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DEPT. COMM. NO. 437

May 9, 2025

VIA EMAIL

The Honorable Ronald D. Kouchi
Senate President
415 South Beretania Street
Hawaiʻi State Capitol, Room 409
Honolulu, Hawaiʻi 96813

VIA EMAIL

The Honorable Nadine K. Nakamura
Speaker, House of Representatives
415 South Beretania Street
Hawaiʻi State Capitol, Room 431
Honolulu, Hawaiʻi 96813

Re: ***Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024*****, Report No. 25-08**

Dear President Kouchi and Speaker Nakamura:

Please find attached Report No. 25-08, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024*, along with a copy of the Auditor's Summary. The audit was performed by KMH LLP pursuant to Section 342G-107, Hawaiʻi Revised Statutes, which requires a management and financial audit of the Deposit Beverage Container Program in fiscal years ending in even-numbered years, after the initial audit for the fiscal year ended June 30, 2005.

The report is accessible through our website at:
https://files.hawaii.gov/auditor/Reports/2025/25-08.pdf.

The summary is also accessible through our website at:
https://files.hawaii.gov/auditor/Overviews/2025/25-08AuditorSummary.pdf.

If you or other Legislators would like a printed version of the report, please let me know.

Very truly yours,

Leslie H. Kondo
State Auditor

Attachments
ec/attach: Members of the Senate
Members of the House of Representatives
Carol Taniguchi, Senate Chief Clerk
Brian Takeshita, House Chief Clerk

Auditor's Summary

Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024

Report No. 25-08

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THE LEGISLATURE ESTABLISHED the Deposit Beverage Container Program (Program) in 2002 to increase recycling of specific types of beverage containers, reduce litter, and provide a connection between beverage container manufacturing decisions and Program management. The Deposit Beverage Container Deposit Special Fund (Special Fund) was created to hold fees, deposits, and accrued interest – moneys that are used to pay deposit beverage container refunds and handling fees and Program-related expenses.

We found that DOH still has made no progress on implementing the prior recommendations, including those codified by the Legislature in Section 342G-121.5, HRS.

Review of Prior Findings

Our initial review, issued in 2005, found DOH's reliance on self-reported numbers from distributors and certified redemption centers exposed the Program to possible fraud and abuse. Six subsequent audits issued between 2008 and 2018 found those initial findings remained relevant; the department had taken no meaningful action to address the chronic issues. Specifically, we have pointed out that distributors and redemption centers have financial incentive to under- or over-report the amounts that the distributors must pay into the Special Fund and amounts that the redemption centers may claim for reimbursement from the Special Fund.

For example, in 2015 we reported that a distributor, Whole Foods Market, Inc., had substantially underpaid the department for years by depositing \$0.06 per *case* of beverages rather than \$0.06 for each individual container. In 2018, auditors identified two instances of actual fraud at a redemption center by comparing receipts received for redeeming containers against the cash receipt log submitted to DOH to support the center's claim for reimbursement; the amounts the redemption center claimed – and DOH reimbursed – were significantly higher than the auditors had received for redeeming containers. DOH took no action against the redemption center and reimbursed the inflated amounts.

In 2021, instead of repeating the same, unaddressed findings, we adopted a new approach to examine *why* DOH had not taken meaningful action to address chronic issues by implementing controls or making other changes. We found the Program viewed our biennial audits as a replacement for internal controls and expected the Auditor to review records and identify errors in the amounts received from distributors or claimed by redemption centers. The following year, the Legislature passed Act 12, Session Laws of Hawai'i 2022, codified as Section 342G-121.5, HRS, to compel DOH to develop and implement procedures to verify the accuracy and completeness of the data reported by beverage distributors and redemption centers, as we repeatedly recommended.

Given the relatively short period between the passage of Act 12 and our 2023 review, as well as DOH's representation that it was in the process of implementing changes, we switched our approach again in 2023. We asked DOH to submit the required financial information and provide an update on steps the Program had taken to address the 2021 audit findings. This report again assessed the implementation of those recommendations, as well as DOH's compliance with Section 342G-121.5, HRS.

What We Found in 2024

In 2024, we examined relevant documents and records, interviewed Program personnel, and evaluated whether DOH's actions addressed our 2021 recommendations. We found DOH still has made no progress on implementing prior recommendations, including those codified by the Legislature in Section 342G-121.5, HRS. Specifically, we found DOH has not implemented any of our eight recommendations, including one the department did not agree with and did not intend to implement. Since the requirement to implement those recommendations was codified in HRS, DOH is not in compliance with its legal mandate.

Financial highlights

For the fiscal year ended June 30, 2024, the special fund reported total revenues of $33.57 million and total expenditures of $23.03 million, resulting in a change of fund balance of $10.54 million. Total revenues consisted of (1) deposit beverage container fees of $10.37 million, (2) unredeemed deposits of $20.81 million, and (3) investment income of $2.38 million, and (4) nonimposed employee fringe benefits of $7,390. Total expenditures consisted of (1) handling and redemption fees of $21.01 million, (2) operating expenditures of $2 million, and (3) administrative expenditures of $28,587.

As of June 30, 2024, total assets were $85.79 million and total liabilities were $7.93 million. Total assets were comprised of (1) cash and cash equivalents of $76.33 million, (2) accounts receivable of $9.24 million, and (3) interest receivable of $226,842. Total liabilities were comprised of (1) vouchers and contracts payable of $4.37 million; (2) accrued wages and employee benefits of $124,548; and (3) beverage container deposits of $3.43 million.

Auditor's Opinion

The special fund received an unmodified opinion that its financial statements presented fairly, in all material respects, the financial position of the fund as of June 30, 2024, in accordance with generally accepted accounting principles.

Findings

One material weakness was reported – some vouchers payable were not recorded, resulting in an overstated fund balance. Management accepted a proposed adjustment of approximately $733,000 to increase vouchers payable and expenditures.

One significant deficiency was also reported, relating to over-reliance on third party certifications. As we found in prior audits, the Program continued to rely on self-reporting from beverage distributors and redemption centers. This overreliance may result in underpayments on deposits and related container payments DOH receives to administer the Program, overpayments of deposit refunds and handling fees to redemption centers, and an overstated redemption rate. An overstated redemption rate could result in a misstatement in DOH's financial statements, as well as higher fees for consumers.

Link to the complete report:

Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024

https://files.hawaii.gov/auditor/Reports/2025/25-08.pdf

Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024

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

Conducted by
The Auditor, State of Hawai'i
and KMH LLP

Report No. 25-08
May 2025

OFFICE OF THE AUDITOR
STATE OF HAWAI'I

OFFICE OF THE AUDITOR
STATE OF HAWAIʻI

Constitutional Mandate

Pursuant to Article VII, Section 10 of the Hawaiʻi State Constitution, the Office of the Auditor shall conduct post-audits of the transactions, accounts, programs and performance of all departments, offices and agencies of the State and its political subdivisions.

The Auditor's position was established to help eliminate waste and inefficiency in government, provide the Legislature with a check against the powers of the executive branch, and ensure that public funds are expended according to legislative intent.

Hawaiʻi Revised Statutes, Chapter 23, gives the Auditor broad powers to examine all books, records, files, papers and documents, and financial affairs of every agency. The Auditor also has the authority to summon people to produce records and answer questions under oath.

Our Mission

To improve government through independent and objective analyses.

We provide independent, objective, and meaningful answers to questions about government performance. Our aim is to hold agencies accountable for their policy implementation, program management and expenditure of public funds.

Our Work

We conduct performance audits (also called management or operations audits), which examine the efficiency and effectiveness of government programs or agencies, as well as financial audits, which attest to the fairness of financial statements of the State and its agencies.

Additionally, we perform procurement audits, sunrise analyses and sunset evaluations of proposed regulatory programs, analyses of proposals to mandate health insurance benefits, analyses of proposed special and revolving funds, analyses of existing special, revolving and trust funds, and special studies requested by the Legislature.

We report our findings and make recommendations to the Governor and the Legislature to help them make informed decisions.

For more information on the Office of the Auditor, visit our website:
https://auditor.hawaii.gov

COVER PHOTO: ISTOCK.COM

Foreword

This is a report on the financial and program audit of the Department of Health's Deposit Beverage Container Program as of and for the fiscal year ended June 30, 2024. The audit was conducted pursuant to Section 342G-107, Hawai‘i Revised Statutes, which requires the Office of the Auditor to conduct a management and financial audit of the Deposit Beverage Container Program and Deposit Beverage Container Deposit Special Fund in fiscal years ending in even-numbered years, after the initial audit for the fiscal year ended June 30, 2005.

We contracted with the certified public accounting firm of KMH LLP for assistance in conducting the financial and program audit of the Deposit Beverage Container Program and Deposit Beverage Container Deposit Special Fund.

Leslie H. Kondo
State Auditor

Table of Contents

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Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2024

Introduction

THIS IS THE TENTH BIENNIAL financial and program audit of Department of Health's (DOH) Deposit Beverage Container Program (Program or DBC Program) and Deposit Beverage Container Deposit Special Fund (Special Fund). The Legislature established the Program in 2002 to increase recycling of specific types of beverage containers, reduce litter, and provide a connection between beverage container manufacturing decisions and the recycling program management.[1]

Our prior reviews have repeatedly raised concerns that DOH's reliance on self-reported information from beverage distributors and redemption centers increases the risk of fraud.

[1] Section 1, Act 176, Session Laws of Hawai‘i 2002, codified as Chapter 342G, Part VIII, Hawai‘i Revised Statutes.

The Special Fund was created to hold fees, deposits, and accrued interest – moneys that are used to pay deposit beverage container refunds and handling fees as well as Program-related expenses.

Our prior reviews have repeatedly raised concerns that DOH's reliance on self-reported information from beverage distributors and redemption centers increases the risk of fraud. Specifically, we have pointed out that distributors and redemption centers have financial incentive to under- or over-report the amounts that the former must pay into the Special Fund and the latter may claim for reimbursement from the Special Fund. For example, in Report No. 15-02, *Financial and Program Audit of the Deposit Beverage Container Program*, we found a distributor, Whole Foods Market, Inc., had substantially underpaid the Program for more than six years – depositing $0.06 for each case of beverages instead of $0.06 for each individual container. DOH did not collect underpayments for the full six-year period, instead settling for payment of $46,198 that Whole Foods represented was the amount of the underpayments from July 2012 through December 2014; however, that resolution left uncollected more than three years of underpayments. And Report No. 19-08, *Financial and Program Audit of the Deposit Beverage Container Program*, identified instances of actual fraud at a redemption center. During that review, auditors compared receipts that they had received for redeeming containers at a redemption center on two separate occasions with the cash receipt log submitted by the redemption center to DOH to support its claim for reimbursement; the amounts the redemption center claimed had been paid to the auditors were significantly more than the amounts auditors received on both occasions. DOH reimbursed the redemption center the inflated amounts and took no action against the redemption center even after being aware of the apparent fraud.

In 2022, the Legislature passed Act 12, SLH 2022, to compel DOH to develop and implement procedures to verify the accuracy and completeness of data reported by beverage distributors and redemption centers as recommended in the Office of the Auditor's biennial reports. Act 12, codified as Section 342G-121.5, Hawai'i Revised Statutes (HRS), requires DOH "to develop a risk-based process to help remedy the flaws in the deposit beverage container program." This statute was effective upon its approval on April 27, 2022.

Our prior reports have included multiple recommendations and assessed the status of the Program's implementation of those recommendations. However, we repeatedly discovered that DOH had done nothing to address the recurring findings and had not implemented any of the recommendations to address those findings. We found that the Program viewed these biennial audits as a replacement for internal controls, expecting the Auditor to perform the Program's job of reviewing records and conducting "secret shopper" activities to identify errors in the amounts received from distributors or claimed by redemption centers. Therefore, in the past audit, the Auditor focused on the status of the department's implementation of the recommendations made in Report No. 21-13, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program*. This report again assesses the implementation status; we also assessed DOH's compliance with Section 342G-121.5, HRS.

We found that DOH still has made no progress on implementing the prior recommendations, including those codified by the Legislature in Section 342G-121.5, HRS.

Background

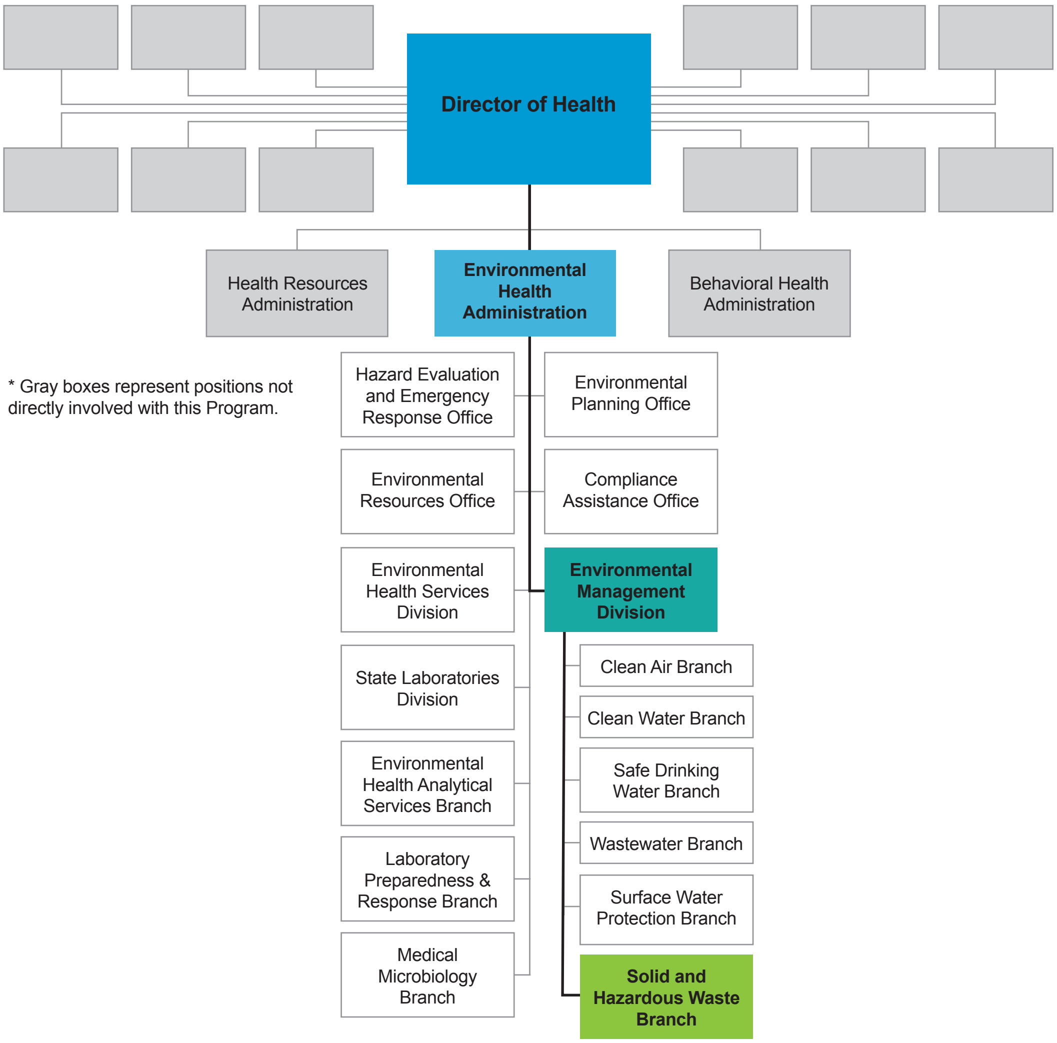
In 2002, the Legislature established the Program through House Bill No. 1256, House Draft 2, Senate Draft 2, Committee Draft 1, which became Act 176, SLH 2002. The act, codified as Chapter 342G, Part VIII, HRS, also created the Special Fund to hold the container deposits and handling fees collected by distributors.

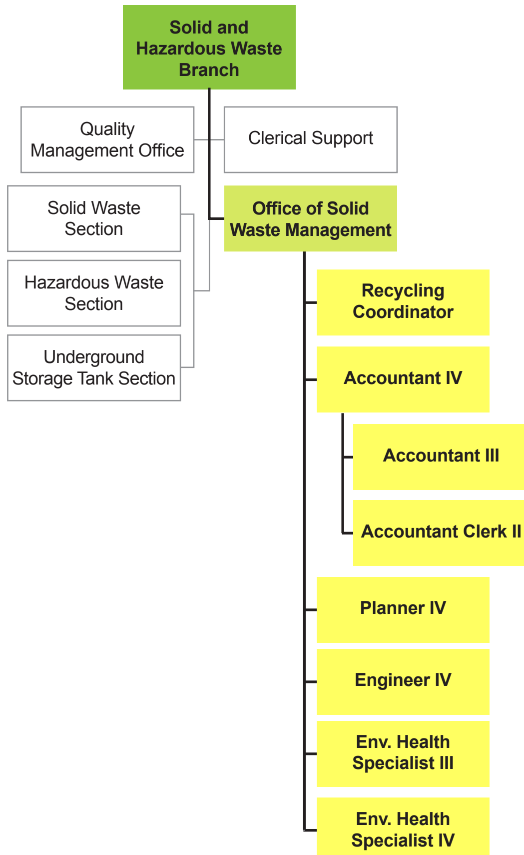
The Legislature intended the Program to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter. The nickel-redemption program created under Act 176 was aimed at recovering 80 percent of the then-estimated 800 million bottles and cans sold annually in Hawai‘i. With the passage of Act 176, Hawai‘i became one of 11 states to have some form of beverage container recycling program.

In 2022, the Legislature passed Act 12, SLH 2022, which noted the Office of the Auditor's biennial reports have repeatedly demonstrated DOH's failure to develop and implement procedures to verify the accuracy and completeness of data reported by beverage distributors and redemption centers. Act 12 requires DOH to develop a risk-based process to address the issues and concerns that we have repeatedly reported.

DOH's Environmental Management Division, Solid and Hazardous Waste Branch, Office of Solid Waste Management (Office of Solid Waste Management or OSWM) is responsible for the implementation and administration of the Program as well as the Special Fund.

Exhibit 1
Department of Health Organization Chart





Source: Department of Health

Review of Prior Audits

The Office of the Auditor conducted its initial audit of the Program in 2005 and found that DOH lacked controls over the Program. This caused DOH to rely entirely on information provided by distributors and certified redemption centers, leaving the Program susceptible to fraud and abuse. Six subsequent audits issued between 2008 and 2018 found that the initial findings and recommendations made in 2005 had not been addressed and remained relevant. For instance, we have consistently reported that DOH's oversight relies on self-reported numbers from beverage distributors, who must report the number of containers sold and the deposits collected, and from redemption centers, which DOH reimburses based on their reporting of refunds paid to consumers who redeem their deposits. Earlier audits raised concerns that DOH did not verify those numbers, exposing the Program to possible fraud and abuse. And, in 2018, auditors identified two instances of actual fraud, which DOH reported to the Department of the Attorney General but did not otherwise address through internal controls or other changes to its operations.

Instead of continuing to report the same unaddressed findings, we took a new approach in 2021, examining *why* DOH failed to take meaningful action to address these chronic issues. In that 2021 follow-up effort, DOH attributed its inaction to understaffing; however, we also noted a belief among DOH management that the department should not be responsible for administering the Program, despite being statutorily required to do so. This belief meant that the Program was not a priority for DOH and may be the simple reason that DOH had not taken any significant steps to shore up its Program. In addition, we provided recommendations that placed the burden of work on the distributors, redemption centers or third-parties that would not be impacted by staff vacancies, which frankly exist throughout the State, to address the purported basis for DOH's inaction.

Report No. 21-13, *Financial and Program Audit of the Deposit Beverage Container Program*, contained recommendations similar to those in the seven prior financial and program audits. It also included recommendations directed to DOH management to establish Program objectives, internal controls, and policies and procedures as well as an action plan for implementation of other recommendations. DOH management is ultimately responsible for the Program and is accountable for the Program, including ensuring that the Program meets its statutory objectives.

In 2023, we again switched our approach for the management audit of the Program, acknowledging that, based on its representations, DOH was in the process of implementing changes to address the audit recommendations in Report No. 21-13, *Financial and Program*

Audit of the Department of Health's Deposit Beverage Container Program, and the requirements of Section 342G-121.5, HRS. We did not believe an assessment as to the status of DOH's implementation of recommendations would be meaningful based on when DOH claimed to have started addressing the recommendations. Instead, we summarized the actions DOH reported it had completed or intended to undertake. We did not audit the Program or otherwise assess the implemented or proposed controls.

What we found in 2024

In 2024, we followed-up on DOH's implementation of the recommendations made in Report No. 21-13, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program*, which included examining relevant documents and records, interviewing Program personnel, and evaluating whether DOH's actions addressed the recommendations.

We found DOH has not implemented any of the eight recommendations; the department disagreed with one recommendation and did not intend to implement that recommendation; the other seven recommendations were not implemented.

We further note that the Legislature mandated DOH to implement the recommendations made in Report No. 21-13 by codifying those recommendations in Section 342G-121.5, HRS. DOH is not in compliance with that legal mandate.

Mandate

Section 342G-107, HRS, requires the Auditor to conduct a management and financial audit of the Program in even-numbered fiscal years, after the initial audit for the fiscal year ended June 30, 2005. This is the Auditor's tenth review of the Program.

Audit Objective

1. To assess the status as reported by DOH of its implementation of the recommendations included in Report No. 21-13, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program*, and DOH's compliance with Section 342G-121.5, HRS.

Definition of Terms

WE DEEM recommendations:

Implemented

where the department or agency provided sufficient and appropriate evidence to support all elements of the recommendation;

Partially Implemented

where some evidence was provided but not all elements of the recommendation were addressed;

Not Implemented

where evidence did not support meaningful movement towards implementation, and/or where no evidence was provided;

Not Implemented - N/A

where circumstances changed to make a recommendation not applicable; and

Not Implemented - Disagree

where the department or agency disagreed with the recommendation, did not intend to implement, and no further action will be reported.

Audit Scope and Methodology

We obtained from DOH the status of its implementation of the recommendations included in Report No. 21-13, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program*. Where DOH self-reported the recommendations as fully or partially implemented, we performed procedures to evaluate the design and operation of implemented controls. Where DOH self-reported the recommendations as not being implemented, we reported that DOH has not implemented the recommendation; we did not perform any further work to determine the reason or reasons that the recommendation was not implemented.

Procedures that we performed in evaluating controls that DOH described it had implemented included the following:

- Interviewed Program personnel, including the OSWM Solid Waste Management Coordinator and the former OSWM Solid Waste Management Coordinator; and
- Reviewed documents and specified information related to the controls.

We did not audit the Program's operations, including the new controls implemented by DOH.

2024 Implementation Status

Recommendation 1

DOH management should establish clear measurable objectives for the Program. Those objectives should state what is to be achieved by Program management and set timelines for completion. The objectives should include a detailed action plan as well as policies and procedures to address the audit findings reported in prior audit reports. DOH management should update and revise the objectives as appropriate.

DOH Self-Reported Status

In February 2025, DOH self-reported that this recommendation was partially implemented based on the July 2023 Deposit Beverage Container Program Audit Implementation Workplan that it had developed. DOH believes this recommendation is partially implemented as many of the actions in the workplan are ongoing.

What we found

Not Implemented

The July 2023 Deposit Beverage Container Program Audit Implementation Workplan consists of 11 pages and is structured in a table format with four columns: Audit Recommendation & Activities; Timeframe for Accomplishment; Results of Activities; and Anticipated Outcomes. The Workplan contains extraneous information like a restatement of the recommendations from Report No. 21-13, background information, and old recommendations from the 2014 and 2018 Program Audits, which DOH deemed not applicable. Almost every recommendation from Report No. 21-13 has only one or two action steps that are broad and often restate the recommendation itself. For instance, an action step for one recommendation is to "implement HRS §342G-121.5," with the anticipated outcome of ensuring "that self-reported distributor reports are reasonably accurate and reduce the potential for fraud," a goal repeated for three other action steps. Most timeframes for accomplishment are either unmet or labeled as "ongoing."

Moreover, the Workplan fails to address Recommendation 1, which specifically recommended that DOH establish clearly measurable objectives, including timelines for when program staff should achieve the goals, and a detailed action plan that includes policies and procedures to meet them. The vague reference to "implement HRS §342G-121.5" is also misleading, as it suggests that DOH is taking action when it is not. Consequently, we consider this recommendation as not implemented.

Recommendation 2

Establish internal controls, including policies and procedures, to ensure that Program management is addressing the issues reported in prior audit reports and managing the Program appropriately. Those internal controls should be designed to provide DOH management with reasonable assurance that the Program is achieving its statutory purpose and administered effectively and efficiently as well as meeting any objectives established by DOH management.

DOH Self-Reported Status

In February 2025, DOH self-reported that this recommendation was partially implemented. In the July 2023 Deposit Beverage Container Program Audit Implementation Workplan, DOH management identified the following internal controls that would "increase accountability among Program staff and OSWM supervisor to ensure that the Program is being managed appropriately and efficiently":

- All Deposit Beverage Container Program staff shall undergo annual performance evaluations, in accordance with collective bargaining agreements, to ensure that the Deposit Beverage Container Program is effectively administered.
- The OSWM Solid Waste Management Coordinator, while excluded from collective bargaining, shall also be evaluated annually to ensure that the Deposit Beverage Container Program is effectively administered.

The July 2023 Deposit Beverage Container Program Audit Implementation Workplan states that these controls were "ongoing."

What we found

Not Implemented

The Anticipated Outcome for this recommendation was to "increase accountability among DBC Program staff and the OSWM supervisor to ensure that the DBC Program is being managed appropriately and efficiently." Evaluations, however, do not inherently address a lack of operational processes and internal controls. Evaluations are meaningless without first establishing effective policies and procedures that direct staff and against which performance can be measured. Therefore, until DOH establishes procedures for staff to follow to address the issues that we have repeatedly reported or other controls like a risk-based audit process to validate distributor and redemption center information, Recommendation 2 is not implemented.

Recommendation 3

Develop an action plan that includes:
1) risk-based process to select distributors and certified redemption center reports submitted to the Program to audit on a periodic basis;
2) a requirement for distributors to periodically submit records that support the information contained in the Monthly Distribution Report Form; and 3) develop policies and procedures to direct and guide staff to consider and initiate administrative enforcement actions, as appropriate.

DOH Self-Reported Status

Not Implemented

In February 2025, DOH self-reported that this recommendation was not implemented. In 2022, the Legislature codified this recommendation as Sections 42G-121.5(a)(1), -121.5(a)(2), and -121.5(b), HRS, *requiring* the department to develop a risk-based approach to select distributors and redemption center reports to periodically audit. DOH is not in compliance with those statutory requirements.

Recommendation 4

Program management should require certain distributors to develop and submit to the Program for approval an internal control process to provide reasonable assurance that the information self-reported on the Monthly Distribution Report Form is accurate and that the distributor maintains sufficient and appropriate records to support the reported information. Program management should amend the Program's administrative rules, if necessary.

DOH Self-Reported Status

Not Implemented

In February 2025, DOH self-reported that this recommendation was not implemented. In 2022, the Legislature codified this recommendation as Section 42G-121.5(c)(1), HRS, *requiring* all distributors "to develop and submit to [the Program] for approval an internal control process to ensure that the monthly or semi-annual distribution report forms contain accurate data and that adequate records are maintained." DOH is not enforcing the requirement on distributors.

Recommendation 5

Program management should develop policies and procedures to direct and guide staff in their respective Program responsibilities. The policies and procedures should be documented and updated, as necessary.

DOH Self-Reported Status

In February 2025, DOH self-reported that this recommendation was partially implemented. The July 2023 Deposit Beverage Container Program Audit Implementation Workplan includes action plans to address this recommendation: 1) update the Deposit Beverage Container Program's 2013 Inspection Manual, and 2) update the Deposit Beverage Container Program's 2017 Accounting Manual. The Inspection Manual, now referred to as the Operations Manual, and the Accounting Manual are still in draft form as of the date of this report.

What we found

Not Implemented

The Auditor included this recommendation to develop or update policies and procedures in Report No. 21-13. After more than four years, DOH has yet to develop the necessary policies and procedures even after the Auditor identified actual issues with respect to both the deposits from distributors and reimbursements to redemption centers. DOH acknowledged that the "draft" policies and procedures do not include any of the actions steps mentioned in the July 2023 Deposit Beverage Container Program Audit Implementation Workplan, whether implemented or not. We deem this recommendation as not implemented.

Recommendation 6

Program management should retain the services of a third party to administer the Program, as authorized under 342G-106, HRS, if the Program does not have sufficient staff or expertise to actively oversee its activities and implement the audit recommendations.

DOH Self-Reported Status

Not Implemented - Disagree

DOH decided against hiring a third party to administer the Program as recommended. The July 2023 Deposit Beverage Container Program Audit Implementation Workplan states that addressing staffing needs is "paramount to DBC Program improvement" and believes the "current OSWM team is knowledgeable, skilled, and dedicated to improving the performance of the DBC Program."

We are compelled to note that the Program has repeatedly represented its intention to address the multitude of issues that we have reported and to implement the audit recommendations. The Program has had multiple OSWM Solid Waste Management Coordinators, but the problems remain unresolved. There has been no meaningful progress in fixing the Program, meaning that the Program continues to rely on self-reports by both distributors and redemption centers, continuing to expose the Program to fraud. Section 342G-106, HRS, allows the use of the special fund to retain a third party to administer the Program. Until the Program can develop meaningful controls and hire and train the necessary staff, we continue to recommend that management should retain a third party to administer the Program to ensure that amounts deposited by distributors and requested to be reimbursed by redemption centers are appropriate.

Recommendation 7

For each redemption center, Program management should annually reconcile the weight of the materials redeemed (for which the Program reimbursed the container deposit and paid the handling fee) with the weight ticket or tickets for each material generated by the certified recycling facility.

DOH Self-Reported Status

In February 2025, DOH self-reported that this recommendation was implemented based on the redemption center "close-out" reconciliation activities being performed, which according to the July 2023 Deposit Beverage Container Program Audit Implementation Workplan, consist of 1) Reconciliation of all Deposit Refund Request Forms with Handling Fee Request Forms and 2) Redemption center material inspections. DOH's objective, or "anticipated outcome" as described in the Workplan, is to "ensure that self-reported DR-1s are reasonably accurate and reduce the potential for fraud."

What we found

Not Implemented

Redemption centers facilitate the redemption of recyclable materials from consumers by paying the consumer for the materials redeemed. The Program then reimburses redemption centers for those redeemed deposit fees. Redemption centers are required to complete and file the Deposit Refund Request Form (DR-1) which includes the number or weight of deposit beverage containers of each material type accepted and the number of deposits paid to consumers by material type.

Redemption centers are required to file the Handling Fee Request Form (HR-1) which includes the weights shipped off-island to end-user recycling facilities. The Program pays redemption centers 50 percent of the handling fees claimed at the time of the initial request. The remaining balance is paid upon receipt of corroborating weight reports obtained from end-user recycling facilities and those weights being within the allowable shrinkage (amount shipped vs the amount reaching the end-user facility) threshold. DOH recalculates the shrinkage to check that it is within the 2.5% shrinkage threshold.

We interviewed the OSWM Solid Waste Management Coordinator, the former OSWM Solid Waste Management Coordinator, and Program Accountant to obtain an understanding of the redemption center "close-out" reconciliation activities. DOH calculates a "close-out" shrinkage threshold that, if exceeded, could be recovered from the redemption center's handling fee reimbursements withheld by the Program. The following describes the "close-out" reconciliation activities in more detail.

On a quarterly basis, a Program Inspector performs a material inspection for each redemption center (by main location). During the material inspection, the total weight of materials is recorded by material type. The Program Inspector enters the weight data into the "Hawaii DBC Material Inspection Form," which is then provided to the Program Accountant.

The Program Accountant inputs the information on the inspection form into the Summary Close-Out spreadsheet along with DR-1 and HR-1 quarterly information to calculate "close-out" shrinkage. OSWM Solid Waste Management Coordinator and Program Accountant indicated that "close-out" shrinkage is calculated as follows (weight in pounds):

"Close-Out" Shrinkage = (DR-1 Total Weight minus HR-1 Total Weight minus Inspection Weight) divided by DR-1 Total Weight

The "close-out" shrinkage threshold is set at 2.5%. The Program Accountant compares the calculated "close-out" shrinkage to the "close-out" shrinkage threshold. If it is within the "close-out" shrinkage threshold, DOH pays the full HR-1 fee to the redemption center. If it exceeds the threshold without appropriate justification, amounts exceeding the "close-out" shrinkage threshold reduces the HR-1 fees paid to the redemption center.

A Summary Close-Out spreadsheet is prepared by the Program Accountant for each redemption company quarterly and includes all locations that the redemption center operates. We compiled and performed limited testing on all 2023 Summary Close-Out spreadsheets. Based on the procedures we performed, we noted the following:

"Close-out" reconciliation activities provide invalid results

During 2023, the "close-out" shrinkage calculations were consistently negative for almost all redemption center operators. Shrinkage thresholds are used by the Program to provide redemption centers with an allowance for the evaporation of liquid in the redeemed beverage containers during the process of processing recycled materials and shipping them to recyclers. Negative shrinkage occurs when the weights recorded on HR-1 forms and inspection reports exceed those recorded on the corresponding DR-1 forms. This means that somehow the recycled material weights increased after being collected by the redemption center. When we inquired with OSWM Solid Waste Management Coordinator and Program Accountant, they were unable to provide a reasonable explanation for the frequency and persistence of the negative shrinkage. The only plausible reasons we could identify for negative shrinkage that the "close-out" shrinkage formula is flawed or that the "close-out" reconciliation activities cannot accurately track the beverage containers reported in the DR-1s to the containers reported in the respective HR-1s.

Lack of controls over the "close-out" reconciliation activities

Management does not perform a review of the Summary Close-Out spreadsheets. We also noted that the related calculations of the "close-out" shrinkage was not clearly documented and there was extensive extraneous information in the spreadsheets. The frequency of invalid results noted above should be an indication to DOH management that the "close-out" reconciliation activities is ineffective, however the lack of monitoring allows this to persist.

High rate of material inspections not being performed

Material inspections were not performed for 18 out of 67 Summary Close-Out spreadsheets. This means that over 25 percent of the Summary Close-Out spreadsheets are meaningless.

Our observations and procedures indicate that the "close-out" reconciliation activities are not only a waste of Program resources but may also provide DOH management with a false sense of security regarding the accuracy of redemption center information. The spreadsheets used in these activities are meaningless and potentially harmful. Consequently, the "close-out" reconciliation activities, which were developed by DOH to ensure the DR-1s are reasonably accurate, are ineffective. Therefore, we have deemed this recommendation as not implemented.

Recommendation 8

Program management should develop an electronic reporting system that requires distributors and redemption centers to input information directly into a centralized database. In addition to eliminating handwritten logs and other manual, duplicative processes, an electronic reporting system may allow the Program to automate certain processes.

DOH Self-Reported Status

Not Implemented

In February 2025, DOH self-reported that this recommendation was not implemented.

Chapter 3
Financial Statement Audit

A Hawaii Limited Liability Partnership

Independent Auditor's Report

To the Auditor
State of Hawai‘i

Opinion

We have audited the financial statements of the State of Hawai‘i, Deposit Beverage Container Special Fund (the Fund), which comprise the balance sheet – governmental fund as of June 30, 2024, and the related statements of revenues, expenditures, and change in fund balance – governmental fund and budgetary comparison for the fiscal year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2024, and the change in its financial position and the budgetary comparison thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States (*Government Auditing Standards)*. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note A, the financial statements of the Fund, are intended to present the financial position and the changes in financial position of only that portion of the governmental fund type of the State of Hawai‘i or the State of Hawai‘i, Department of Health that are attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the respective financial position of the State of Hawai‘i or the State of Hawai‘i, Department of Health as of June 30, 2024, and the changes in its financial position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

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Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Fund's ability to continue as a going concern for 12 months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Fund's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements are not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 30, 2025 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

KMH LLP

KMH LLP

Honolulu, Hawai'i
April 30, 2025

Department of Health
State of Hawai`i
Deposit Beverage Container Deposit Special Fund
Balance Sheet - Governmental Fund
June 30, 2024

Assets

Equity in Cash and Cash Equivalents and Investments in State Treasury	$ 76,328,171
Accounts Receivable, Net of Allowance for Doubtful Accounts of $2,024,723	9,236,877
Accrued Interest Receivable	226,842
Total assets	$ 85,791,890

Liabilities and Fund Balance

Liabilities:	
Vouchers and contracts payable	$ 4,372,821
Accrued wages and employee benefits payable	124,548
Beverage container deposits	3,434,351
Total liabilities	7,931,720
Fund Balance--	
Committed to Deposit Beverage Container Program	77,860,170
Total liabilities and fund balance	$ 85,791,890

See accompanying notes to the financial statements.

Department of Health
State of Hawai`i
Deposit Beverage Container Deposit Special Fund
Statement of Revenues, Expenditures and
Change in Fund Balance - Governmental Fund
For the Fiscal Year Ended June 30, 2024

Revenues:	
Deposit beverage container fees	$ 10,373,156
Unredeemed deposits	20,811,105
Investment income	2,379,016
Nonimposed employee fringe benefits	7,390
Total revenues	33,570,667
Expenditures:	
Handling and redemption fees	21,007,141
Operating expenditures	1,998,013
Administrative expenditures	28,587
Total expenditures	23,033,741
Change in fund balance	10,536,926
Fund Balance at July 1, 2023	67,323,244
Fund Balance at June 30, 2024	$ 77,860,170

See accompanying notes to the financial statements.

Department of Health
State of Hawai`i
Deposit Beverage Container Deposit Special Fund
Budgetary Comparison Statement
For the Fiscal Year Ended June 30, 2024

	Budgeted Amounts			
	Original	Final	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Revenues--				
Deposit Beverage Container Deposit	$ 71,219,367	$ 71,219,367	$ 60,582,577	$ (10,636,790)
Expenditures--				
Environmental Health Administration	71,219,367	71,219,367	63,439,680	7,779,687
Deficiency of revenues under expenditures	$ -	$ -	$ (2,857,103)	$ (2,857,103)

See accompanying notes to the financial statements.

Department of Health
State of Hawaiʻi
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

In 2002, the State of Hawaiʻi Legislature passed Act 176 to establish the Deposit Beverage Container Deposit Program and the Deposit Beverage Container Deposit Special Fund (DBC Fund). The purpose of Act 176 was to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter.

Pursuant to Section 342G, Part VIII of the Hawaiʻi Revised Statutes (HRS), the DBC Fund was initiated on July 1, 2005, to implement a Deposit Beverage Container Program, establish minimum standards for the collection of empty beverage containers, to foster systems of redemption which facilitate recycling of empty beverage containers, and to minimize costs without inconveniencing customers. Under the DBC Fund, the State of Hawaiʻi (the State) collects from manufacturers and distributors, a $0.05 per container refundable deposit on eligible beverage containers manufactured in or imported to the State that are expected to be sold in the State. The deposits are used to reimburse redemption centers. In addition, the DBC Fund assessed a per container handling fee of $0.015 per container until August 31, 2015. Effective September 1, 2015, the handling fee was lowered to $0.01 per container.

The DBC Fund is administered by employees of the Solid Waste Branch, Environmental Management Division of the State of Hawaiʻi, Department of Health (the Department).

The accompanying financial statements are intended to present the financial position and the changes in financial position of only that portion of the governmental fund type of the State and the Department that are attributable to the transactions of the DBC Fund. They do not purport to, and do not, present fairly the financial position of the State or the Department as of June 30, 2024, and the changes in its financial position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

1. Basis of Presentation

The financial statements of the DBC Fund are reported using the current financial resources measurement focus and modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the DBC Fund considers revenues to be available if they are collected within 60 days after the end of the current fiscal year. Revenues susceptible to accrual include a container fee of $0.01 per beverage container sold. In addition, the amounts for deposits of $0.05 are deferred when collected, and the amount estimated to be forfeited is recognized as unredeemed deposits revenue at the end of the fiscal year.

Department of Health
State of Hawai'i
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Expenditures are generally recorded when a liability is incurred; however, expenditures related to compensated absences are recorded only when payment is due.

Encumbrances are recorded for obligations in the form of purchase orders or contracts at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at fiscal year-end are reported as reservations of fund balance since they do not constitute expenditures or liabilities.

Had the financial statements been presented on the full accrual basis of accounting, additional adjustments would need to be recorded. These adjustments are recorded on a department-wide level for all governmental activities of the Department. The DBC Fund's portion of these department-wide accruals includes adjustments for capital assets and accrued vacation. At June 30, 2024, the DBC Fund's portion of these accruals was as follows:

Total fund balance on the modified-accrual basis of accounting	$ 77,860,170
Capital assets used in governmental activities are not financial resources and therefore are not reported as an asset in the governmental funds	1,746
Compensated absences reported in the statement of net position do not require the use of current financial resources and are not reported as liabilities in the governmental funds	(101,944)
Total net assets on the full accrual basis of accounting	$ 77,759,972

At June 30, 2024, the DBC Fund's portion of the department-wide activities is not materially different from the DBC Fund's activity.

Department of Health
State of Hawai‘i
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

2. Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. A significant item subject to such estimates and assumptions is unredeemed deposits. Actual results could differ from those estimates.

3. Governmental Funds - Fund Balance

The DBC Fund accounts for governmental fund balances in accordance with Governmental Accounting Standards Board (GASB) Statement No. 54 (GASBS 54), *Fund Balance* Reporting *and Governmental Fund Type Definitions*. GASBS 54’s hierarchical fund balance classification structure is based primarily on the extent to which a government is bound to follow constraints on how resources can be spent. Classifications include:

- *Nonspendable fund balance* - amounts that are not in spendable form (such as inventory) or are required to be maintained intact;

- *Restricted* - amounts constrained to specific purposes by their providers (such as creditors, grantors or other governments) through constitutional provisions, or by enabling legislation;

- *Committed* - amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest level of action to remove or change the constraint;

- *Assigned* - amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the government delegates the authority; and

- *Unassigned* - amounts that are available for any purpose; positive amounts are reported only in the general fund.

Department of Health
State of Hawai'i
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

When both restricted and unrestricted balances are available for use, it is the DBC Fund's policy to use restricted fund balance first, then unrestricted fund balance. Furthermore, committed fund balances are reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of those unrestricted classifications can be used.

4. Equity in Cash and Cash Equivalents and Investments in State Treasury

All monies of the DBC Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2024, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available for the DBC Fund since such information is determined on a statewide basis. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States of America. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

5. Accounts Receivable

Revenue is earned when it is considered measurable and available. The accounts receivable balance represents the expected receipts from distributors based on deliveries of the containers as of June 30, 2024, net of any allowance for uncollectible accounts. At June 30, 2024, allowance for uncollectible accounts amounted to $2,024,723.

6. Beverage Container Deposits and Container Fees

Deposits of $0.05 are made by distributors to the DBC Fund for each qualifying container sold. The DBC Fund maintains all deposits until the recycling centers claim reimbursement for the deposits that they pay out to the consumers. The DBC Fund maintains the deposits that are expected to be redeemed. In addition, deposits of $0.01 are made by the distributors to the DBC Fund for each qualifying container as a container fee.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Amounts paid out to the consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e. aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management adjusts the deposit liability balance and unredeemed deposit revenue recognized based on the amount of deposits refunded in the first three months of the subsequent fiscal year related to deposits collected prior to year end. Deposits not refunded within the first three months of the subsequent fiscal year are recognized as revenue for the previous year and recorded as unredeemed deposits in the accompanying statement of revenues, expenditures and change in fund balance.

7. Administrative Costs

The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the DBC Fund, since they are not practical to determine.

NOTE C - BUDGETING AND BUDGETARY CONTROL

The DBC Fund follows these procedures in establishing the budgetary data reflected in the basic financial statements:

The Budget

Not less than 20 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.

Legislative Review

The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs, and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances and will assist in determining the State's program and financial plan and budget.

Department of Health
State of Hawaiʻi
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

Program Execution

Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the Programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

A budget is adopted for the DBC Fund and is prepared on the cash basis of accounting, which is a basis of accounting other than U.S. GAAP.

The major differences between the budgetary and U.S. GAAP bases are that: (1) the budget is prepared on the cash basis of accounting; (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis; and (3) collections and payments of certain refundable deposits are not recognized as revenues and expenditures under U.S. GAAP.

Since budgetary basis differs from U.S. GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of excess of expenditures over revenues on a budgetary basis for 2024, to the change in fund balance presented in conformity with U.S. GAAP follows:

Deficiency of revenues under expenditures - actual on a budgetary basis	$ (2,857,103)
Current year's appropriations encumbered at June 30, 2024	31,695,416
Expenditures for liquidation of prior fiscal year encumbrances	(22,243,409)
Accruals and other adjustments	3,942,022
Change in fund balance - U.S. GAAP basis	$ 10,536,926

Department of Health
State of Hawaiʻi
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE D - BEVERAGE CONTAINER DEPOSITS

The changes to the beverage container deposits liability during fiscal year 2024 were as follows:

Balance as of July 1, 2023	$	2,572,405
Increase: Deposits Received from distributors		49,024,940
Decrease: Payments made to recycling centers, net of refunds		(27,351,889)
Decrease: Unredeemed deposits recognized as revenue		(20,811,105)
Balance as of June 30, 2024	$	3,434,351

NOTE E - EMPLOYEE BENEFIT PLANS

Substantially all eligible employees of the DBC Fund participate in the State's retirement and other post-employment benefit plans. The State's plans include the Employee's Retirement System (ERS) of the State, the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), a deferred compensation plan, and sick leave benefits. For information on the State's benefit plans, refer to the State of Hawaiʻi, ERS's, and EUTF's Annual Comprehensive Financial Reports (ACFR), or the audited financial statements of the Department. The State's ACFR can be found at the DAGS website: http://ags.hawaii.gov/reports/financial-reports/. The ERS ACFR can be found at the ERS website: http://ers.ehawaii.gov/resources/financials/. The EUTF ACFR can be found at the EUTF website: http://eutf.hawaii.gov/reports/. The actuarial valuations of the ERS and EUTF does not provide retirement and other post-employment benefit, respectively, information by department or agency. Accordingly, the State's policy on the accounting and reporting for retirement and OPEB is to allocate a portion of the State's Annual Required Contribution (ARC), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the stand-alone department financial statements or in the State's ACFR.

Department of Health
State of Hawai'i
Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements
June 30, 2024

NOTE F - COMMITMENTS AND CONTINGENCIES

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including those incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2024, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The DBC Fund did not have a portion of the State's workers' compensation expense for the fiscal year ended June 30, 2024.

KMHLLP

A Hawaii Limited Liability Partnership

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Independent Auditor's Report

To the Auditor
State of Hawai‘i

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States (*Government Auditing Standards)*, the financial statements of the State of Hawai‘i, Deposit Beverage Container Deposit Special Fund (the Fund), which comprise the balance sheet – governmental fund as of June 30, 2024, and the related statements of revenues, expenditures and change in fund balance – governmental fund, budgetary comparison for the fiscal year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 30, 2025.

Report on Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we considered to be a material weakness and a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiency described below to be a material weakness:

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Financial Statement Reporting – Vouchers Payable

In accordance with Governmental Accounting Standard Board (GASB) Statement No. 34, fund financial statements should be prepared using the current financial resources measurement focus and the modified accrual basis of accounting. Under this focus/basis expenditures should be recognized in the period in which the fund liability is incurred.

During our audit, it was determined that there were some vouchers payable that were not recorded, which resulted in net position fund balance being overstated. We proposed and management accepted an adjustment of approximately $733,000 to increase vouchers payable and expenditures. The adjustment was recorded in the Fund's financial statements as of June 30, 2024.

Expenditures that were incurred but not paid by year-end are accrued. Management is responsible for reviewing accruals to ensure they are complete and accurate. The error noted above was detected during the audit when unusual variances were noted for expenditures. Management was not diligent in identifying outstanding accruals. The lack of diligence in review increases the risk of material misstatements as demonstrated by the results of this year's audit.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency below to be a significant deficiency:

Reliance on Third Party Certifications

The Deposit Beverage Container Program (Program) receives beverage container deposits and container fees from distributors and refunds deposits and pays handling fees to redemption centers based on certified information. Consistent with prior years, the Program relies on certifications from distributors to support deposits and container fees received. The Program also relies on certifications from redemption centers to support deposit refunds and handling fees paid. Overreliance on the self-reporting by distributors and redemption centers may result in underpayments on deposits and the related container fees received by the Department to administer the program, overpayments of deposit refunds and handling fees to redemption centers, and an overstated redemption rate. An overstated redemption rate could result in a misstatement in the Department's financial statements, as well as higher container fees for consumers to support the program.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Fund Management's Response to Findings

The Fund management's responses to the findings identified in our audit are described in the attached response. The Fund management's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KMH LLP

KMH LLP

Honolulu, Hawai'i
April 30, 2025

KMHLLP

A Hawaii Limited Liability Partnership

May 7, 2025

Mr. Leslie Kondo
State Auditor
Office of the Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

RE: Comments on the Department of Health's Response to the Audit Findings

Dear Mr. Kondo:

We provided a draft of this report to the Department of Health (DOH) and met via video conference with the Deputy Director of Environmental Health Administration, Chief of Environmental Health Administration, Acting Chief of Solid and Hazardous Waste Branch, Solid Waste Management Coordinator, Program Accountant and Chief of Administrative Services Office to discuss our audit findings. DOH provided its written response to the draft report, which is included in the report in its entirety as Attachment 1.

During the meeting, DOH management expressed an interest in the management audit and improvement of the Program, which differed from previous Program audits. While we acknowledge the change in sentiment towards the Program, we do not believe significant revisions to the draft report are necessary.

In its response, DOH requested that we clarify that it was the previous management, not the current group, who had expressed that "the department should not be responsible for managing the Program." We informed DOH that this statement was included in the Review of Prior Audits section, indicating that these comments were made in the past. However, we agreed to make a minor wording change to the draft report.

In its response to Recommendations 3 and 8, DOH acknowledged their initial self-reported status of "not implemented," but upon further consideration, DOH now believes that the status should be self-reported as "partially implemented." In our view, DOH had sufficient time to consider the self-reported implementation status or contact us to make changes to their representations. While they may have revised their position in retrospect, our analysis was conducted based on the information they provided to us during the audit. We look forward to auditing their updated status in the next Program audit.

In its response, DOH disagreed with our assessment of Recommendation 7 as "not implemented" but did not provide any compelling evidence to warrant a change in our assessment. We had difficulty comprehending this part of their response. In the report, we concluded that Recommendation 7 was "not implemented" due to the invalid results from the "close-out" reconciliation activities. From what we can understand, DOH provides the following reasons for the negative shrinkage:

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1. Estimated weights of material in close-out inspection process
2. Condensation or introduction of rainwater
3. Accuracy of segregation rates

Estimated weights during the inspection process can lead to variations; however, these estimates are taken at a specific point in time and will eventually be weighed in later shipments. If close-out inspection estimates are consistently performed and adjusted in subsequent measurement periods, then DOH should not experience persistent negative shrinkage. Therefore, DOH should investigate further to ensure that estimated weights are being consistently applied and adjusted in subsequent measurements.

Condensation and the introduction of rainwater could explain negative shrinkage or the increase in recycled material weights. However, the close-out calculations observed do not support this explanation as plausible or reasonable. In the close-out calculations provided to us, negative shrinkage was mostly in the tens of thousands of pounds. Considering that recycled materials are compressed after processing to save storage space (refer to the picture at the beginning of this report), it is unlikely that condensation or the introduction of rainwater would add thousands of gallons of water (approximate conversion of ten thousand pounds of water) to the recycled material.

While segregated rates may affect the accuracy of the close-out calculation, DOH does not provide sufficient evidence to support that this explanation is plausible. Although segregated rates could influence the close-out calculation, the impact is limited to recycled materials being counted per container rather than by weight. Our understanding and experience with the Program indicate that most recycled containers are redeemed by weight. Without a detailed analysis, there is insufficient evidence to consider this explanation plausible.

Based on our discussion above, the “close-out” reconciliation activities are not effective. Even DOH admits that “close-out inspections would need to occur more frequently than [P]rogram resources allow to accurately track containers.” Therefore, we determined that no change to our assessment of the status of Recommendation 7 is required.

In its response to Recommendations 1, 2 and 5, DOH disagreed with our evaluation of the implementation status throughout the report and identified several actions or ideas that they believe deserve more “credit.” We agree that status can be left up to interpretation, however our objective was to identify meaningful solutions to address the risk of over-reliance on self-reported data. Existing policies, procedures, and ideas will not move the meter to meet the objective of making meaningful changes. Therefore, we did not change our assessment of the implementation status of Recommendations 1, 2 and 5.

We appreciate the cooperation and assistance extended by DOH management.

KMH LLP

KMH LLP
Honolulu, Hawaii

JOSH GREEN, M.D.
GOVERNOR OF HAWAIʻI
KE KIAʻĀINA O KA MOKUʻĀINA ʻO HAWAIʻI

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In reply, please refer to:
File:

April 30, 2025

Mr. Leslie Kondo
State Auditor
Office of the Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Mr. Kondo:

Thank you for the opportunity to review and provide comment on the *DRAFT Financial and Program Audit of the Department of Health's [DOH's], Deposit Beverage Container [DBC] Program, June 30, 2024*.

The DOH recognizes the need to address existing challenges within the DBC Program and acknowledges the audit report's identification of these issues and recommended solutions. However, the DOH respectfully takes issue with the assertion that there is a "…belief among DOH management that the department should not be responsible for managing the Program, despite being statutorily required to do so." To the contrary, current DOH management fully supports the DBC Program and is committed to its improvement.

Furthermore, while we acknowledge prior recommendations, the DOH also respectfully disagrees with the conclusion that "no progress" has been made in their implementation, including those codified by the Legislature in Section 342G-121.5 of the Hawaii Revised Statutes. Detailed comments on specific recommendations are provided in the enclosure for your consideration.

Thank you for your review of the DBC program and for providing us with the opportunity to comment on the draft audit report.

Sincerely,

Kenneth Fink

KENNETH S. FINK, MD, MGA, MPH
Director of Health

Enclosure

Enclosure
DOH Responses to the DRAFT Financial and Program Audit of the
DOH's Deposit Beverage Container Program, dated April 2025, received on April 14, 2025
April 30, 2025 Letter to Mr. Leslie Kondo, State Auditor
Page 1 of 5

General
We disagree that the Department of Health (DOH) "has made no progress on implementing the prior recommendations, including those codified by the Legislature codified in Section 342G-121.5, HRS [Hawaii Revised Statutes]." Discussion on these specific items is provided under each "auditor recommendation" below.

DOH Management (PDF Page 6)
The DOH takes issue with the assertion that there is a "…belief among DOH management that the department should not be responsible for managing the Program, despite being statutorily required to do so." The current DOH management fully supports the Deposit Beverage Container (DBC) Program and the program's efforts to improve it. For example, the DOH recognizes the need to provide the Office of Solid Waste Management (OSWM) the ability to provide greater focus on existing recycling programs, like the Deposit Beverage Container program. Thus, we have initiated a reorganization of the Solid and Hazardous Waste Branch so that newly created sections may relieve the OSWM of other responsibilities, such as statewide solid waste planning and enforcement, and OSWM can place greater focus on existing statewide recycling programs, such as the DBC Program. The DOH requests the insertion of the year of the applicable management team for the phrase to read: "…belief among 2020 DOH management that…"

Personnel
Regarding personnel we note that the program currently has the following vacant positions: Recycling Coordinator, Engineer, Planner, Environmental Health Specialist and Account Clerk. Efforts to fill these positions are ongoing. Over the period of FY23 and FY24, the OSWM lost three staff, while onboarding four staff. Staff turnover is expected due to retirements, promotions, and relocations, but recruitment, hiring, and onboarding takes time, and often slows progress. Nonetheless, progress is being made as noted below.

Recommendations (PDF Page 7)
We further disagree with or acknowledge six of the "Not Implemented" determinations despite the DOH giving evidence of taking action. We present the following information in support of requests to amend the "Not Implemented" status/determinations for Recommendations 1, 2, 3, 5, 7, and 8.

Recommendation 1, Implementation Workplan (PDF Pages 9-10)
The DOH disagrees with the "Not Implemented" determination and considers this recommendation "Partially Implemented" as originally self-reported.

The DOH prepared and submitted to the Auditor a Deposit Beverage Container Program Audit Implementation Workplan, dated July 2023. The workplan addresses Recommendations 1 through 7 of the 2020 Audit and lists specific action items with their associated time frame and anticipated outcomes. In the case of the example presented in the draft audit report regarding "implement §342G-121.5," detail was provided in the workplan that stated that administrative rules and procedures to implement will be developed. The DOH had solicited and contracted a consultant to facilitate a working group and assist in the development of proposed administrative rules, for which meetings were scheduled to occur in 2024. However, after further evaluation of the statute, it was decided that implementation can occur directly from statute, expediting implementation. The DOH issued letters in February and April 2025 to distributors and expects to receive their Distributor Internal Control Process Document (ICPD) by June 30, 2025, and distributor independent audits for FY25 by September 30, 2025.

The DOH considers this recommendation partially implemented as it required updates.

Recommendation 2, Internal Controls (PDF Pages 10-11)
The DOH disagrees with the "Not Implemented" determination and considers this recommendation "Partially Implemented" as originally self-reported.

The draft audit recognizes that the DOH is utilizing annual employee performance appraisal system evaluations to increase accountability, however, states, "[e]valuations are meaningless without first establishing effective policies and procedures that direct staff and against which performance can be measured." The DOH utilizes an Accounting Manual and an Operations Manual that defines our policies and procedures. Both documents are considered draft because the procedures for the close-out inspections and report, and distributor audits, which are the subject of Recommendations 3 and 7, still need improvement. We understand from our meeting with the Auditor and their consultants on April 23, 2025, that they do not consider the existence of the Accounting and Operations Manuals because they were labeled as "draft." We clarified that we only left the label "draft" because there were a handful of sections that were being revised and are otherwise implementing the manuals.

Recommendation 3, Plan for risk-based audits, distributor record submission, and enforcement (PDF Page 11)
The DOH acknowledges the original self-reported "Not Implemented" status and considers this recommendation "Partially Implemented."

1) The DOH conducted a pilot distributor audit in May 2024 that involved gathering documentation in support of the semi-annual distributor report. Accuracy issues were identified and rectified with the distributor making an adjustment payment. Based on lessons learned, the DOH is working on revising the procedures for this audit and will continue these distributor audits at least until a contractor is onboard, as described below. As discussed during our April 23, 2025, meeting, the risk-based process of selecting distributors and certified redemption centers is considered enforcement sensitive, thus we will not be providing detailed descriptions on this process. In general, the audits will be focused mainly on the largest distributors and redemption centers due to their higher volume and greater potential for loss. Distributors reporting and paying deposits and fees on a monthly basis will be randomly selected for audit. To ensure comprehensive coverage across all distributors and redemption centers, smaller distributors reporting and paying semi-annually will also be audited, though less frequently and on a random basis. The frequency of audits will likely vary according to

the number of records to be analyzed and any findings of errors or fraud that will need further investigation.

2) The DOH is currently developing a request for proposals to procure a variety of services, including audit services. Contractor led audits for both distributors and certified redemption centers will begin once audit services are secured. The DOH received Governor's approval to contract technical and/or professional services on April 14, 2025.

3) Enforcement action is an option that the DOH considers on a case-by-case basis. The Program's enforcement process is outlined in its Program Operations Manual, dated 2013, and is applicable for any enforcement case that may be developed, including those that may be derived from these audits. The policy guides the assessment and settlement of DBC enforcement cases. For example, in the second half of 2024, the program issued 28 warning letters and one Notice of Violation and Order (NOVO) to distributors for late or non-payment of deposits and fees. Most warning letters have resulted in a return to compliance and the NOVO resulted in a settlement agreement that required payment of delinquent deposits and fees in addition to a $25,000.00 administrative penalty.

Recommendation 4, Distributor Internal Control Process (PDF Page 12)
The DOH concurs with the original self-reported "Not Implemented" status because actions for this recommendation began in FY25.

The Distributor ICPD requirement is being implemented along with the distributor audits as required by §342G-121.5, HRS. Notifications have been issued to all distributors to submit ICPDs by June 30, 2025, and independent audits due by September 30, 2025. The audits will assess how effectively distributors apply their internal control process in determining eligible deposit beverage containers and the accuracy of subsequent reporting and payment of deposits and fees.

Recommendation 5, Policies and Procedures (PDF pages 12-13)
The DOH disagrees with the "Not Implemented" determination and considers this recommendation "Partially Implemented" as originally self-reported.

The Operations Manual and Accounting Manual have undergone revisions and remain in draft status; however, they are still being utilized in program operations. Both documents are usable as references for existing staff as well for new staff trainings. As discussed under Recommendation 2, the Accounting Manual remained in draft status pending write-up of procedures that are the subject of Recommendation 3. Both documents will be updated to include policies and procedures which were already being implemented. Based on our meeting on April 23, 2025, we understand that the Auditor and their consultants do not consider draft documents as implementable, thus, did not recognize that we are implementing the draft manuals. We will take this understanding under advisement and will consider finalizing the document prior to having all components fully developed and tested and managed these as "updates."

Recommendation 6, Third party administration of DBC Program (PDF Pages 13-14)
The DOH concurs with the "Not Implemented – Disagree" determination.

The Program notes that discussions were previously held with a third-party regarding the administration the DBC program. However, it was determined to be too expensive and not sustainably and financially feasible. Therefore, we are unable to implement the recommendation and must disagree to implement.

Recommendation 7, Close-out reconciliation (PDF Pages 14-16)
The DOH disagrees with the "Not Implemented" determination and considers this "Partially Implemented" as opposed to the self-reported implemented status.

1) Redemption center claims require third-party supporting documentation in the form of shipper's bills of lading and receiving reports from end users. The documentation needs to confirm that type and weight of material being claimed. This is an ongoing activity.

2) Close-out inspections were instituted to extend the tracking of DBC material to redemption center facilities prior to shipment. During the inspections, DBC material onsite is observed and quantified by estimation (e.g., number of baled aluminum DBC). The estimated weight of material makes it difficult-to-impossible to corroborate accurately with the weights reported on the bills of lading, hence the auditor's determination of invalid data.

   The draft auditor's report also states that the only plausible reasons for the frequency and persistence of negative shrinkage is that the "close-out" shrinkage formula is flawed or that the "close-out" reconciliation activities cannot accurately track the beverage containers. Another contributing factor may result from the partial accounting of containers destined for a specific shipping container. Because close-out inspections are a point-in-time assessment, they might not capture the total number of deposit beverage containers required to fill a single shipping container. If this is the case, close-out inspections would need to occur more frequently than program resources allow to accurately track containers. As mentioned in the draft auditor's report, shrinkage thresholds are used as an allowance for evaporation of liquid in the redeemed beverage containers. With that understanding, one plausible explanation for negative shrinkage would be the opposite of evaporation, or condensation or the introduction of rainwater. Another could be the accuracy of the segregated rates.

   Close-out inspections were initiated to ensure prompt shipment of DBC material by redemption centers and to not hold material for extended periods, as recyclers could try to hold out for better market value of their commodity. The Program will continue to do close-out inspections and close-out reporting, unless the program can develop better means of verifying the accuracy of Deposit Refund Request Forms (DR-1s). However, we know an exact match will never occur, as there are a number of factors in play. For example, in addition to the shrinkage rate, the conversion between number count to weight will never be consistent. The calculation of a segregated rate is based on "representative" samples; however, consumers have their preferences and preferences change, products change, and manufacturers are continuously changing their containers. While the DOH intends to update the segregated rate within the next year, it will remain a snapshot in time. There has been a claim from a recycler that glass weights increased by about 25%. Thus, the effect of changing segregated rates could be a factor, and not necessarily the close-out process.

Recommendation 8, Electronic reporting system for distributor and redemption centers (PDF Page 16)
The DOH acknowledges the original self-reported "Not Implemented" status and considers this recommendation "Partially Implemented."

The development of the DBC Program data management system, known as the OSWM system, began in 2021 and is proceeding in stages. The mapping and DBC Program database components are complete, as outlined in the Implementation Workplan. The redemption center and dealer mobile inspection component has been developed and is currently awaiting field testing by the Program before finalization. The next stage will focus on the distributor reporting component, with the Program working with developers to issue a task order in 2025. The final stage to complete the entire OSWM system will be the redemption center reporting for the DR-1s and Handling Fee Request Form. The software development team is a shared resource across the Environmental Health Administration's programs, and work on each OSWM system component is prioritized within an administration-wide development queue.