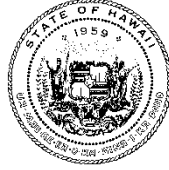


NEIL ABERCROMBIE  
GOVERNOR



Dean H. Seki  
Comptroller

Maria E. Zielinski  
Deputy Comptroller

STATE OF HAWAII  
DEPARTMENT OF ACCOUNTING  
AND GENERAL SERVICES  
P.O. BOX 119  
HONOLULU, HAWAII 96810-0119

TESTIMONY  
OF  
DEAN H. SEKI, COMPTROLLER  
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES  
TO THE  
SENATE COMMITTEE  
ON  
WAYS AND MEANS  
ON  
January 30, 2014

S.B. 2779

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

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

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

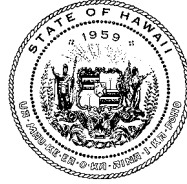
S.B. 2779 authorizes the Department of Taxation to release certain otherwise confidential  
information to the Legislative Auditor or the Legislative Auditor's authorized agents solely for  
the purpose of conducting the annual audit of the Comprehensive Annual Financial Report  
(CAFR) of the State of Hawaii. Specifically, S.B. 2779 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 is passed for the State's future audits. A serious audit scope limitation would result if S.B. 2779 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.

**NEIL ABERCROMBIE**  
GOVERNOR

**SHAN TSUTSUI**  
LT. GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF TAXATION**  
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HONOLULU, HAWAII 96809  
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FAX NO: (808) 587-1584

**FREDERICK D. PABLO**  
DIRECTOR OF TAXATION

**JOSHUA WISCH**  
DEPUTY DIRECTOR

To: The Honorable David Y. Ige, Chair  
and Members of the Senate Committee on Ways and Means

Date: Thursday, January 30, 2014  
Time: 10:00 a.m.  
Place: Conference Room 211, State Capitol

From: Frederick D. Pablo, Director  
Department of Taxation

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

The Department appreciates the intent of S.B. 2779 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.



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

**Senate Committee on Ways and Means**

January 30, 2014

Chair Ige and Members of the Committee:

Thank you for the opportunity to testify in strong support of Senate Bill No. 2779 (SB2779), 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 this year's 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.

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, 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. 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.



TESTIMONY BY KALBERT K. YOUNG  
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE SENATE COMMITTEE ON WAYS AND MEANS  
ON  
SENATE BILL NO. 2779

January 30, 2014

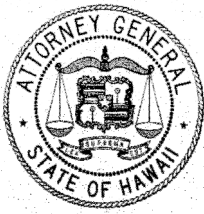
RELATING TO FINANCIAL AUDIT OF THE STATE OF HAWAII BY THE LEGISLATIVE  
AUDITOR

Senate Bill No. 2779 authorizes the Department of Taxation to release confidential information to the Legislative Auditor or the Legislative Auditor's authorized agent solely for the purpose of conducting the annual audit of the State of Hawaii, otherwise known as the Comprehensive Annual Financial Report (CAFR) of the State of Hawaii. The CAFR is an essential report used by outside parties to ascertain the financial health of the State. It is a component of the annual disclosure statements that State provides investors and holders of State bonds. Completion of the CAFR is also a metric used to gauge financial management's commitment to ensuring transparency of government finances.

The Department of Budget and Finance supports this measure. Since 2011, the Administration has made significant progress in ensuring that the CAFR is completed in a timely manner. We have been able to produce the CAFR within 7 months of the close of the fiscal year for two years running. It has resulted in positive comments by ratings agencies and has resulted in increased participation by institutional investors. This resulted in decreased costs to taxpayers for debt service. Providing for the limited accessibility of tax records to the auditor may help to further expedite the multiple complexities and reviews required during the construction of the CAFR.

Thank you for the opportunity to testify.





**TESTIMONY OF  
THE DEPARTMENT OF THE ATTORNEY GENERAL  
TWENTY-SEVENTH LEGISLATURE, 2014**

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**ON THE FOLLOWING MEASURE:**

S.B. NO. 2779, RELATING TO THE FINANCIAL AUDIT OF THE STATE OF HAWAII  
BY THE LEGISLATIVE AUDITOR.

**BEFORE THE:**

SENATE COMMITTEE ON WAYS AND MEANS

**DATE:** Thursday, January 30, 2014

**TIME:** 9:00 a.m.

**LOCATION:** State Capitol, Room 211

**TESTIFIER(S):** WRITTEN COMMENTS ONLY. For more information, call  
Hugh R. Jones 586-1473

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Chair Ige and Members of the Committee:

The Department of the Attorney General offers the following written comments on this bill. Section 235-116, Hawaii Revised Statutes (HRS), and other provisions of title 14, HRS, make it a criminal offense for any officer or employee of the Department of Taxation to disclose tax returns, or tax return “information” without the taxpayer’s written consent. Because the government’s collection of taxes is dependent on voluntary reporting by taxpayers, strict confidentiality protections ensure that taxpayers may report sources of legal and illegal income without fear or reprisals.

There is no state law definition of this return information but analogous provisions of the Internal Revenue Code (IRC §6103(b)) provide useful guidance and basically define return information as any item of information about a taxpayer reported on a tax return.

IRC §6103(i)(8)(A) provides for disclosure of return information by the Internal Revenue Service (IRS) to the Comptroller General for purposes of auditing the IRS; however, it is subject to oversight and “disapproval” by the Joint Committee on Taxation. IRC §6103(i)(8)(C). There is no comparable state law exception for disclosure or return information to the State Auditor, and no comparable “check and balance” such as federal “disapproval” by the Joint Committee on Taxation.

The purpose of this bill is to provide the State Auditor with access to tax return information where relevant and necessary to the completion of the State’s comprehensive annual financial review and to subject that information to the State Auditor’s confidentiality statute,

section 23-9.5, HRS. This bill will create a narrow and limited exception to laws mandating the confidentiality of taxpayers' returns and return information so that this annual financial audit may be completed.

# TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: ADMINISTRATION, Trust fund liability for amounts passed on as tax

BILL NUMBER: SB 2779; HB 2230 (Identical)

INTRODUCED BY: SB by Kim by request; HB by Souki by request

BRIEF SUMMARY: Authorizes the Legislative Auditor to access tax return information for purposes of conducting the Comprehensive Annual Financial Report, or CAFR, which is the overall audit of the State of Hawaii agencies. Also requires the Legislative Auditor and its authorized agents to keep that information confidential.

EFFECTIVE DATE: Upon approval

STAFF COMMENTS: This is an administration measure submitted by the department of the attorney general AGS-06 (14). It appears that the Department of Taxation has raised questions about the Legislative Auditor's authority and ability to review tax returns and other records in connection with the CAFR, the annual financial audit of the State of Hawaii. Apparently these questions have caused delays in performing the audit.

This measure appears necessary and appropriate; however, some technical comments may be in order.

In its proposed amendment to HRS section 23-5, the bill states that “[r]eturn information provided to the auditor by the department of taxation shall be considered working papers of the auditor pursuant to section 23-9.5.” HRS section 23-9.5 simply states that working papers of the auditor are confidential. However, tax return information consistently has been held to be confidential even against subpoenas or other court processes seeking that information, while audit working papers have not. For that reason we would recommend either deleting that sentence or replacing it with language similar to: “Return information provided to the auditor by the department of taxation shall be considered information that by its nature must be confidential in order for the government to avoid the frustration of a legitimate government function, within the meaning of section 92F-13(3).”

Digested 1/27/14