes or measurable results. They can be used to report on how money was spent, but without an understanding of how the spending is tied to goals or performance objectives, they are just a presentation of numbers.

For example, HVCB and HTJ are required to include in their reports "a comparison of the quarterly results with the stated goals contained in the Annual Plan." However, as previously mentioned, the HVCB and HTJ annual plans contain no goal in the form of measurable outcomes. The quarterly reports instead discuss current industry trends and marketing activities for the period.

Similarly, SMG's 2007 quarterly reports detail as a major accomplishment, "A Second Definite Booking Generated from the *Pot of Gold* Promotion." While the number of definite bookings is a key performance measure of SMG’s annual marketing plan, no benchmarks have been set, so it is difficult to determine whether two bookings for the money expended is adequate. Moreover, SMG reported “May Day is Lei Day” in Chicago, a signature event, as a major accomplishment. This sales and promotion blitz was attended by 65 meeting planners, but SMG provides little if any indication on the return to the taxpayer.

Since the HTA relies on the contractors to set their own performance targets and goals, there is no way to gauge whether progress has been made towards achieving the long-term tourism strategic plan goals. However, as the contracting agency for these multi-million dollar contracts, the authority is ultimately accountable.

Visitor program effectiveness is difficult but not impossible to measure

In previous reports, we raised the issue of the need for HTA to develop measures that could demonstrate the effectiveness of its activities and programs. Industry experts attest to the complexity and difficulty in assessing the effectiveness of tourism development efforts such as promoting brand awareness. But they also acknowledge that absent objectively determined results, the effectiveness of taxpayer funds spent on promoting Hawai‘i’s most important industry cannot be demonstrated.

Management and staff we interviewed acknowledged that benchmarks would be good but hard to do in marketing for brand and image since there are external factors beyond the authority’s control. The question asked by authority management was “where could we begin?” Answers to this question can be found in performance management guides including those from one of the leading organizations among the tourism and destination marketing organizations.

The tourism industry has begun to embrace performance management practices. For example, in the handbook *Standard CVB Performance Reporting*, the Destination Marketing Association International (DMAI) has developed best practice methods for performance reporting on marketing destinations and convention centers. The handbook recognizes the necessity of reporting the achievements of marketing activities objectively and in a form that does not require a deep background or expertise in the industry to understand. This element is essential when presenting results to non-industry stakeholders, such as legislators and the general public.

In our review of various strategic plans and audit reports, we found that other state tourism authorities have incorporated objectively measurable outcomes and performance measures in their plans for activities related to tourism promotions. Tourism agencies in Montana, Florida, Texas, and Louisiana use a range of performance measures to establish baseline starting points, monitor performance, and account for accomplishments.

For example, some of these measures provide benchmarks and indicators for the impact of advertising campaigns. Results may be shown as a campaign's influence in the decisions to visit, or provide a dollar return on investment—the amount in increased visitor revenues for every dollar spent on promotion.

The HTA Still Does Not Provide Measurable Results for Its Major Marketing Contractors

The Hawai'i Tourism Authority's failure to establish clear objectives and account for its own activities extends to its major contractors. Here again, the authority's "objectives" with respect to major marketing areas are not defined. And the only stated goal of the authority in the major contracts we reviewed refers to an "overall goal" of *Ke Kumu*, the HTA's strategic plan, which was phased out in 2004. These multi-year, multi-million dollar contracts were awarded without the means to measure performance and were renewed with scant scrutiny and consideration of alternatives. We found the contractor renewal process places more emphasis on contractor continuity rather than performance. Our interviews of board members and HTA staff, and the board minutes we reviewed, show little evidence that the authority seriously considered open competition or alternative contractors who might perform more effectively.

In our *Management and Financial Audit of the Hawai'i Tourism Authority's Major Contracts,* Report No. 03-10, June 2003, we stated that contractor reports contained vague information and failed to tie results to goals and objectives. At the time, the authority required a variety of reports—annual, quarterly and monthly variance reports—that we found did not contain any information analyzing the outcome or impact of HVCB's marketing expenditures and activities.

In this audit, we reviewed the contracts, annual marketing plans, and quarterly and monthly variance reports of HVCB, HTJ, and SMG and found the issues as described above have not been corrected. The current reporting does not include any means to measure contractors' performance against set goals or otherwise objectively measurable deliverables. Although the authority staff and its board of directors assert that their oversight process provides for accountability and results, the documents we reviewed showed little evidence of the rigor needed to ensure that the state receives an optimal return on marketing funds spent by the HVCB, HTJ and SMG. Instead, the board of directors accepts the findings of a largely opinion-based performance management and evaluation process.

Deliverables are unclear, not objectively measurable and oftentimes defined by the contractors themselves

Specific to the HVCB and HTJ contracts, references are made throughout to "HTA's stated goal and objectives" but nowhere in the contracts are these clearly defined. Moreover, the related evaluations of contractor performance provide no further evidence of clear objectives and measurable outcomes. The National State Auditors Association, Best Practices in Contracting for Services, states that one element of good contract formation is a clear performance standard and measurable outcomes.

The details for scope of work and objectives as defined within the contracts for HVCB, HTJ, and SMG could not be readily determined. The individual contracts referred to several other documents to define the work that would be performed. The contracts require the contractor to develop, propose, manage, and implement various tourism marketing activities or programs "that shall reflect the implementation of the HTA Strategic Plan, Directives, and Policies." The contracts state that activities and programs shall be fully described in the annual tourism marketing plan for HTA's prior approval.

The scope of work identified in HVCB and HTJ contracts focuses on the development of an annual tourism marketing plan and budget and "each annual plan shall be prepared by the Contractor for approval by HTA and constitutes the Contractor's recommended plan to achieve the objectives of (the Authority) in the MMA (major marketing areas), consistent with (the Authority's) stated goals and objectives." Provisions within the HVCB and HTJ contracts call for the contractors to set their own goals and objectives, again, so long as they are in line with the goal set in a plan phased out by the authority. The contracts also allow the contractors to "define the methods or means to measure the results of each tourism marketing program and activity described in the Annual Plan."

Similarly, the agreement between HTA and SMG to operate and market the Hawai'i Convention Center requires SMG to provide a comprehensive marketing plan for the sales and marketing for each fiscal year. The contract scope of services also requires the development of an annual plan to address sales and marketing of the convention center for the express purpose of citywide and other large meetings, conventions and incentives.

Again, the authority relies on SMG to develop its own objectives, performance measures, goals, and targets. Specifically, the goals and targets are defined to mean:

> "…all the objectives, performance measures, goals and targets that *Contractor has proposed and agreed to meet* or try to meet in the approved annual plans together with any other objectives, performance measures, goals, targets or review and evaluation criteria that Contractor has agreed to meet in any amendment to the approved comprehensive marketing plan." (emphasis added)

Essentially, the authority relies on the contractor to set up its own contract terms, deliverables, and even the means by which contractor performance will be evaluated.

Like the contracts for the HVCB and HTJ, SMG's contract states: "each proposed annual plan shall provide a detailed plan…all in accordance with and as may be required to implement and achieve the goals and objectives set forth by the state in accordance with the State Tourism Strategic Plan, known as *Ke Kumu*." But the authority phased out its strategic plan in 2004.

Authority officials claim that they do not want to micro-manage their contractors. Further, they contend that responsible staff is "on top" of the contractors and constantly monitoring performance. However, lacking objective measures, benchmarks, and documentation, the authority is unable to demonstrate the effectiveness of its oversight process.

Contract performance evaluations and renewal processes lack evidence of objective scrutiny and consideration of alternatives

Authority officials assert that they have established an oversight process that provides for accountability and results. However, we found that HTA evaluations of contractors' performance are not objectively scrutinized, relying instead on contractors' internal controls and subjective opinions. In addition, the contract renewal process places more emphasis on contractor continuity rather than performance. Nor does it seriously consider open competition or alternative contractors, who might perform more effectively.

In 2007, the authority board of directors approved extensions to HVCB's and HTJ's contracts for another four years, through the period ending December 31, 2011, and in 2005 extended SMG's contract for another five years, through June 30, 2011.

Board minutes on contract renewal discussions for the terms of the three major contracts in 2005 and 2006 show little evidence of scrutiny and consideration of alternative providers. Contract renewals were justified based on "positive" staff assessment reports and a desire to maintain "continuity." A discussion on the need for competitive procurement led the authority board of directors to conclude that such was not warranted as they were "happy" with the contractors. The Hawai‘i Public Procurement Code establishes as a principle that all state procurement be competitive. Even agencies exempt from the procedure requirements of the procurement law, such as HTA, are encouraged to follow this principle. In addition, the state budget law, Chapter 37, HRS, requires all state agencies to consider alternative objectives, policies, plans, and procedures that offer potential for more effective and efficient use of resources in assessing continuing programs. The board minutes indicate that HTA falls short on both counts.

According to HTA officials, a positive contractor evaluation is based on a “360-degree evaluation,” a three-part assessment by HTA staff, a contractor self-assessment, and a survey of contractor constituents including stakeholders such as hoteliers and travel agents. For the HVCB and HTJ contracts, the authority also relied on marketing effectiveness surveys. The effectiveness surveys were contracted by a private company to measure “intention to travel to Hawaii, plans for Hawaii travel and attitudes” regarding key attributes for Hawai‘i and its competitors for the major market segments. We found that both the 360-degree evaluation and the marketing effectiveness survey provide little objective data that are useful to demonstrate the effectiveness of a contractor.

The 360-degree evaluation is an adaptation of a human resource performance appraisal tool to gather feedback from various sources, including the employee under review, supervisors, peers, subordinates, and internal and external customers. While the tool is widely used to assess personnel, it is unclear if the 360-degree evaluation is an effective tool to evaluate contractor performance.

We found, and management, board members, and experts agreed, that the results of the 360-degree evaluations were subjective, based on the evaluator’s comments. This evaluation makes no assessment of goals achieved because specific goals are not mentioned. It does not include performance measures that provide for outcomes, nor goals, targets, and benchmarks by which to measure performance. The process lacks verifiable objective benchmarks, is focused on activities rather than results, and fails to establish a relationship between planned outcomes and benchmarks to measurable achievements. Moreover, the authority’s board of directors cannot review all three parts of the 360-degree evaluation because it is not provided to them. Instead, the evaluations are presented to the board in a summary, which includes response rates of stakeholder surveys. Further, the evaluation does not address negative comments by the stakeholders. We also found that HTA’s assessment of the contractors fail to provide sufficient details on the steps necessary to improve their marketing efforts.

The contractor self-assessments report work performed in a positive light. In addition, one survey of contractor constituents was based on the opinions of only 11 respondents as shown in Exhibit 2.1. And while the percentage return of 34 percent is reasonable, we are unable to determine the sufficiency or justification behind the individuals/companies surveyed.

Exhibit 2.1
HVCB, HTJ, and SMG 360-degree Evaluation Constituent Survey Results 2007

Subject of Survey	Surveys Issued	Responses Received	Percent Return
HVCB leisure	54	23	43
HVCB CMI	32	11	34
HTJ	135	37	27
SMG	251	81	32

Source: Hawai‘i Tourism Authority

Moreover, the results reported to the authority board of directors did not include the sometimes critical comments received with the responses to the survey. Some examples include:

HVCB	• *They have a big budget, but seems as though they cannot organize sufficiently to plan and spend it properly.* • *Has a solid plan to gather data, evaluate, review options, go to market. But process takes a long time.*
HTJ	• *They are spending for unnecessary advertisements.* • *Unsure as it is unclear where all the money is being spent.*
SMG	• *If it wasn't for the State funding they would belly up already.* • *What are we waiting for, action needs to be taken, how long are we going to accept no improvement being made?*

Contractor self-assessments speak generally of only the positive work performed, but provide no clear indication of how the actions were carried out. For example, HVCB reports that "HVCB's marketing efforts contributed to record-setting industry performance in 2006 and strong first half of 2007." This claim is not accompanied by supporting data. In addition, HTJ reports that the key indicators of their success are being "#1 Preferred Destination Ranking, growth in visitor spending, increase in length of stay, positive changes in the CMI [corporate meetings and incentives] market, and recovery of the romance market.” However, the HTJ’s annual marketing plan lacks benchmark values for each of these measures, and the self-assessment provides no information on the changes achieved as a result of the contractor’s efforts.

The authority solicits selected stakeholders’ opinion for the third piece of the 360-degree evaluation. The authority compiles, with the contractor’s help, a list of stakeholders doing business with the contractor and hires a vendor to prepare a satisfaction survey of the chosen stakeholder. The surveys seek opinions on issues including: knowledge of the visitor industry, ability to communicate clearly and concisely, effective cost management, and planning processes.

In the most recent survey for 2007, stakeholder response rates ranged between 27 and 43 percent as shown in Exhibit 2.1. There were also numerous negative comments received by stakeholders, with the authority having no clear process to address these comments. As needed, comments are directed to the responsible party, usually the specific marketing manager who oversees the contract. When we asked how this may be tracked to ensure that a follow-up will be performed, we were informed that there is no formal documentation of a follow-up. Therefore, no clear evidence is available to determine how comments from 360-degree evaluations translate into actions.

The second component of the documentation supporting contract renewal is an attitudinal awareness survey of potential visitors from the largest market segments (United States and Japan). This survey is compiled quarterly and measures states of mind over time. By understanding preference attitudes, HTA contends that it can evaluate the success or failure of the marketing strategies being implemented by the contractors.

However, we found that these surveys have limitations when used as a tool for contractor evaluation. First, the survey measures states of mind, rather than the number of visitors who visited Hawai‘i in response to a contractor’s efforts, also known as conversion rates. Second, the survey’s results are subject to interpretation, since there are many factors other than a contractor’s activities that can affect the responses to this survey. In addition, contractor plans and assessments cite the survey as a measure but provide no baseline or predetermined desirable target values for planned activities that could be used to gauge their accomplishments.

Conversion rating is a common research method to measure the effectiveness of tourism promotions. The authority does not produce conversion data, but board minutes reflect interest in having contractors develop them within the attitudinal survey. Similarly, the authority management has also voiced reservations about this type of evaluation, cautioning that “. . .it is important to note that there are numerous variables in the marketplace that affect a consumer’s behavior to purchase a vacation and are not controlled by the marketing contractors (terrorist attacks on September 11), cost of fuel, airline bankruptcy.” Therefore, one evaluation should not be taken on its own.

Despite Better Oversight To Reduce Risk in Contract Management, Weaknesses Remain

In this audit, we found that the authority has made efforts to correct past deficiencies to ensure that the spending of millions of dollars in marketing money complies with state law and contractual guidelines. However, while the written policies and contractual terms are generally adequate to ensure that state funds will be spent appropriately, there remains room for improvement. Among the issues for improvement we identified is a need to address overly casual contract administration that resulted in shoddy contracts and deviations from contract terms. We found problems in contracts that represent a significant portion of HTA’s budget in promoting Hawai‘i’s tourism industry—an eight and one-half year, $53-million contract to market the Hawai‘i Convention Center and an eight-year, $66-million contract to market Hawai‘i in Japan. We also found a $33-million discrepancy in the SMG contract and a three-year $1.5 million retroactive budget increase that was “not intended” and not paid to SMG.

Minor issues in Hawai‘i Visitors and Convention Bureau audit reflect improved procedures over previously reported deficiencies

In response to our recommendations in our *Management and Financial Audit of the Hawai‘i Tourism Authority’s Major Contracts*, Report No. 03-10, June 2003, the authority contracted with N&K CPAs, Inc., and Candon Consulting Group, LLC, for advice on ways to improve its management and the reporting of its operational financial activities, including the oversight of other major contractors.

We contracted with N&K CPAs, Inc., to perform an agreed-upon procedures engagement of the Hawai‘i Visitors and Convention Bureau, to review the following conditions:

- Inappropriate compensation, including bonuses and severance packages, of state-funded HVCB employees and executives; or any compensation arrangements that could impair independence;
- Improper expenditures that do not comply with HTA contractual terms or the HVCB’s policies, including but not limited to, travel and entertainment expenses;
- Inappropriate year-end accruals, related to services not yet rendered, to prevent contract moneys from being returned to the HTA; and

- Inadequate oversight over the HVCB's contractors that are funded by state moneys, including the improper procurement, monitoring, and evaluation of contractors; contractors beginning work without an executive contract; state funded contracts exceeding the scope provided by the HVCB's contract with the HTA; and legal contracts utilized to undermine efforts of the HTA and the State.

The areas under review included compensation arrangements, travel and entertainment expenses, accounts payable and accrued liabilities, contract administration and petty cash. In the opinion of N&K CPAs, Inc., the HVCB improved its procedures in these areas. Overall it reports that "management at the Bureau has taken a stronger role in enforcing current policies and procedures and making changes as warranted." The agreed-upon procedures engagement conducted by N&K CPAs, Inc., can be found in Appendix A.

The clerical errors and oversight in documentation requirements discussed in the N&K CPAs, Inc., report for the period covering January to December 2007 are minor in comparison to the inaccurate accounting practices and poor record-keeping found by N&K CPAs, Inc., covering the period from January 2001 to December 2002, which was reported to the authority in 2004 following our last audit. Nevertheless, measures to address concerns reported in our previous audit about bonuses paid to HVCB employees need to be augmented to ensure that bonuses are paid in correct amounts.

A lack of adequate safeguards resulted in overpayments and shortchanges in performance-based bonuses paid to HVCB employees. Employee bonuses are computed by an HVCB employee, who receives bonuses as well. There is no one employee who checks or reviews the calculations by the HVCB employee responsible for computing bonuses. The computation contains minor mistakes, such as an incorrect rounding, that can result in significant errors in the bonuses calculated.

As shown in the agreed-upon procedures engagement appended to this report, four of ten bonus payments reviewed were incorrect. These errors showcase two departures from recommended safeguards. First, an employee should not benefit from errors and irregularities for tasks performed. Second, procedures must be in place designed to prevent or detect errors and irregularities in the normal course of business. Corrective measures such as assigning computations to a person not eligible for a bonus and a review by a person other than the preparer are needed to prevent mistakes that result in overpayments and shortchanges of employee bonuses.

Informal deviations with Hawai‘i Tourism Japan impair financial accountability

The contract with Hawai‘i Tourism Japan for marketing activities, which includes 12 amendments or renewals over a four-year contract period (2004 to 2007), contain errors that are inconsistent with sound contract administration. Although less serious, we also found a $15,000 discrepancy, which was corrected six months later, and at least two instances where the wrong schedule was amended.

Hawai‘i Tourism Japan expenditures that raised questions pertain primarily to items that are accepted by HTA as common practice in Japan but would not be acceptable uses of public funds in the United States. Examples include payment of some commuting expenses and gifts, one of which cost more than $400 to employees on such occasions as weddings, retirement, or termination. In fact, HTA policy, which applies to HTJ, also does not permit such expenditures.

The HTA has not consistently held HTJ to the terms of the contract which reveals a sense of informality in dealings between the parties. Informal deviations from contractual terms are contrary to standard contract language developed by the Department of the Attorney General and incorporated in all the major contracts under review. In addition, waiving these contractual provisions has diminished the authority's ability to account for the contractor's stewardship for the public funds allocated under the contract, more than $33 million over the past four years.

The agreements between HTA and its major contractors include a list of standard provisions, entitled "General Conditions," drafted by the Department of the Attorney General. Among the 40 provisions, the modification clause states: "Any modification, alteration, amendment, change, or extension of any term, provision, or condition of this Contract permitted by this Contract shall be made by written amendment to this Contract." It adds further, "No oral modification, alteration, amendment, change, or extension of any term, provision, or condition of this Contract shall be permitted." We found three provisions in the HTJ contract that are not enforced by HTA, all relating to financial accountability, and a payment that appears to be based on an informal departure from the contractual compensation provisions.

First, the authority has allowed HTJ to keep its records and provide financial statements in a format that does not meet contractual standards. The contract requires HTJ to keep its financial records and provide related reports in accordance with Generally Accepted Accounting Principles (GAAP) as applicable in the United States. The GAAP are standards promulgated by the Financial Accounting Standards Board, which must be followed in public accounting. These standards provide the framework for financial accounting and set the general methods used to process, prepare, and present financial transactions to ensure that financial information is consistent, relevant, reliable, and comparable.

Second, in the four years that HTJ has been a contractor, the authority has not required and the company has not provided audited annual financial statements and management letters by a certified public accountant as specified by the contract. Such audits independently attest to the accuracy and completeness of financial statements in accordance with applicable auditing standards, which also require a review of relevant internal policies and processes for their adequacy and compliance with accounting standards. The authority lacks this independent confirmation of the accuracy and adequacy of HTJ's financial processes, records, and reports.

Third, a contractual provision requiring HTJ to report transactions in excess of $75,000 was waived informally. We found a written record of this waiver in the form of a memo to file by a HTA staff overseeing the contract. However, we did not find this change to the terms of the contract reflected in an amendment to the contract. Consequently, there is no documentation that the change was approved by the authority's board of directors. While this waiver may be justified, as the majority of the funds to HTJ are paid to a single subcontractor (Dentsu for advertising services), it presents the appearance of a lack of attention to detail in the administration of major contracts.

Moreover, we found that in 2007, the owner of HTJ, in addition to the agreed upon compensation of approximately $120,000, received a bonus of about $8,700, paid with state funds. Bonuses are not provided for in the contract with HTJ, which includes provisions determining the owner's compensation but no guidelines for determining any bonuses.

The authority's chief administrative officer explained that departures from contractual provisions are based on practical considerations and staff judgments. However, the standards of contracting require such waivers to be in the form of written amendments to the contract. As changes to contractual terms are subject to board approval, the standards also ensure that authority staff could not informally make changes to contracts without the board of directors' knowledge.

Hawai'i Tourism Japan has also been unable to provide timely and accurate reports on its $8 million in annual expenditures. Nevertheless, HTA claims to be monitoring the contractor's fiscal activities and allows this contractor to continue substandard accounting practices. We found a number of concerns about this contractor's accounting systems and methods that draw doubt on HTA's assurances. Among these concerns is the lack of segregation for critical accounting functions, accounting methods that fail to meet recognized standards, and the absence of competent and independent scrutiny of the contractor's accounting systems and related financial information. Errors we found in financial reports relied on by HTA and a haphazard method for tracking an advance adds weight to these concerns.

We found a serious control weakness relating to the principle of separation of duties, where one individual is authorized or able to perform tasks allowing the commitment and concealment of errors and irregularities. In this case, the executive director, who is the sole shareholder of Hawai‘i Tourism Japan, effectively controls all phases of the accounting process, being able to approve, record, and report financial transactions reported to and relied on by HTA. Separation of duty, a key concept of internal controls, demands the disseminating of tasks and associated privileges for sensitive business processes among multiple users to prevent fraud and errors unless compensating safeguards are in place. Instead, this problem is compounded by a lack of an independent audit, which, as noted previously, is required by contract but has never been performed.

In addition, HTJ's accounting system, based on an electronic spreadsheet, does not satisfy one of the most basic functions of such a system—facilitating the production of reports. Hawai‘i Tourism Japan is contractually required to submit monthly financial reports in a prescribed form, which are heavily relied on by HTA staff overseeing the contractor. We found that transactions recorded in the contractor's accounting system must be interpreted and reclassified to manually prepare the reports required by HTA. Only the busy executive director/sole stockholder has the knowledge to do this, one of the reasons that these reports are frequently not submitted by the contractual deadline. Our analysis of the reports submitted in 2007 revealed numerous errors that had gone unnoticed by HTA. Moreover, our review indicates that the reports did not agree with the contractor's accounting records. We found differences between total expenditures reported to HTA and total expenditures according to the contractor's general ledger in five of the 12 months of 2007. While these discrepancies were not significant in amount, their frequency and pervasiveness raise doubts about the reliability of the financial information and HTA's ability to adequately oversee the contractor's expenditures of $8 million per year.

Although HTA staff professes close scrutiny of its contractors, we found at least one example consistent with heavy reliance on contractor controls rather than systematic oversight. In January 2006, HTJ received an advance of about $400,000 but did not use the funds all year. Documentation related to this transaction indicates that HTA relied on the contractor to keep track of this amount. Monthly reconciliations during 2006, including the year-end reconciliation, do not reflect the status of the unspent advance. Internal communications indicate that the funds should have been spent or returned in 2006. The authority acknowledged that the status of the $400,000 should have been resolved at year's end, but this did not happen. Both HTA and Hawai'i Tourism Japan missed this during the year-end closing process for 2006 funds. The authority was unable to show us how, after the year-end reconciliation, any diversion of the $400,000 would have been discovered by means other than by accident.

An examination of SMG expenditures reveals a lack of stewardship for public funds

The Hawai'i Convention Center operator has policies in place approved by the HTA and a review and approval process that, ostensibly, provides assurance of propriety and compliance with the policies. In a sample review of 34 judgmentally selected transactions for calendar year 2007, we found that approvals are given for transactions that do not comply with policy, raising a question on the rigor of the review and approval process.

Nearly half of the 34 transactions reviewed lacked evidence that competitive procurement requirements were followed. The policy of SMG requires requests for proposals or multiple quotations for purchases of specified magnitude and written explanations if exceptions are made. Supporting documentation for three of the four transactions of the $5,000 to $24,999 range in our sample did not include required multiple quotations. All three purchases exceeding $25,000 lacked evidence that a required bid was obtained, and no explanation for the exception was found in the supporting documentation. The SMG policy requires a determination of reasonableness of price when quotations are not obtained nor required. None of the 17 purchases in our sample that lacked documentation for required competitive procurement measures included such a determination. For example, SMG routinely purchases limousine services. While such services are already suspect as possibly extravagant, we found no evidence that SMG staff seeks to ensure the best deal available, or determines that the services paid for are reasonable. We found that one-way limousine fares between the airport and the same Waikiki hotel ranged between $75 and $121, a difference of 62 percent.

Our first audit reported on the use of the marketing flexibility fund, which enabled HVCB to exceed its budget. Like the HVCB, SMG's contract for marketing the Hawai'i Convention Center provides for a $2 million-a-year marketing flexibility fund to secure meetings, conventions, and certain trade shows to Hawai'i with special incentives. The SMG contractual guidelines for the marketing flexibility fund include vaguely worded spending criteria such as: "necessary to overcome booking obstacles and/or position Hawai'i to beat the competition," and authorize the convention center's general manager to commit the funds "in the best interest of the State."

The majority of these funds is used to reimburse the Hawai‘i Convention Center for discounts to published facility rental rates but can also involve the provision of goods and services. Contractual agreements between the center and its clients specify the discounts, as well as the goods and services SMG will provide before and during an event. These agreements are submitted to and approved by the authority's chief administrative officer.

Examples of goods and services provided before and during an event include sending a delegation to a mainland conference in order to build attendance for a Hawai‘i event the following year. In one case, SMG spent $8,000 to send Hawaiian entertainers on such a trip. Marketing flexibility fund expenditures can also include ground transportation for attendees, which for a large conference can exceed $100,000, and banners, which can cost more than $17,000. While these types of expenditures can be readily reconciled with the use of public funds or the intent of the marketing flexibility fund, others are clearly outside normal parameters and depend for their justification on contractors' judgment and interpretation on what is necessary to overcome booking obstacles or to beat the competition. Expenditures we questioned as potentially extravagant or difficult to reconcile with the use of public funds include:

- Limousine services for transferring client representatives between hotels and the Honolulu International Airport, where government rules would dictate the least expensive mode of transportation;
- Hiring five limousines at over $1,600 to transport potential clients to and from a promotional dinner event in a mainland city;
- A $1,560 helicopter ride between the airport and the Turtle Bay resort for a meeting planner of an event at the Hawai‘i Convention Center; and
- A $260 iPod as a gift to a client representative.

Documentation for all of these expenditures shows all the required approvals but lacks justifications. For example, documentation for the iPod gift did not include the explanation provided to us that the gift replaced an item lost in a theft and intended to help minimize the effect of this negative experience by a client representative. The authority's chief administrative officer plays an active role in scrutinizing these expenditures, claiming to reject many proposed expenditures. But he was not familiar with all of the items we questioned. Both SMG and authority representatives defended the questioned items, explaining that they were typical expenditures for the marketing department of a convention center and met the criteria for the marketing flexibility fund.

Some uses of funds that we questioned remain a matter of judgment. For example, SMG, with HTA approval, uses the services of an advisory board, composed of up to 15 members. Mostly from the mainland, the advisory board typically meets annually in Hawai‘i with all expenses paid by SMG, as much as $35,000 for the week-long meeting. The advisory board's function is described as providing invaluable assistance in setting strategies for the convention center and serving as ambassadors to promote and bring conferences to Hawai‘i. The items we questioned include $2,600 for limousine pick-up and drop-off at the airport for the members and $28 per person breakfast buffets. The Hawai‘i Convention Center operator is adamant that the value of the members' uncompensated services and industry practices justify these expenditures. The authority's chief administrative officer concurred, judging the council "cost-effective," since its members are business leaders, convention center clients, and experts familiar with trends and opportunities in the convention business.

Based on the examples cited, spending practices of HTA's contractors differ markedly from typical uses of public funds. The lack of clear criteria and the dependence on judgment to determine the appropriateness of expenditures in an environment with a high risk for excesses and abuse highlights the need for compensating controls.

In reviewing the original SMG contract with the Convention Center Authority in 1996 to operate the Hawai‘i Convention Center and 28 amendments or extensions, we discovered numerous inaccuracies and discrepancies among 21 supplemental agreements since the HTA assumed oversight in 2000. The authority's board of directors approved, and its president and SMG executed, at least seven faulty amendments or extensions between June 2005 and September 2007 to a $53 million contract for marketing the Hawai‘i Convention Center.

Examples include amendments to incorrect schedules, such as amending the original schedule governing the scope of services instead of the compensation schedule in at least four cases; erroneous budget amounts, such as a $145,000 discrepancy when the amount spelled out did not match the numerals; and retroactive changes to budget amounts by adding $1.5 million to three years already past. Particularly glaring is a $33-million discrepancy between the maximum amount for a multi-year contract extension and the total annual amounts provided. Exhibit 2.2 shows the successive changes to the marketing budget, and Appendix B includes a copy of the supplemental agreement entered into on September 4, 2007, with the $33 million discrepancy.

Exhibit 2.2
Contractual SMG Marketing Budgets as Amended Between 2003 and 2011

Fiscal Year	Contract Period	Original Budget 1/1/03	Amended 11/3/03	Amended 9/22/05	Amended 9/4/07**
FY2002-03 (half year)	1/1/03-6/30/03	$2,215,000	$2,215,000	$2,215,000	$2,215,000
FY2003-04	7/1/03-6/30/04	$5,800,000	$5,600,000	$5,800,000	$5,800,000
FY2004-05	7/1/04-6/30/05	$6,000,000	$6,000,000	$6,000,000	$6,500,000*
FY2005-06	7/1/05-6/30/06	$6,000,000	$6,000,000	$6,000,000	$6,500,000*
FY2006-07	7/1/06-6/30/07			$6,000,000	$6,500,000*
FY2007-08	7/1/07-6/30/08			$6,000,000	$6,500,000
FY2008-09	7/1/08-6/30/09			$6,000,000	$6,500,000
FY2009-10	7/1/09-6/30/10			$6,000,000	$6,500,000
FY2010-11	7/1/10-6/30/11			$6,000,000	$6,500,000
Total		$20,015,000	$19,815,000	$50,015,000	$53,515,000***
Maximum per contract		$20,015,000	$19,815,000	$50,015,000	$20,015,000

Discrepancies noted:

*Retroactive increases totaling $1.5 million after the contract period ended
**Retroactive increase 14 months after the 7/1/03-6/30/04 period ended
***Multi-year contract cap is $20,015,000 for the period January 1, 2003 through June 30, 2011. Contract amount of $53,515,000 exceeds multi-year contract cap by $33,500,000.

Source: Hawai'i Tourism Authority

Conclusion

During this audit, we found that the HTA has improved administrative controls over the HVCB and its other contractors. But the fundamental issue remains: the authority's planning processes and its assessment of marketing efforts continue to be largely based on conjecture and opinion with no objective measures of success or failure. In addition, we found that while HTA officials spent much time and effort to create and adapt various strategic plans, they have largely ignored those documents as they pursued an annual budgetary approach to planning and spending. In other words, by choosing to map out their strategy and appropriate funds on a year-to-year basis, HTA officials have returned to the approach to tourism promotion that the authority was created to replace.

With little evidence of effective strategic planning and program implementation, it is unclear if HTA's past efforts have addressed some of tourism's long-term, structural problems to better prepare the state and the industry for the difficult economic challenges in the future. With decision-making largely based on educated guesswork instead of clear goal-setting and objective performance measurements, it is also difficult to ascertain if HTA's efforts will be effective during the current economic crisis.

Recommendations

1. The HTA board of directors should provide the leadership needed to ensure that the authority:

    a. Develops an action plan that provides stakeholders with a clear picture of its strategic marketing directions and expected outcomes under the Hawai‘i Tourism Strategic Plan;

    b. To the extent possible, incorporates quantifiable goals, objectives, and measures as a basis for objective evaluations and accountability for its achievements; and

    c. Reports its achievements in terms of its success in meeting planned outcomes, using benchmarks and performance measures to the extent feasible.

2. With regard to its oversight over contractors, the Hawai‘i Tourism Authority should:

    a. To the extent possible, incorporate objectively measurable outcomes and performance indicators in its contracts;

    b. Clearly define deliverables with measurable outcomes, performance measures and benchmarks as a basis for evaluation and contract renewal/extension purposes;

    c. Include objectively measurable outcomes in its annual tourism marketing plans;

    d. To the extent possible, consider alternative providers to the existing major contractors and ensure that such consideration is documented;

    e. Adopt a review process which ensures that original agreements, modifications, and supplements to contracts are free of errors and accurately reflect the intent of the parties;

f. Ensure that contract provisions are adhered to or modify contractual provisions in writing where enforcement is deemed impractical; and

g. Ensure that established policies and procedures for procurement of goods and services are adhered to by contractors, mandating appropriate tasks to be performed by contractors' auditors where necessary.

Appendix A
Special Report on the Hawai'i Visitors and Convention Bureau

SPECIAL REPORT ON THE HAWAII VISITORS AND CONVENTION BUREAU

N&K CPAs, Inc.
ACCOUNTANTS|CONSULTANTS
AMERICAN SAVINGS BANK TOWER | 1001 BISHOP STREET, SUITE 1700 | HONOLULU, HAWAII 96813-3696
T (808) 524-2255 F (808) 523-2090 | nkcpa.com

N&K CPAs, Inc.
ACCOUNTANTS | CONSULTANTS

AMERICAN SAVINGS BANK TOWER
1001 BISHOP STREET, SUITE 1700
HONOLULU, HAWAII 96813-3696
T (808) 524-2255 F (808) 523-2090

State Auditor
Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813

To the State Auditor:

In connection with our contract to assist the Office of the Auditor on the status of prior findings of the Hawaii Visitors and Convention Bureau (Bureau), we reviewed the following areas:

• Compensation Arrangements	Attachment I
• Travel and Entertainment Expenses	Attachment II
• Accounts Payable and Accrued Liabilities	Attachment III
• Contract Administration	Attachment IV
• Petty Cash	Attachment V

For a detailed discussion of the work performed, and a summary of our findings and recommendations, please refer to Attachments I through V.

The Bureau has improved its procedures in the areas identified above. We found some clerical errors and oversight in documentation requirements. We made recommendations addressing some of our findings that we feel address these errors. Overall, it appears that management at the Bureau has taken a stronger role in enforcing current policies and procedures and making changes as warranted.

If you have any questions regarding this letter, please call me at 524-2255.

N&K CPAs, Inc.

Honolulu, Hawaii
May 20, 2008

ATTACHMENT I

COMPENSATION ARRANGEMENTS

Objective

To determine whether there was inappropriate compensation of state-funded Bureau employees and executives or any compensation arrangements that could impair independence during the year ended December 31, 2007.

Procedures

As part of our engagement, we performed the following:

1. Inquired with appropriate personnel in the Human Resources department on whether there were any bonuses and severance packages of state-funded Bureau employees and executives; or any compensation arrangements that could impair independence.

2. Inquired with the appropriate personnel in the Human Resources department on the hiring process and how employment agreements were entered into.

3. Obtained a listing of current and terminated employees for the year ended December 31, 2007 and selected a judgmental sample of 20 employees and performed the following:

    a. Obtained and reviewed personnel file for evidence of existence of employee noting employee name, title, and hire date.

    b. Reviewed approved compensation noting effective rate and date.

    c. Reviewed performance evaluations noting manager/reviewer and employee signature, date, and completeness of the form.

4. Reviewed the personnel file for appropriate documentation and employment agreement, as applicable, including performance evaluations, as a basis for reasonableness of wage increases.

5. Obtained a listing of 2007 bonuses paid in 2008.

6. Inquired with appropriate personnel in the Finance and Corporate Services department on the eligibility criteria for bonuses and bonus computations.

ATTACHMENT I
(Continued)

7. Performed the following for the sample of employees who received bonuses for 2007:

   a. Determined whether the employee was indeed eligible to receive a bonus based on the position criteria.

   b. Reviewed copy of the Incentive Plan Worksheet for accuracy noting employee name, base salary, bonus potential, and actual bonus earned. In addition, agreed total number of annual visitors to the Department of Business, Economic Development, and Tourism (DBEDT) 2006 Annual Visitor Research Report.

   c. Recomputed and agreed amount of employee bonus to the total employee bonus earned per the Incentive Plan Worksheet. In addition, agreed the total bonus per the Incentive Plan Worksheet with the HVCB 2007 Bonus Schedule as approved by the Chief Operating Officer (COO) and the President.

Background

The Bureau has a compensation committee that approves the compensation structure of the various positions. In calendar year 2007, 20 of the Bureau's 79 active employees were eligible for bonuses. Of the 20, 16 Bureau employees qualified for bonuses and earned approximately $482,800 in which total base payroll, including bonuses, approximated $5,792,800. The bonuses ranged from 11% to 44% of an employee's compensation.

Leisure goals and bonuses are driven by visitor spending, total per day spending and budget expenditure compliance. Corporate Meetings and Incentive (CMI) goals and bonuses are driven by production or leads (also known as bookings). Island Chapter Executive Directors' goals and bonuses are based on island visitor expenditures, expense control and also an action goal. Membership goals and bonuses are based on total membership. The statistical information for visitor spending, total per day spending and island visitor expenditures are provided by the DBEDT which is published and released every summer for the prior year. In general, the management group is the eligible bonus group, except for CMI, in which the executive assistant and various coordinators are also eligible.

ATTACHMENT I
(Continued)

Findings

During our testing of a sample size of 20 employees, 10 employees qualified for bonuses. A lack of proper safeguards has resulted in overpayments and shortchanges of bonuses paid to employees. The Bureau's bonuses are computed by an employee who is also a bonus recipient and this employee's calculations are not required to be reviewed. Four of the 10 bonus payments included in our sample were in error as shown in the summary below.

Employee	Annual Salary	Bonus Paid	Corrected Bonus	Over/(Under) Paid	Resolution
A	$ 131,730	$ 22,859	$ 24,084	$ (1,225)	Paid to employee
B	$ 149,093	$ 36,744	$ 27,276	$ 9,468	Collected from employee
C	$ 127,000	$ 24,130	$ 23,787	$ 343	Charged to Private funds
D	$ 152,000	$ 41,532	$ 41,678	$ (146)	Not claimed as requested
Total				$ 8,440	

These errors showcase two departures from recommended safeguards. First, that an employee should not be in a position of benefitting from errors and irregularities from tasks performed. Second, procedures must be in place that are likely to prevent or detect errors or irregularities in the normal course of business. Corrective measures, such as assigning computations to a person not eligible for a bonus or a review by an independent person other than the preparer, are needed.

Recommendation

The Bureau should implement an independent review of the bonus calculation to ensure that data entry or calculation errors are addressed during the initial and final stages prior to bonus finalization.

ATTACHMENT II

TRAVEL AND ENTERTAINMENT EXPENSES

Objective

To determine whether there were any improper expenditures that do not comply with the Authority's contractual terms or the Bureau's policies, specifically travel and entertainment expenses, for the year ended December 31, 2007.

Procedures

As part of our engagement, we performed the following:

1. Obtained and reviewed the Bureau's travel and entertainment policies.
2. Inquired with appropriate personnel charged with oversight of these expenses on the disbursement and reimbursement process.
3. Obtained the cash disbursement journal for the year, scanned for reasonableness and sorted the information to determine that the amount coded to the travel and entertainment expenses was complete.
4. Selected a sample of travel and entertainment expenses from a population that totaled approximately $1,311,900 and performed the following:
    a. Reviewed for proper approval, coding, classification and supporting documentation to determine whether expense was in compliance with the Bureau's travel and entertainment policy. In addition, we reviewed whether the staff expense reimbursements were submitted within ten (10) days of completion of travel, as applicable.

    b. Reviewed the Travel Request Authorization (TRA) form for proper approval.
5. Read the consultant report on the Bureau's travel and entertainment policy review for the period January 1, 2007 through July 31, 2007.

Background

The Bureau's travel and entertainment policies for staff and non-staff (i.e., consultants, contractors, etc.) are essentially the same, except for provisions relating to the use of a corporate credit card and timely claim submission that apply to staff only. In general, the

ATTACHMENT II
(Continued)

Bureau's policy is that the Bureau will reimburse employees for actual and reasonable expenses incurred in conducting Bureau business that are properly documented, approved and in accordance with this policy. Non-compliance with this policy may result in expenses not being reimbursed, and appropriate management action, up to and including suspension and/or termination.

Employees must submit the approved copy of the TRA, copies of airline quotes, and all pages of their original travel itineraries with their travel expense reports. Employees will not be reimbursed for air travel, lodging or car rental expenses unless travel arrangements were made in compliance with the Bureau's travel policy guidelines. An employee's travel expense report must be reviewed and approved by the department head.

Findings

There was one instance in which there was a lack of supporting documentation for the travel and entertainment expenses. We were informed that this was an isolated instance in which the Bureau employee (regional director) was on medical leave. Since the Bureau was ultimately responsible for the charges on the corporate credit card, the Bureau retrieved the credit card statements and attempted to determine whether the charge was a personal expense or business expense and remitted the payment directly to the credit card company in the amount of $4,260.17, which was the balance on the credit card and cancelled the credit card. The Bureau determined the amount paid was less than the amount of reimbursable expenses.

Three travel and entertainment reimbursement requests were not submitted within 10 days of the completion of travel. Subsequent to year end, the Bureau revised its travel and entertainment policy for staff to replace the 10 day deadline with "as soon as possible."

ATTACHMENT III

ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Objective

To determine whether there were any inappropriate year-end accruals, related to services not yet rendered, to prevent contract monies from being returned to the Authority for the year ended December 31, 2007.

Procedures

As part of our engagement, we performed the following:

1. Obtained a listing of accounts payable and accrued liabilities as of December 31, 2007.

2. Selected a sample and reviewed for proper approval, coding, classification and (original) supporting documentation to determine whether the good or service was received or rendered in 2007 and was a valid liability as of year end.

3. Inquired with responsible personnel on their knowledge of whether all year-end accruals were valid liabilities as of year end.

Background

The Bureau maintains its accounting records on an accrual basis. This requires recording income when earned and expenses when incurred, as opposed to when cash is received or paid. To achieve this, accounting entries of estimated amounts to be accrued are made at month-end and reversed in the following month. The Bureau contracts with independent auditors to audit its financial statements, which include a review of the appropriateness of accrual entries.

The Bureau's Annual Tourism Marketing Plan, which includes the planned activities and the amounts budgeted to carry them out, is approved by the Authority prior to the beginning of the fiscal year. Any subsequent revisions to the activities or budgets are subject to Authority approval.

ATTACHMENT III
(Continued)

Findings

There were two instances in which estimated amounts for services rendered were less than the amount recorded at December 31, 2007. Subsequent to year end, the vendors informed the Bureau that they were not going to bill for the remaining amount of the contract because not all of the specifications were met. The result was that the Bureau recorded $24,000 more in expenses as shown in the following table.

Expense	Total Amount Accrued	Amount Over Accrued	Fund Charged	Resolution
On-line advertising	$ 63,357	$14,000	1 (Public)	Reversed after year end
Co-op marketing	$100,000	$10,000	3 (Private)	Reversed after year end

ATTACHMENT IV

CONTRACT ADMINISTRATION

Objective

To determine whether there was adequate oversight over the Bureau's contractors that are funded by state monies for the year ended December 31, 2007.

Procedures

As part of our engagement, we performed the following:

1. Obtained and reviewed the Bureau's policy on procurement.
2. Obtained a listing of 67 active contracts from the Bureau for the year under review.
3. Selected a sample of active contracts and reviewed for proper procurement in accordance with the Bureau's procurement policy, as applicable.
4. Reviewed contract for annual evaluation to determine justification for contract renewal or extension.

Background

The Tourism Marketing Management Services Agreement (TMMSA), the Bureau's contract with the Authority, ended on December 31, 2004. However, the parties have been exercising options to extend the term for one-year periods, including the period from January 1, 2007 through December 31, 2007.

The TMMSA provides that "all such subcontracts to be executed by Contractor (other than Subcontracts that are substantially administrative or ministerial, or do not involve the expenditures, or a series of related expenditures of $75,000 or more) shall be subject to the prior written approval of HTA (which may include any written approval by HTA prior to the Effective Date)."

Each quarter, the Bureau submits a "Commitments Greater Than $75k Report" which is a cumulative report listing the subcontracts that meet the threshold for reporting. The Bureau's policy of submitting all subcontracts greater than $75,000 (even though the subcontract may be within the subcontract definition that does not require Authority approval) is beyond the requirements of the TMMSA.

ATTACHMENT IV
(Continued)

The department head is responsible for preparing the contract using a standard template. Any deviations from the standard template must be approved by the Bureau's attorney or the COO. On an annual contract basis, the Bureau evaluates its contractors on various criteria to determine whether a contract renewal or extension is a consideration.

Findings

One contract exceeding $75,000 was not submitted for approval to the Authority in accordance with the TMMSA. There were also two instances in which the contracts were executed and effective after the term start date. The lack of a formal review process did not allow the contract to be reviewed in its entirety by the last person signing the contract.

There was also one instance in which the vendor received an overall fair evaluation with some poor grades for working relationship and work product for the 2007 year. However, the two evaluations for the 2005 and 2006 year were good or excellent evaluations which justified the 2007 contract renewal. The contract was not renewed in 2008.

ATTACHMENT V

PETTY CASH

Objective

To determine the propriety of handling petty cash funds for the year ended December 31, 2007.

Procedures

As part of our engagement, we performed the following:

1. Obtained the Bureau's policy on petty cash.
2. Inquired with appropriate personnel charged with oversight of the petty cash function.
3. Obtained a listing of petty cash transactions charged to public funds.
4. Selected a sample of six months and reviewed for proper approval, coding, classification and supporting documentation.

Background

The Bureau has a petty cash policy and procedure. The petty cash fund is maintained at $500 in a locked box in a locked cabinet and is replenished on a monthly basis. A petty cash log is maintained and updated by the Office Manager as replenishment is made. The Office Manager allows a one-week turnaround time for the fund to be replenished upon request. All petty cash disbursements require an original receipt except for postage, parking meters and phone calls. Any questionable petty cash transactions are referred to the COO.

Findings

Petty cash transactions reviewed were properly supported and coded.

Appendix B
HTA and SMG Supplemental Agreement No. 17 Attachment M3

SUPPLEMENTAL AGREEMENT NO. 27
ATTACHMENT M3

FUNDING AND METHOD OF PAYMENT - SALES & MARKETING OF THE CENTER

Attachment M3, "Funding and Method of Payment – Sales & Marketing of the Center," is hereby amended by deleting the phrases in brackets and adding the underlined phrases to read as follows:

A. Funding Amounts. The STATE agrees to fund the CONTRACTOR's actual cost of marketing activities and for Marketing Flexibility funds in an amount not to exceed TWENTY MILLION FIFTEEN THOUSAND AND NO/100 DOLLARS ($20,015,000.00) over the life of this [Agreement] Contract as follows: (1) ONE MILLION EIGHT HUNDRED FIFTEEN THOUSAND AND NO/100 DOLLARS ($1,815,000.00) for the period January 1, 2003 through June 30, 2003, (2) THREE MILLION EIGHT HUNDRED THOUSAND AND NO/100 DOLLARS ($3,800,000.00) for the period July 1, 2003 through June 30, 2004, and (3) [FOUR MILLION AND NO/100 DOLLARS] FOUR MILLION FIVE HUNDRED THOUSAND AND NO/100 DOLLARS ($4,500,000.00) for each Fiscal Year during the period July 1, 2004 through June 30, 2011. In addition, the STATE agrees to provide marketing flexibility funds as follows: (1) FOUR HUNDRED THOUSAND AND NO/100 DOLLARS ($400,000.00) for the period January 1, 2003 through June 30, 2003, and (2) TWO MILLION AND NO/100 DOLLARS ($2,000,000.00) for each Fiscal Year during the period July 1, 2003 to June 30, 2011. It is acknowledged and agreed that the foregoing marketing flexibility funds shall be used for marketing flexibility fund commitments that have been made prior to the date of [this] Supplemental Agreement No. 20. The funding set forth in this Paragraph A is intended to fully reimburse the CONTRACTOR for CONTRACTOR's professional and technical services and all costs and expenses incurred by the CONTRACTOR in marketing the Center. All funds not expended in any one (1) Fiscal Year may be carried over to the next Fiscal Year. Any and all unexpended and/or uncommitted marketing funds as of the date of termination of this [Agreement] Contract, shall be returned to the tourism special fund. The foregoing amounts include all taxes that may be incurred by CONTRACTOR in connection with this [Agreement] Contract.

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Responses of the Affected Agencies

Comments on Agency Responses

We transmitted drafts of this report to the Board of Directors of the Hawaiʻi Tourism Authority and the authority's interim executive director on December 26, 2008. A copy of the transmittal letter to the board chair is included as Attachment 1. A similar letter was sent to the interim executive director. The joint response of the board chair and interim executive director is included as Attachment 2.

The Hawaiʻi Tourism Authority replied that it "is committed to addressing the points raised by the audit, . . . and is in the process of developing an operational plan to address the audit's findings and recommendations." The authority provided information to clarify a number of points, which neither contradict nor change our findings and recommendations. For example, the HTA reiterated that:

- Its planning process includes both a short-term approach through its annual budget process and a longer-term perspective through the Hawaiʻi Tourism Strategic Plan (TSP);

- Its overall role in marketing is to create a brand image for the destination and use the marketing effectiveness study by TNS Research to objectively measure the performance of its marketing programs and contractors to impact Hawaiʻi's brand awareness as a favorable visitor destination; and

- With respect to contract management related to its marketing contractors—the Hawaiʻi Visitors and Convention Bureau, Hawaiʻi Tourism Japan and SMG—the various issues identified in our audit have either already been resolved or are in the process of being reviewed and addressed.

The authority intends to "also *explore the need* to develop a longer range plan of its own which would also be aligned with the [Hawaiʻi Tourism Strategic Plan]" but believes that it has been using valid and reliable performance measurements to successfully impact Hawaiʻi's brand awareness as a favorable visitor destination. (Emphasis added.) The authority differentiates its role to promote tourism through brand awareness efforts from tourism promotion through the direct sale and purchase of travel products such as hotel accommodations. It distinguishes measures of effectiveness directed at determining the success of its marketing contractors' efforts towards developing brand awareness from actual bookings which are beyond the control of its contractors. The authority decided "it would be more beneficial to implement an accountability system that most appropriately tracks the success of programs in generating the desire to travel to . . . Hawaiʻi." Because of factors beyond its control, the HTA "selected consideration and intention to travel to Hawaiʻi as the most controllable and measurable performance metrics" and contracted with a leading international research company to track the impact and effectiveness of the marketing programs in its three major markets encompassing North America and Japan.

However, the authority's response and clarifications do not appear to fully embrace one of the report's important points—that HTA's plans lack quantifiable, objective benchmarks linking the activities and resources spent by HTA and its contractors to pre-determined outcomes in a format that does not rely on or require industry expertise. While HTA's response lists available measures, such do not appear in its plans, contracts, or reports to the public and the Legislature to provide a meaningful before and after comparison of the effect of its deployment of state resources. We discuss this issue in our report with reference to performance reporting standards promulgated by the Destination Marketing Association International (DMAI). Acknowledging the difficulty of finding direct cause-effect measures in an industry that traditionally relies on professional judgment, we explain in detail why that is not sufficient and show that industry leaders, such as the DMAI, not only agree but also provide a blueprint for better accountability.

In addition, HTA's role is not solely that of a brand marketer as suggested in the response. The authority has a dual role as lead agency for the development of the state-wide Hawaiʻi Tourism Strategic Plan and that of an active partner in its implementation. A prime example is its contract for the marketing and operation of the Hawaiʻi Convention Center. This contract and related performance reports lack objectively measurable targets, capable of demonstrating the contractor's achievement of predetermined benchmarks. Consequently HTA's reports to stakeholders reflect a "trust me" approach requiring the public to rely on HTA opinions and subjective evaluations for an accounting of taxpayer funds.

Finally, the use of performance measures is not limited to broad, agency-level activities. Measures are useful for planning for and assessing performance of many programs, initiatives, or projects, even of staff members. Our report seeks to convey that objectively measured goals and their use in assessment and reporting are hallmarks of commitment to results in a strategically oriented agency and that HTA can benefit from adopting such an orientation.

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
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December 26, 2008

COPY

Mr. Kelvin Bloom, Chair
Board of Directors
Hawai'i Tourism Authority
Hawai'i Convention Center
1801 Kalākaua Avenue
Honolulu, Hawai'i 96815

Dear Mr. Bloom:

Enclosed for your information are 16 copies, numbered 6 to 21, of our confidential draft report, *Management and Financial Audit of Hawai'i Tourism Authority's Major Contracts*. We ask that you telephone us by Tuesday, December 30, 2008, on whether or not you intend to comment on our recommendations. Please distribute the copies to the members of the board. If you wish your comments to be included in the report, please submit them no later than Monday, January 5, 2009.

The Interim President and Chief Executive Officer of the Hawai'i Tourism Authority, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

Hawai'i Tourism Authority

LINDA LINGLE
Governor

LLOYD I. UNEBASAMI
Interim President and
Chief Executive Officer

Hawai'i Convention Center, 1801 Kalakaua Avenue, Honolulu, Hawai'i 96815
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January 5, 2009

Ms. Marion Higa
State Auditor
Office of the Auditor
465 South King Street, Room 500
Honolulu, HI 96813

Dear Ms. Higa:

Thank you for providing us with a draft copy of the ***Management and Financial Audit of the Hawai'i Tourism Authority's Major Contracts*** and the opportunity to provide comments on issues contained within the draft report.

Since the previous audit issued in June 2003, the Hawai'i Tourism Authority (HTA) has made significant progress to address concerns and to implement recommendations from that report (Report No. 03-10). We appreciate the acknowledgement by the state auditor in this report that our oversight of contract management has improved. More specifically, since that time, in terms of accountability and responsibility, we have implemented several measures to ensure contractor compliance, minimize the state's liability, and optimize the state's expenditures for tourism promotion.

Despite the strides made and acknowledged, the HTA also recognizes that improvement is an ongoing process and as such, is committed to continuing enhancement of its tourism efforts in all areas. However, after careful review of the audit, we also wanted to clarify the following information included in the report (and as described in more detail below):

- The HTA's planning process includes both a short-term approach through its annual budget process and a longer-term perspective through the Hawai'i Tourism Strategic Plan (TSP).

- The HTA's overall role in marketing is to create a brand image for the destination. As such, the HTA utilizes the marketing effectiveness study by an independent contractor, TNS Research, to objectively measure the performance of its marketing programs and contractors to impact Hawai'i's brand awareness as a favorable visitor destination.

- With respect to better controls and contract management related to HTA's marketing contractors – HVCB, HTJ and SMG – the various issues have either already been resolved or are in the process of being reviewed and addressed.

Areas of Clarification

- The audit (Page 18) states that HTA has a short-range approach to tourism policy and no functional strategic plan of its own.

  It needs to be clarified that the Hawai'i Tourism Strategic Plan (TSP) is intentionally a broad, long-range, strategic plan for the state that incorporates all aspects of Hawai'i's visitor industry including components that are outside the direct responsibility of HTA such as natural resources, workforce development and safety and security. Consistent with the TSP, the HTA develops its own agency programs and budget based on the nine TSP initiatives prior to each upcoming fiscal year. This allows the HTA to remain responsive to the rapidly changing marketplace while continuing to address the longer term health and sustainability of Hawai'i's visitor industry with its ongoing plans and programs.

  Additionally, given the recommendations of this report, the HTA will also explore the need to develop a longer range plan of its own which would also be aligned with the TSP.

- The audit (Page 21) states that the HTA does not have objective measurable outcomes and performance measures in its plans for activities related to tourism promotion like other agencies including Montana, Texas and Louisiana.

  The HTA believes that the measurements used by other destinations as identified in the audit (e.g., daily spending, arrivals, etc.) are more relevant to measure efforts related to the purchase and sale of goods and services or the results of a visitor converting from brand awareness to an actual booking for travel products. Consistent with its statutory duty, the HTA's role in tourism promotion is to develop a brand awareness of Hawai'i as a favorable destination for leisure and business travel. The HTA's role to promote tourism through brand awareness efforts is differentiated from the promotion of tourism through the direct sale and purchase of travel products such as hotel accommodations over which the HTA does not have control. This is so because there are numerous factors which a contractor cannot control, and are described in more detail below. Therefore, while the HTA did consider utilizing these factors to measure the success of its marketing programs, after careful analysis we determined that it would be more beneficial to implement an accountability system that most appropriately tracks the success of programs in generating the desire to travel to the Hawai'i.

  Therefore, the HTA's measurements of effectiveness were directed at determining the success of its marketing contractors' efforts towards developing brand awareness and not actual bookings, which are beyond the control of HTA's marketing contractors. It should also be noted that HTA does monitor actual market performance such as visitor spending, visitor arrivals and visitor satisfaction. However, these measures are directly affected by factors outside of the influence of state-funded marketing programs. Examples of such factors are macroeconomic variables (mortgage crisis, stock market, international economies, fuel prices, forces of nature like hurricanes); political environment (nationally and worldwide); time value (time to get to vacation experience versus closer destinations); airlift issues including the cost of air travel and seat availability; the cost and availability of hotel rooms, and the relative value of foreign currency (strength against the dollar).

Because of these uncontrollable factors, the HTA selected consideration and intention to travel to Hawai'i as the most controllable and measurable performance metrics. As a result, the HTA contracted with TNS, a leading international research company, to develop a comprehensive system to track the impact and effectiveness of our marketing programs in three major marketing areas (MMAs) – U.S. West, U.S. East and Japan. Initiated in 2003, this quarterly study scrutinizes the intention to travel, brand valuation (positive impression of the Hawai'i brand overall and relative to competitors), and measurement of specific marketing attributes of Hawai'i in the three MMAs).

This type of study is an objective assessment and measurement of the HTA's marketing programs and is also an important indicator in the HTA's product development efforts. The results of the quarterly study allow HTA's marketing partners to immediately react to and adjust their respective marketing strategies to better align with the needs and desires of potential visitors. The HTA has found the TNS studies to be an effective way to measure visitors' intentions to travel to Hawai'i and better brand the destination. Moreover, specific findings provided in the TNS study and other objective data currently utilized by HTA have allowed the agency to take immediate tactical short term action in response to unforeseen external variables while maintaining a focus on the long term strategic plan. For instance, the HTA's recent marketing campaign in North America showcasing Hawai'i's value is a direct response to the current worldwide economic condition and a perception identified in the TNS study that Hawai'i is an expensive place to visit. This campaign is a short term tactical action that responds to an external variable outside of HTA's control but is consistent with the TSP's long term marketing strategy of promoting a brand awareness of Hawai'i as favorable visitor destination.

It is important to note that in addition to the TNS marketing effectiveness study, the HTA also utilizes extensive and objective data obtained by its consultants or developed by the Research and Economic Analysis Division of the State Department of Business, Economic Development & Tourism, to regularly monitor and analyze multiple objective data to evaluate and corroborate on a cumulative basis, the impact of its overall efforts. These include but are not limited to the following:

- Visitor arrivals and length of stay;
- Visitor expenditures - per person daily spending and total spending by market;
- Available air lift, forecasted seats and load factors;
- Market penetration against identified lifestyle segments;
- Advertising dollar equivalency of public relations efforts;
- Percentage of out-bound travel from key markets;
- Activity levels for access and co-op programs, both in matching fund ratios of 3 to 1 as well as measurement of the business stimulated;
- Overall cost per arrival by market and return on marketing dollar investment against visitor expenditures from that market; and
- Visitor satisfaction; and,
- Resident Sentiment Study.

In sum, the HTA believes that it has been using valid and reliable performance measurements to monitor its marketing contractors' performance to successfully impact Hawai'i's brand awareness as a favorable visitor destination.

- In response to the points raised regarding HVCB (Page 28): The HTA has already met with HVCB to discuss the audit. Additionally, HVCB has either modified or corrected its internal procedures as needed, in response to the various findings (A copy of HVCB's letter to the HTA dated December 30, 2008, is available for review).

- In response to the points raised regarding HTJ (Page 30): The majority of audit findings in this section focused on the fact that the HTA has allowed HTJ to operate using business practices that are customary for Japanese businesses. HTA is currently reviewing this to determine which processes and practices need to be revised to better match U.S. business practices and procedures. However, there are findings such as the approval process for items in the amount of $75,000 and above, the submission of reports in a timely manner and the cross check and approval process that the HTA will begin to immediately address.

- In response to the points raised regarding SMG (Page 33): HTA will carefully review all procedures to address any shortcomings. SMG is contracted to operate and market the Hawai'i Convention Center (HCC). Accordingly, SMG is provided the tools to successfully accomplish its mission. The Marketing Flexibility Fund (MFF) is a necessary tool to help secure conventions and meetings for the HCC and combat the traditional challenges of holding conventions and meetings in Hawai'i. These challenges include Hawai'i being too far away from their membership, time value (time spent away from business and home to attend the meeting in Hawai'i), cost of airfare and rooms in Hawai'i, high shipping costs to Hawai'i and the perception of a trip to Hawai'i being a "boondoggle" – issues that other competitive destinations do not face.

  The HTA's Chief Administrative Officer (CAO) reviews all MFF requests and scrutinizes total amounts and categories which are offered to clients. These offers include rent, ground transportation, food, attendance building costs and at times, costs for clients' final site visit before signing contracts to hold their event at the HCC. As reported, there may be occasions which the CAO rejected MFF requests from SMG due to lack of good business judgment of either cost categories or dollar amounts requested. However, the HTA's CAO does not oversee daily transactions as reported in this report.

  The HTA believes that the expenses identified in the audit (Page 34) that SMG procured for its clients such as limousine services, a helicopter ride and an iPod, are consistent with industry practices and necessary in order for the HCC to be competitive. However, the HTA also understands the need for additional scrutiny due to its role as a government entity.

  To address this issue, HTA has begun a comprehensive review of all procedures with SMG again, to tighten up and strengthen the procedures required to operate the HCC efficiently and effectively. This is consistent with the procedures the HTA followed to address issues raised in the previous audit of HTA's Major Marketing Contractors (HVCB).

Commitment to Continual Improvement

The health of the tourism industry in Hawai'i over the past five years is a broad measure of the success of HTA's efforts. But with the economic difficulties faced by the State of Hawai'i and the tourism industry, we fully understand and appreciate the need to constantly review our efforts to ensure the most efficient and effective use of state funds.

The HTA takes its fiduciary responsibility very seriously and are committed to addressing the points raised by the audit, and continuously responding to our stakeholders and the marketplace in our efforts to improve all of our programs including marketing. To date, the HTA has already begun a comprehensive review of policies and procedures with respect to the contract management and is in the process of developing an operational plan to address the audit's findings and recommendations.

If you have any questions regarding this audit or any of the items discussed above, please call Lloyd Unebasami at (808) 973-2264.

Sincerely,

Kelvin Bloom
Chair

Lloyd Unebasami
Interim President &
Chief Executive Officer