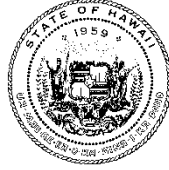


NEIL ABERCROMBIE
GOVERNOR



Dean H. Seki
Comptroller

Maria E. Zielinski
Deputy Comptroller

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
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TESTIMONY
OF
DEAN H. SEKI, COMPTROLLER
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
TO THE
HOUSE COMMITTEE
ON
FINANCE
ON
April 3, 2014

S.B. 2779, S.D. 1

RELATING TO FINANCIAL AUDIT OF THE STATE OF HAWAII BY THE LEGISLATIVE
AUDITOR

Chair Luke and members of the Committee, thank you for the opportunity to testify on
S.B. 2779, S.D. 1.

The Department of Accounting and General Services strongly supports S.B. 2779, S.D. 1,
an administration-sponsored measure.

S.B. 2779, S.D. 1 authorizes the Department of Taxation to release certain otherwise
confidential information to the Legislative Auditor or the Legislative Auditor's authorized agents
solely for the purpose of conducting the annual audit of the Comprehensive Annual Financial
Report (CAFR) of the State of Hawaii. Specifically, S.B. 2779, S.D. 1 allows the Auditor to
examine tax return information of the Department of Taxation solely with respect to the audit of
the CAFR.

Since access to this tax information is necessary for testing by the Legislative Auditor or the Legislative Auditor's authorized agents for purposes of the CAFR audit, it is critical that S.B. 2779, S.D. 1 is passed for the State's future audits. A serious audit scope limitation would result if S.B. 2779, S.D. 1 were not passed. Specifically, the State would not be able to obtain an unqualified audit opinion for its CAFR which would negatively affect the State's credit rating as well as its ability to obtain financing.

Thank you for the opportunity to testify on this matter.



**TESTIMONY OF JAN K. YAMANE, ACTING STATE AUDITOR
ON SENATE BILL NO. 2779, SENATE DRAFT 1,
RELATING TO FINANCIAL AUDIT OF THE STATE OF HAWAII BY
THE LEGISLATIVE AUDITOR**

House Committee on Finance

April 3, 2014

Chair Luke and Members of the Committee:

Thank you for the opportunity to testify in strong support of Senate Bill No. 2779, Senate Draft 1 (SB2779, SD1), which is an administration bill. The purpose of this bill is to specifically authorize the Legislative Auditor to access information in the possession of the Department of Taxation for purposes of conducting financial audits of the State of Hawai'i, while also requiring the Legislative Auditor to keep the information confidential.

As you are aware, it is our constitutional and statutory duty to conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions, to certify to the accuracy of all financial statements issued by the respective accounting officers. We report our findings and recommendations to the Governor and the Legislature. This bill is needed to address an issue raised in connection with the Comprehensive Annual Financial Report (CAFR) and was drafted in collaboration with the Departments of Accounting and General Services, Attorney General, Budget and Finance, and

Taxation. Due to the criticality of the passage of this bill, we compromised our usual position that we should have access to all records—including all tax records—when carrying out our constitutional duty to audit. In this measure, we have agreed with the named executive branch agencies to accept to tax records for purposes of the CAFR work only.

Each year our office contracts with several public accounting firms to conduct financial statement audits for the State of Hawai‘i, including the CAFR. In order to complete this work, our office and contract auditors have accessed taxpayer information from the Department of Taxation (DoTAX), the largest revenue-generating agency in the state. This year, DoTAX, as advised by the Department of the Attorney General, determined that the law required DoTAX to withhold taxpayer information from our auditors. We responded that, without information from DoTAX critical to the CAFR, we would likely have to issue an audit opinion unfavorable to the State.

There are four common types of financial statement audit opinion reports. Each presents a different situation encountered during an auditor’s work. From best to worst, they are: 1) an unmodified opinion (also referred to as a *clean opinion*); 2) a qualified opinion; 3) an adverse opinion; and 4) a disclaimer of opinion. Collectively, items 2), 3) and 4)—qualified, adverse, and disclaimer of opinion—are referred to as *modified opinion* reports.

The first—an unmodified opinion—reflects an auditor’s opinion that an entity’s financial statements give a true and fair view in accordance with *Government Auditing Standards*, issued

by the Comptroller General of the United States. Each year the State of Hawai'i has earned a clean opinion from its auditors.

The second type of report—a qualified opinion—is issued when one or more areas of an entity's financial statements do not conform to generally accepted accounting principles (GAAP) or there is a limitation of scope. A scope limitation occurs when an auditor cannot audit one or more areas of the financial statements, and may occur if we are unable to access taxpayer information from DoTAX. The third type of report—an adverse opinion—is issued when an auditee's financial statements are materially misstated and, as a whole, do not conform to GAAP. The last type of report—disclaimer of opinion, or simply, *disclaimer*—can be issued under several circumstances. One of these involves a limitation on scope imposed by a client (such as DoTAX not allowing auditors access to its taxpayer records), resulting in an auditor being unable to obtain sufficient appropriate audit evidence as required by *Government Auditing Standards*. Although disclaimers are rarely used, a disclaimer may occur where auditees willfully hide or refuse to provide evidence and information to auditors in significant areas of the financial statements. Thus, a disclaimer may be appropriate if DoTAX withholds information from the auditors.

Whatever the case—whether qualified, adverse, or disclaimer of opinion—an unfavorable opinion would adversely impact the State's ability to attract investors. I defer to the Department of Budget and Finance to elaborate on the impact an unfavorable opinion would have on the State.

Returning to the merits of SB2779, SD1, Section 2 of this bill would enable my office and contract auditors to access tax information from DoTAX in preparation of the CAFR. All information accessed would be considered confidential working papers pursuant to Section 23-9.5, Hawai'i Revised Statutes (HRS). Sections 3 through 7 of the bill amend various provisions in Title 14, *Taxation*, HRS, to enable auditor access. For these changes, I defer to the Department of Taxation and the Department of the Attorney General.

Thank you for the opportunity to testify in strong support of Senate Bill No. 2779, SD 1. I want to thank the directors and deputy directors of the Departments of Accounting and General Services, Attorney General, Budget and Finance, and Taxation, for collaborating with us on this measure. I am available for questions should you have any.

NEIL ABERCROMBIE
GOVERNOR

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LT. GOVERNOR



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DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR

LATE TESTIMONY

To: The Honorable Sylvia Luke, Chair
and Members of the House Committee on Finance

Date: Thursday, April 3, 2014
Time: 2:05 p.m.
Place: Conference Room 308, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. No. 2779, S.D. 1, Relating to Financial Audit of the State of Hawaii by
the Legislative Auditor

The Department appreciates the intent of S.B. 2779, S.D. 1, to provide a narrow and limited exception to the State's taxpayer confidentiality provisions solely for the purpose of conducting the State's annual certified financial audit.

While the Department has concerns about disclosure of confidential tax information, the Department is cognizant of the Auditor's duty to complete the annual certified financial audit. To the extent limited access to taxpayer information is necessary to complete the annual certified financial audit, the Department will provide the relevant data as needed. The Department defers to the Department of the Attorney General as to whether the bill's provisions sufficiently protects confidential taxpayer information.

State taxes are administered largely through voluntary compliance on the part of taxpayers. Part of the motivation to voluntarily report tax information is the State's laws protecting the confidentiality of that information. Any erosion of that promise of confidentiality may have negative consequences for continued voluntary compliance by taxpayers under Title 14 of the Hawaii Revised Statutes. For these reasons, the Department only supports limited access to taxpayer information as needed to complete the annual certified financial audit.

Thank you for the opportunity to provide comments.