

**Informational Briefing of
Senate Committee on Ways and Means
and
Senate Committee on Economic
Development and Technology**

Tuesday, February 9, 2010

**Marion M. Higa
State Auditor**

**Investigation of Specific Issues of the
Department of Business, Economic
Development & Tourism**

Report No. 10-01
January 2010

Investigation Request

- **Act 213, SLH 2007** - requested the Auditor to investigate DBEDT
- Track reallocation of \$50,000 appropriated for the Community-Based Economic Development Program (CBED)
- Track reallocation of funds between programs in the Strategic Marketing & Support Division (SMSD)

Our Objectives

1. Determine appropriations and expenditures for the SMSD, FY1990-91 to present
2. Determine whether state approved budget planning process applied to SMSD activities
3. Make recommendations as appropriate

Summary of Findings

1. DBEDT withheld relevant information and provided erroneous and misleading information to state officials that enabled it to spend private and federal reimbursement funds at its discretion
2. A lack of effective internal controls has enabled Out-of-State offices to spend money with little accountability and created opportunities for fraud and abuse

**Finding 1: Withholding of information,
spending at department's discretion**

**2003 MDCP award reimbursed DBEDT for
expenditure of general funds**

- Award terms: 100% cash match (\$399,500) and 100% in-kind contributions or cash match
- Out-of-State Office costs to be used for cash match requirement

**DBEDT needed state approval to spend
\$399,500**

- Finance director and governor approved DBEDT request to spend MDCP funds
- Legislature set federal spending ceiling per DBEDT request

State officials unaware MDCCP funds were reimbursement moneys

- DBEDT characterized the MDCCP funds as *grant moneys* and not *reimbursements* to B&F, DAGS, Legislature
- DBEDT failed to clarify that reimbursements could supplant general funds

Department supplanted general funds with MDCP funds

- **Feb 2005** - Comptroller approves DBEDT request to use MDCP funds for visiting dignitaries' receptions
- **Oct 2005** - DBEDT uses *general* funds for Chinese visiting governor activities
- **Sept 2006** - DBEDT uses *MDCP* funds to pay for Chinese visiting dignitary reception

Department supplanted general funds with MDCP funds (cont.)

- **April 2007** – Director assures lawmakers MDCP funds have not been used for Out-of-State offices' overhead costs
- **June 2007** - DBEDT opens MDCP bank account in China with \$30,000 in reimbursement funds
- **July 2007 - Aug 2008** - DBEDT transfers \$110,000 in reimbursement funds to Beijing

Department supplanted general funds with MDCP funds (cont.)

- **Aug 2007- July 2008** - MDCP funds pay salary and costs for Beijing executive director's assistant
- **Aug - Dec 2008** - MDCP funds support the entire Beijing office operations to offset legislative budget cuts

MDCP reimbursement funds to be used to support Beijing office

- Department accounts hold more than \$250,000 in MDCP reimbursement funds
- Remaining funds to be used for the Beijing office and will be exhausted by next biennium

Issue of who controls the funds must be addressed

- DBEDT argues: Use of MDCP funds is in keeping with the spirit of the award
- Governor's budget execution policies: deposit into state treasury; similarity of objectives permits spending within ceilings

Issue of who controls the funds must be addressed (cont.)

- Finance director, House FIN budget chief, and DAGS branch chiefs agree: Reimbursements should be ***returned*** to general fund
- State law mandates unspent & unencumbered general funds be ***returned*** to state treasury

False or withheld information regarding 2005 China/Korea trade mission

- DBEDT pursued private funds
- DBEDT involved non-profit entities to organize mission
 - Hawai'i Pacific Export Council
 - Pacific and Asian Affairs Council (PAAC)

Key Issues

1. Did the department procure goods and services?
2. Were those procurements subject to state law?

103D-102, HRS: The procurement code applies to any departmental procurement of goods and services, irrespective of source of funding

Department sought and received AG opinion regarding its 2005 mission model

- DBEDT represents that the Export Council:
 - Handles fees paid by participants
 - Employs service providers needed
 - Pays service providers

AG opinion raises concern about DBEDT influence on mission funds expenditure

- **April 2005** - Dept of the Attorney General responds to DBEDT inquiry on proposed 2005 trade mission model
- AG concerned that DBEDT could influence mission funds expenditures and “strongly suggested” it remove itself from that position

State Procurement Office is convinced DBEDT's involvement is minimal

April 2005:

- Director meets with SPO administrator and staff to discuss mission model
- Based on Director's representations, SPO believes the Export Council is lead organizer with final say over expenditures
- SPO concludes DBEDT's involvement is "minimal"; expenditures not subject to procurement code

Department provided incomplete and misleading information to SPO

April 2005:

- Director failed to disclose PAAC's involvement
- PAAC opened bank account for mission funds **8 days** before SPO meeting
- Director did not inform SPO of "protocol" agreement finalized **4 days** before SPO meeting

Department provided incomplete and misleading information to SPO (cont.)

April 2006:

- SPO revisits department's role in mission
- Director disputes SPO administrator's recollection of the 2005 meeting
- SPO administrator stands by 2005 position: based on DBEDT information, Export Council was lead organizer

Department provided incomplete and misleading information to SPO (cont.)

April 2006:

- Director states DBEDT's *only* role was to consent to the Export Council and PAAC and its only involvement was as a participant in the activities as a result of their efforts
- Based on department information, SPO concludes PAAC or the Export Council hired vendors and expended mission funds

Export Council and PAAC argue their 2005 mission roles were specific



- **Hawaii Pacific Export Council:** promote the 2005 mission to increase participation



- **PAAC:** provide accounting services, check issuance to vendors based on invoices received from DBEDT

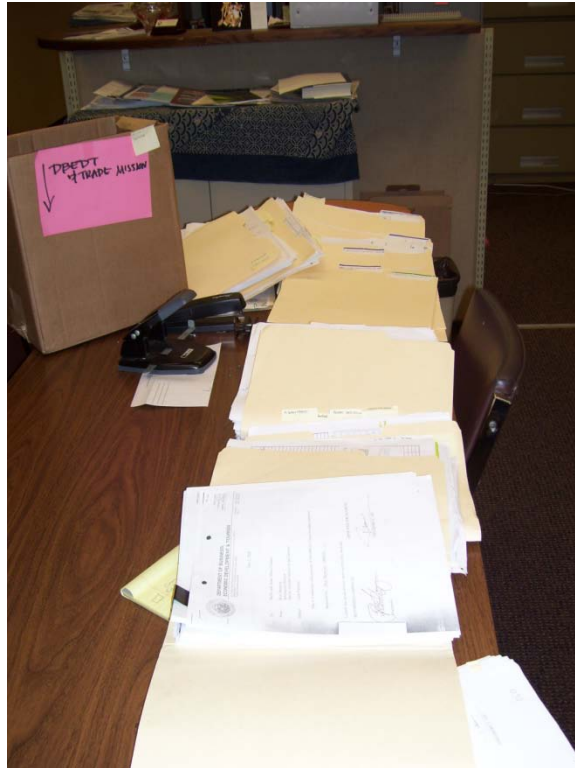
Department was the procuring agent in the 2005 mission



Export Council and **PAAC** agree:

- DBEDT was the lead organizer of 2005 mission
- DBEDT solicited vendors and procured goods and services for the mission

2005 mission fiscal documents



PAAC offices house 2005 mission fiscal documents including invoices and emails from department officials

**Department payment authorization forms
were signed by director or designee**

- DBEDT form authorizing payment for goods and services accompanied invoices
- Form was signed by director, designee, or director's special assistant and forwarded to PAAC



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

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May 31, 2005

To: Pacific and Asian Affairs Council
From: Rick Manayan
Information Director
Special Assistant/Advisor to the Director
Subject: Invoice Payment

This is to authorize payment for the attached invoice.

Date invoice received: 5/31/05

Invoice: W-050626A

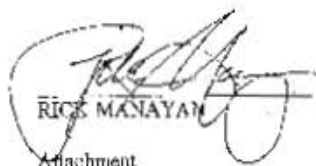
Invoice Date: 5/26/05

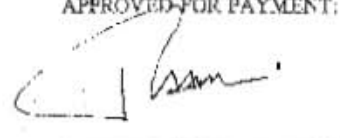
Requested by: WorldSound

I certify that goods/services were satisfactorily received.

RECOMMEND APPROVAL:

APPROVED FOR PAYMENT:


RICK MANAYAN
Attachment


THEODORE F. LIU

(#111-0010)
#110

Export Council & PAAC review of mission invoices was informal



Export Council and PAAC:

- Review process included no written spending criteria
- No recollection of rejecting any invoice sent by DBEDT or who would be responsible to pay for rejected bills

Department 2005 mission purchases

- **March 2005** – SPO rejects DBEDT request to exempt a company providing entertainment for China promotional events from procurement laws
- **May 2005** - DBEDT authorizes \$15,000 payment to the same company to provide entertainment in China
- DBEDT authorizes an additional \$5,000 to company's CEO for consulting services

Department 2005 mission purchases (cont.)

- DBEDT authorizes \$20,000 cash in mission funds to be provided to the director's special assistant, uses include:
 - "VIP Sponsors Mahalo Dinner" in China including \$30-a-glass champagne: **\$3,100**
 - "VIP After-Concert Cocktail Party": **\$4,000**

The department continued to spend mission funds after the delegation returned

- DBEDT continued to spend mission funds, through November 2005
- Post-trip expenditures:
 - July 2005 luau for a visiting state councilor from China; DBEDT sought “special treatment”: **\$1,700**
 - Oct 2005 reception at Washington Place for a visiting governor from China: **\$13,000**

The department continued to spend mission funds after the delegation returned (cont.)

- Gift items including office supplies for future dignitaries: **\$7,000**

Department also spent general funds on post-mission activities

- Oct 2005 activities to host governor from China, including catering, lei, gifts, goods and services, and transportation: **\$11,750**

Federal trade mission policies should be emulated

- U.S. Department of Commerce policy emphasizes trade missions are not private rewards for participants
 - Federal trade missions participant fees not used for airfare, lodging, meals, and incidentals
 - Participant selection criteria are tied to performance measures
 - Records' transparency emphasized

Finding 2: Lack of effective internal controls of overseas office creates opportunities for abuse

- DBEDT unable to verify overseas offices' expenditures
 - Geographical distance
 - Language barriers

Verification of Beijing office expenditures is a trust-based system

- Beijing office sends DBEDT monthly expenditure reports and invoices
- Beijing office purchasing primarily in cash
- Receipts and invoices written in Chinese

Verification of Beijing office expenditures is a trust-based system (cont.)

- Receipts and invoices from Beijing office often lacked English descriptions
- DBEDT employees who review receipts and invoices:
 - Do not read Chinese
 - Admit English description requirement not consistently followed
 - Simply “trust” or “assume” invoices are legitimate

Deposit of private funds jeopardized Taipei office's non-profit status

- Weak internal controls allowed deposit of private funds into Taipei office bank account
- Sept 2005 - \$35,000 in 2005 China/Korea mission funds deposited into the Taipei office account

Deposit of private funds jeopardized Taipei office's non-profit status (cont.)

- SMSD administrator admits depositing private funds directly into overseas offices account places the office's non-profit status at risk
- SMSD administrator did not know of deposit prior to our inquiry

Department failed to meet statutory reporting requirements

- Statutorily required Out-of-State offices' quarterly financial reports not consistently provided

Conclusions

- DBEDT demonstrated a troubling pattern of disclosing selective information regarding the MDCP award and 2005 China/Korea trade mission
- Subsequent actions by state agencies and lawmakers enabled the department to expend funds that circumvented and/or undermined the intent of state laws

Conclusions (cont.)

- Lack of effective internal controls for Out-of-State offices expenditures place the department at risk of abuse or fraud
- Findings are based on actions taken by the department between 2005 and 2008 which demonstrate a pattern of behavior

Recommendations

- a) Freeze MDCP reimbursement funds spending
- b) Conduct a financial audit of the overseas offices' accounting system and procedures
- c) Future trade missions incorporate federal trade mission policies as guide
- d) SPO review PAAC-held trade mission files and interview stakeholders to determine applicability of procurement code

Recommendations (cont.)

- e) Legislative review of MDCP spending ceiling & classification of remaining MDCP
- f) Legislative discussions with DBEDT to determine appropriate overseas offices' reporting requirements
- g) Governor consider removal of department director