



**Highways Division
Department of Transportation
State of Hawaii**

Single Audit Reports
(With Independent Auditors' Reports Thereon)

June 30, 2016

Submitted by
**THE AUDITOR
STATE OF HAWAII**

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Reports

Year Ended June 30, 2016

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Section I

Introduction

January 17, 2017

The Auditor
State of Hawaii:

We have completed our audit of the financial statements of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2016. We have also audited the Highways Division's compliance with requirements applicable to its major federal financial assistance programs for the year ended June 30, 2016. We submit herein our reports pertaining to our audit of the Highways Division's financial statements and federal financial assistance programs.

The audit objectives and scope of our audit were as follows.

AUDIT OBJECTIVES

1. To provide opinions on the fair presentation of the Highways Division's financial statements and the schedule of expenditures of federal awards as of and for the year ended June 30, 2016, in accordance with accounting principles generally accepted in the United States of America. Our independent auditors' report, which expressed unmodified opinions on the Highways Division's financial statements, is issued under separate cover.
2. To consider the Highways Division's internal control over financing reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements.
3. To perform tests of the Highways Division's compliance with certain provisions, laws, regulations, contracts, and grant agreements that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the Highways Division's internal control over compliance with requirements that could have a direct and material effect on its major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, and to test and report on internal control over compliance.
5. To provide an opinion on the Highways Division's compliance with applicable laws, regulations, contracts and grants that could have a direct and material effect on its major federal program.

SCOPE OF AUDIT

We performed an audit of the Highways Division's financial statements and schedule of expenditures of federal awards as of and for the year ended June 30, 2016, in accordance with auditing standards generally accepted in the United States of America, the standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance).

ORGANIZATION OF REPORT

Our report is organized into three sections as follows:

Section I, entitled "Introduction," describes the objectives and scope of our audit and the organization and contents of this report.

Section II, entitled "Internal Control Over Financial Reporting and Compliance and Other Matters," contains our report on the Highways Division's internal control over financial reporting and on compliance and other matters based upon our audit of the Highways Division's financial statements.

Section III, entitled "Compliance and Internal Control Over Federal Awards," contains our report on the Highways Division's compliance and internal control over its major federal program in accordance with the Uniform Guidance, a schedule of expenditures of federal awards and related notes, and a schedule of findings and questioned costs.

We would like to take this opportunity to express our appreciation to the personnel of the Highways Division for the cooperation and assistance extended to us during our audit. We will be pleased to discuss any questions that you or your associates may have regarding our findings and recommendations.

Sincerely,

KKDLY LLC

Section II

Internal Control Over Financial Reporting and Compliance and Other Matters

Independent Auditors' 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*

The Auditor
State of Hawaii:

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, the financial statements of the governmental activities and each major fund of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), as of and for the year ended June 30, 2016, and the related notes to the basic financial statements, which collectively comprise the Highways Division's basic financial statements, and have issued our report thereon dated January 17, 2017.

Internal Control Over Financial Reporting

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

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Highways Division'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 determination of financial statement amounts. 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*.

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.

KKDL LLC

Honolulu, Hawaii
January 17, 2017

Section III

Compliance and Internal Control Over Federal Awards

**Independent Auditors' Report on Compliance For Each Major Federal Program;
Report on Internal Control Over Compliance; and Report on Schedule of Expenditures
of Federal Awards Required by the Uniform Guidance**

The Auditor
State of Hawaii:

Report on Compliance for Each Major Federal Program

We have audited the Highways Division, Department of Transportation, State of Hawaii's (the Highways Division), compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Highways Division's major federal program for the year ended June 30, 2016. The Highways Division's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for the Highways Division's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Highways Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of the Highways Division's compliance.

Opinion on Each Major Federal Program

In our opinion, the Highways Division complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2016.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and which are described in Appendix 1 to the accompanying schedule of findings and questioned costs as Findings 2016-001 and 2016-002. Our opinion on the major federal program is not modified with respect to these matters.

The Highways Division's responses to the noncompliance findings identified in our audit are described in Appendix 1 to the accompanying schedule of findings and questioned costs. The Highways Division's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control Over Compliance

Management of the Highways Division is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Highways Division's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Highways Division's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in Appendix 1 to the accompanying schedule of findings and questioned costs as Findings 2016-001 and 2016-002, that we consider to be significant deficiencies.

The Highways Division's responses to the internal control over compliance findings identified in our audit are described in Appendix 1 to the accompanying schedule of findings and questioned costs. The Highways Division's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the governmental activities and each major fund of the Highways Division as of and for the year ended June 30, 2016, and the related notes to the basic financial statements, which collectively comprise the Highways Division's basic financial statements. We issued our report thereon dated January 17, 2017, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

KKDL Y LLC

Honolulu, Hawaii
January 17, 2017

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2016

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Passed Through to Subrecipients	Federal Expenditures
U.S. Department of Transportation			
Highway Planning and Construction Cluster:			
Highway Planning and Construction	20.205	\$ 50,910,204	\$ 197,037,019
ARRA - Highway Planning and Construction	20.205	713,383	2,877,453
Total 20.205		<u>51,623,587</u>	<u>199,914,472</u>
State and Community Highway Safety Program:			
Highway Safety Cluster:			
NHTSA Grant	20.600	3,579,018	5,149,540
Fatal Accident Reporting System Grant	20.600	-	13,000
Total 20.600		<u>3,579,018</u>	<u>5,162,540</u>
Commercial Driver's License Program Improvement Grant	20.232	69,175	69,175
National Motor Carrier Safety Program - Assistance program grant	20.218	-	685,590
Total Federal Expenditures		<u><u>\$ 55,271,780</u></u>	<u><u>\$ 205,831,777</u></u>

See accompanying Independent Auditors' Report on Compliance For Each Major Federal Program; Report on Internal control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance and the Notes to Schedule of Expenditures of Federal Awards

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2016

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of the Highways Division, Department of Transportation, State of Hawaii (the Highways Division), for the year ended June 30, 2016. The information in this Schedule is presented in accordance with the requirements of the Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Highways Division, it is not intended to, and does not present the financial position and changes in financial position of the Highways Division.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the cash basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

3. Indirect Cost Rate

The Highways Division has not elected to use the 10 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year Ended June 30, 2016

SECTION I – SUMMARY OF AUDITORS’ RESULTS

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ___ Yes No
- Significant deficiency(ies) identified? ___ Yes None reported
- Noncompliance material to financial statements noted? ___ Yes No

Federal Awards

Internal control over major program:

- Material weakness(es) identified? ___ Yes No
- Significant deficiency(ies) identified? Yes ___ None reported

Type of auditors’ report issued on compliance for major federal program:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR Section 200.516(a)?

Yes ___ No

Identification of major federal program:

CFDA Number

Name of Federal Program or Cluster

20.205

U.S. Department of Transportation –
Highway Planning and Construction

Dollar threshold used to distinguish between Type A and Type B programs?

\$3,000,000

Auditee qualified as low-risk auditee?

Yes ___ No

(Continued)

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs (Continued)

Year Ended June 30, 2016

SECTION II – FINANCIAL STATEMENT FINDINGS

None noted.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Refer to Appendix 1.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2016

**Finding 2016-001
Davis-Bacon Act**

**U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205**

Condition

Certain Highways Division construction projects are subject to the provisions of the Davis-Bacon Act (the Act). In order to monitor compliance with these provisions, the Highways Division has developed policies and procedures requiring contractors and subcontractors to submit weekly certified payroll reports within 7 calendar days after the pay checks are disbursed. Upon receipt of the certified payroll reports, the Highways Division would then date and time stamp the reports, and forward the reports to the respective project engineer for his or her review to determine compliance with the Act.

During our audit, we selected and tested a sample of 50 certified payroll reports. We noted that 19 of the certified payroll reports were received after the 7-day deadline. Additionally, we identified 4 instances where the certified payroll reports did not contain any evidence (e.g., signature, initial, check marks, etc.) documenting the review by the Highways Division project engineer.

Criteria

The Highways Division must ensure that contractors and subcontractors working on construction projects funded with Federal financial assistance comply with the provisions of the Act and the U.S. Department of Labor regulations (29 CFR part 5). Specifically, contractors and subcontractors must submit weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payroll reports), evidencing that their employees were paid wages not less than those established for locality of the project (i.e., prevailing wage rates).

Cause

The Highways Division did not adhere to its internal policies and procedures requiring project engineers to obtain and review certified payroll reports on a timely basis to determine that the contractor or subcontractor is complying with the prevailing wage rates. We also noted that each district office has different procedures in place to document compliance with provisions of the Act.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2016

Effect

The Highways Division was not in compliance with the provisions of the Act requiring the timely receipt and review of certified payroll reports submitted by contractors and subcontractors to determine that their employees are paid prevailing wage rates.

Identification of a Repeat Finding

This is a report finding from the immediate previous audit reported as Finding 2015-001.

Recommendation

We again recommend that the Highways Division adhere to its internal policy requiring project engineers to obtain and review certified payroll reports on a timely basis (i.e., within 7 days after the pay checks are disbursed) to determine that the contractor or subcontractor is complying with the prevailing wage rate requirement. We also recommend that the Highways Division develop standardized procedures to document the date and time of receipt of the certified payroll reports, as well as the review and approval of those certified payroll reports by the project engineers.

Views of Responsible Officials and Planned Corrective Action

Management concurs with the finding. The Highways Division's existing policies on certified payroll submission, specifically Procedure No. 10-02-08 of the Highways Procedures Manual and the 2005 Standard Plans and Specifications, are strictly being enforced by constantly following up with the District Engineers that certified payroll must be received from contractors, date stamped and reviewed for compliance in a timely basis. Highways will also make sure that all the field construction offices are provided with date stamp equipment. The detail of this finding is being analyzed by the Construction and Maintenance Branch to find further solutions to this non-compliance. Fiscal year 2016 shows significant improvement in the timely receipt and review of certified payrolls as compared to fiscal year 2015 and is expected to continue in future fiscal years. All certified payrolls were date stamped when received and only a very few failed to show evidence documenting the review by the project engineer. Highways Division will also ensure that construction field offices are provided with the date stamp equipment.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2016

**Finding 2016-002
Subrecipient Monitoring**

**U.S. Federal Highways Administration
Highway Planning and Construction
CFDA No. 20.205**

Condition

For certain Highways Division capital projects, the Highways Division provides a portion of its federal awards to subrecipients such as the local counties in the State of Hawaii. Accordingly, the Highways Division is subject to subrecipient monitoring requirements applicable to federal awards. Under the terms of the Uniform Guidance, the Highways Division is required to include specific information about the federal award in all applicable subaward agreements.

As of June 30, 2016, the Highways Division had not yet implemented procedures to modify its subrecipient subaward agreements to include the level of detail required by the Uniform Guidance. Shortly after year-end, in September 2016, the Highways Division implemented a new subaward process, which included the preparation of subaward agreements containing all information specified by the Uniform Guidance. As a result, the Highways Division fully resolved this finding in September 2016.

Criteria

In accordance with the Uniform Guidance (2 CFR Part 200.331(a)), pass-through entities must ensure that every subaward is clearly identified to the subrecipient as a subaward and includes, amongst other required information; the subrecipient name, the period of performance start and end date, the federal award date, description of the project, applicable indirect cost rate, and CFDA number.

Cause

The Highways Division was fully aware of the importance of complying with the new subrecipient monitoring as defined in the Uniform Guidance. The Highways Division began its efforts early on to implement a revised subaward process that included modifying the format of subaward agreements to be in compliance with the Uniform Guidance. However, this proved to be a laborious and lengthy undertaking. The process was additionally challenging due to the unavailability of timely guidance and training until 2015.

**HIGHWAYS DIVISION
DEPARTMENT OF TRANSPORTATION
STATE OF HAWAII**

Single Audit Findings

June 30, 2016

Effect

During fiscal year 2016, the Highways Division was not in compliance with the requirements of the Uniform Guidance requiring specific award information be included in applicable subaward agreements. However, as previously discussed, the Highways Division fully implemented their new subaward process in September 2016, which brought them into compliance with the subrecipient monitoring requirements as specified in the Uniform Guidance.

Recommendation

We recommend that the Highways Division continue to adhere to the new subrecipient award policy and procedures implemented in September 2016.

Views of Responsible Officials and Planned Corrective Action

Management concurs with this finding. As noted above, in September 2016, the Highways Division implemented a new subaward process, which included the preparation of subaward agreements containing all information specified by the Uniform Guidance. The Highways Division is now fully compliant with the respective requirements.