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OFFICE OF THE AUDITOR
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LESLIE H. KONDO
State Auditor

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DEPT. COMM. NO. 208

December 22, 2021

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 Scott K. Saiki
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, 2020*, Report No. 21-13

Dear President Kouchi and Speaker Saiki:

We are attaching a copy of Report No. 21-13, *Financial and Program Audit of the Department of Health's Deposit Beverage Container Program, June 30, 2020*, along with a copy of the Auditor's Summary. The audit was performed 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/2021/21-13.pdf.

The summary is also accessible through our website at:
https://files.hawaii.gov/auditor/Overviews/2021/21-13AuditorSummary.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

LHK:emo

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, 2020

Report No. 21-13

PHOTO: ISTOCK.COM

Empty Promises: The Department of Health has done little to address the Deposit Beverage Container Program’s significant and fundamental problems.

SECTION 342G-107, Hawai‘i Revised Statutes, requires the Office of the Auditor to conduct a management and financial audit of the Deposit Beverage Container Program (Program) in fiscal years ending in even numbers. This financial and program audit for fiscal year ended June 30, 2020 was conducted by the certified public accounting firm of KMH LLP with the assistance of the Office of the Auditor.

What Did We Find?

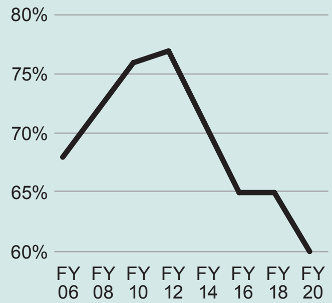
We have repeatedly expressed concerns about the Program’s reliance on self-reported data from distributors and redemption centers, explicitly stating that the Department of Health’s (DOH) passive oversight exposes the Program to possible fraud, waste, and abuse. During an initial meeting with the department, management conceded the program has done little to address previous audit findings, despite the actual fraud that was reported in 2018. DOH’s administration of the Program continues to rely on self-reported information.

We have repeatedly expressed the same concerns about the Program’s reliance on self-reported data from distributors and redemption centers, explicitly stating that the department’s passive oversight exposes the Program to possible fraud, waste, and abuse.

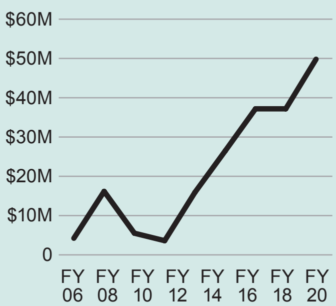
Deposit, No Return

As redemption rates fall, the balance of the Deposit Beverage Container Deposit Special Fund continues to grow.

Redemption Rates



Fund Balances



Declining redemption rates (the percentage of deposit beverage containers sold that are redeemed by consumers) over recent years has resulted in a growing Deposit Beverage Container Deposit Special Fund. As of June 30, 2020, the fund's balance hit $50.3 million, an all-time high. Considering the program's significant administrative needs, we suggest that the department ask the Legislature to consider allowing a certain amount of the fund be used to support additional program-related expenses.

Source: Department of Health and KMH LLP

Without any controls in place – i.e., policies, procedures, or processes – we could not audit the department's performance of its statutory responsibilities, and the Program continues to be at risk of fraud, waste, and abuse.

As a result, we redirected this year's review to ascertain and report why DOH has failed to address the long-standing findings that have been repeated for years. Our review primarily consisted of a series of interviews with DOH and Program management, including the then-Deputy Director of Environmental Health, the Solid and Hazardous Waste Branch Chief, the Solid Waste Coordinator, and the Recycling Coordinator.

During this review, the Solid Waste Coordinator described a "compliance testing pilot project" the Coordinator had started in July 2020 to cross-reference customer-signed receipts with redemption center daily reports and the forms submitted to request reimbursement of the redemption amounts paid to consumers. According to the Solid Waste Coordinator, if successful, Program staff would review and cross-reference one redemption center's records per quarter. As of June 30, 2020, there were 62 redemption centers in the state, meaning it would take Program staff more than 15 years to complete testing of every redemption center. In our next audit of the Program, we will likely assess this and other improvements to the Program that the department represents it had started subsequent to our current audit.

Why Did These Problems Occur?

DOH and Program management have taken no substantive actions to address the prior audit findings, including any measures to identify and prevent the type of fraud that we reported in 2019. DOH's disinterest or reluctance to properly administer the Program may be because management does not believe the Program should be its responsibility. According to the Deputy Director for Environmental Health at the time, the prior DOH Director believed that the department should not be administering the Program in the first place and that those duties should be contracted out. However, administration of the Program is a department responsibility, and until the Legislature amends that responsibility, DOH must be accountable for the Program's shortcomings. DOH and Program management must prioritize addressing the audit findings and other Program improvements; starting with the DOH director, they must clearly convey the importance and urgency of addressing the Program shortcomings to other managers and Program staff.

Why Do These Problems Matter?

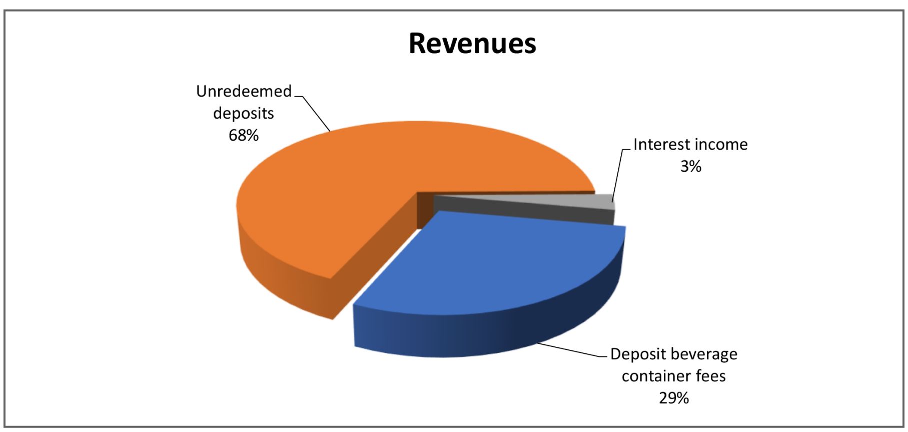
In prior audits, we performed very limited testing of distributors and redemption centers' compliance with their respective statutory requirements. We found many instances where distributors and redemption centers have improperly enriched themselves – whether intentionally or not – because of the department's lack of controls and its passive administration. And, because DOH is entirely reliant on distributors to self-report the number of containers sold, and on redemption centers to self-report the number of containers redeemed, there is both incentive and opportunity to continue to do so.

In addition, the moneys that the Program collects are the deposits and handling fees collected from consumers that are held in a fund for those consumers who redeem the containers at redemption centers. While the number of containers that consumers redeem continues to decline (which means the fund continues to grow), DOH is accountable for the deposits and handling fees. Should the Program ever run short of funds, taxpayers would be – but should not be – responsible for reimbursing the amounts redemption centers pay to consumers who redeem their containers.

If the department believes that the administration of the Program is not aligned with its current capabilities, it should hire a third-party to administer the Program, which the statute expressly allows. Whether through a third-party or its own staff, we recommend DOH take immediate action to address the deficiencies in the administration of the Program that have been repeatedly identified in prior reports.

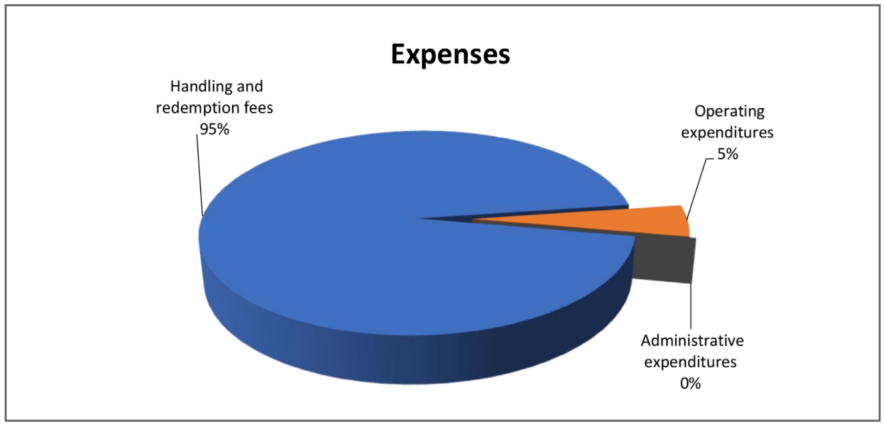
Financial Audit of the Department of Health, Deposit Beverage Container Deposit Special Fund

Financial Statements, Fiscal Year Ended June 30, 2020



Financial Highlights

For the fiscal year ended June 30, 2020, the Deposit Beverage Container Deposit Special Fund (Fund) reported total revenues of $27.66 million and total expenditures of $21.94 million, resulting in a change in fund balance of $5.72 million. Total revenues consisted of (1) deposit beverage container fees of $7.92 million, (2) unredeemed deposits of $18.86 million, and (3) interest income of $870,000. Total expenditures consisted of (1) handling and redemption fees of $20.71 million, (2) operating expenditures of $1.17 million, and (3) administrative expenditures of $50,000.



As of June 30, 2020, total assets were $55.91 million and total liabilities were $5.58 million. Total assets were comprised of (1) cash and cash equivalents of $55.65 million, (2) accounts receivable of $170,000, and (3) interest receivable of $90,000. Total liabilities were comprised of (1) vouchers and contracts payable of $3.3 million, (2) beverage container deposits of $2.05 million, (3) unearned revenue of $200,000, and (4) accrued wages and employee benefits of $30,000.

Auditors' Opinions

The Fund received an unmodified opinion that its financial statements were presented fairly, in all material respects, in accordance with generally accepted accounting principles.

Findings

There were no reported deficiencies in internal control over financial reporting that were considered to be material weaknesses and no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, the auditors identified a significant deficiency in internal control. 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. The significant deficiency is reported on page 40 of the report.

For the complete report and financial statements visit our website at:
https://files.hawaii.gov/auditor/Reports/2021/21-13.pdf

Financial and Program Audit of the Department of Health’s Deposit Beverage Container Program, June 30, 2020

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. 21-13
December 2021

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 governmen t 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, 2020. 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. The audit was conducted by the certified public accounting firm of KMH LLP with the assistance of the Office of the Auditor.

Leslie H. Kondo
State Auditor

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Exhibits


PHOTO: ISTOCK.COM

Empty Promises: The Department of Health has done little to address the Deposit Beverage Container Program's significant and fundamental problems.

Introduction

THIS IS THE EIGHTH BIENNIAL financial and program audit of the Department of Health's Deposit Beverage Container Program (Program) and the Deposit Beverage Container Deposit Special Fund (Special Fund). The Legislature established the Program in 2002, finding "a need to expand participation in recycling programs and to minimize the cost to those participating and to government." The Program is intended to increase participation in recycling of specified types of beverage containers, to provide a connection between manufacturing decisions and recycling program management, and to reduce litter.[1] The Special Fund was created to hold the deposit beverage container fees and deposits, which are used to pay deposit beverage container refunds and handling fees.

We have repeatedly expressed the same concerns about the Program's reliance on self-reported data from distributors and redemption centers, explicitly stating that the department's passive oversight exposes the Program to possible fraud, waste, and abuse.

The seven previous audits, conducted over the years 2005 through 2018 by the Office of the Auditor and multiple certified public accounting

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

firms contracted by the Office of the Auditor, repeatedly found that the Department of Health (DOH) runs the Program as essentially an honor system, relying on reporting by interested parties to account for the flows of beverage containers and cash. Beverage distributors, which are responsible for accounting for the containers and deposits entering the system, are entrusted to self-report their own numbers as they pay into the Special Fund accordingly. Meanwhile, on the back-end of the process, redemption centers, which are responsible for refunding deposits to consumers who redeem containers, also self-report those amounts and are in turn paid by DOH based on those unverified numbers.

We have repeatedly expressed the same concerns about the Program's reliance on self-reported data from distributors and redemption centers, explicitly stating that the department's passive oversight exposes the Program to possible fraud, waste, and abuse. However, we found that the department has made no meaningful improvements to the Program. In addition, while it did refer a 2018 instance of actual fraud to the Department of the Attorney General, the department did not address the matter with the vendor who was perpetrating the fraud.

In past audits, because DOH's "administration" of the Program consisted of relying completely on unsupported data from distributors and redemption centers, we could not audit the department's performance of its responsibilities – there simply was nothing for us to assess. DOH had no system or procedures to ensure the amounts deposited by distributors, and very little assurances that reimbursements paid to redemption centers, were the appropriate amounts. For that reason, we instead performed limited and selective testing of distributors and redemption centers' compliance with their respective statutory requirements. This included determining if distributors maintained adequate records and support for beverage sales as well as making sure redemption centers' reports included, among other things, the number or weight of the redeemed containers, the amount of refunds paid, and the weight of the containers transported to a permitted recycling center. However, this is the type of work DOH should be doing in its administration of the Program. Section 342G-107, Hawai'i Revised Statutes (HRS), requires us to audit the Program, i.e., to assess DOH's performance of its statutory responsibilities, not to perform core functions for the Program.

For that reason, we redirected this year's review to ascertain ***why*** DOH has failed to address the long-standing findings that have been repeated for years. Our review primarily consisted of a series of interviews with DOH and Program management, including the Deputy Director of Environmental Health, the Solid and Hazardous Waste Branch Chief, the Solid Waste Coordinator, and the Recycling Coordinator. During these interviews, some expressed their disappointment that we were not reviewing or testing distributors and redemption centers' compliance with statutory requirements, which they had come to rely on as DOH's periodic oversight of the distributors and redemption centers.

While performance audits do provide an important review of a program's activities, they are not a component of management's internal control system, and auditors are not part of management. In other words, ensuring that distributors are accurately reporting the number of containers imported and that correct deposits and handling fees are paid into the Special Fund is DOH's responsibility, as is ensuring that redemption centers are properly refunding deposits to consumers and reporting the accurate number of containers redeemed. The department must make addressing the long-standing weaknesses in its administration of the Program a priority, and that commitment needs to start with DOH management who must hold Program management accountable for its use and oversight of public funds.

Background

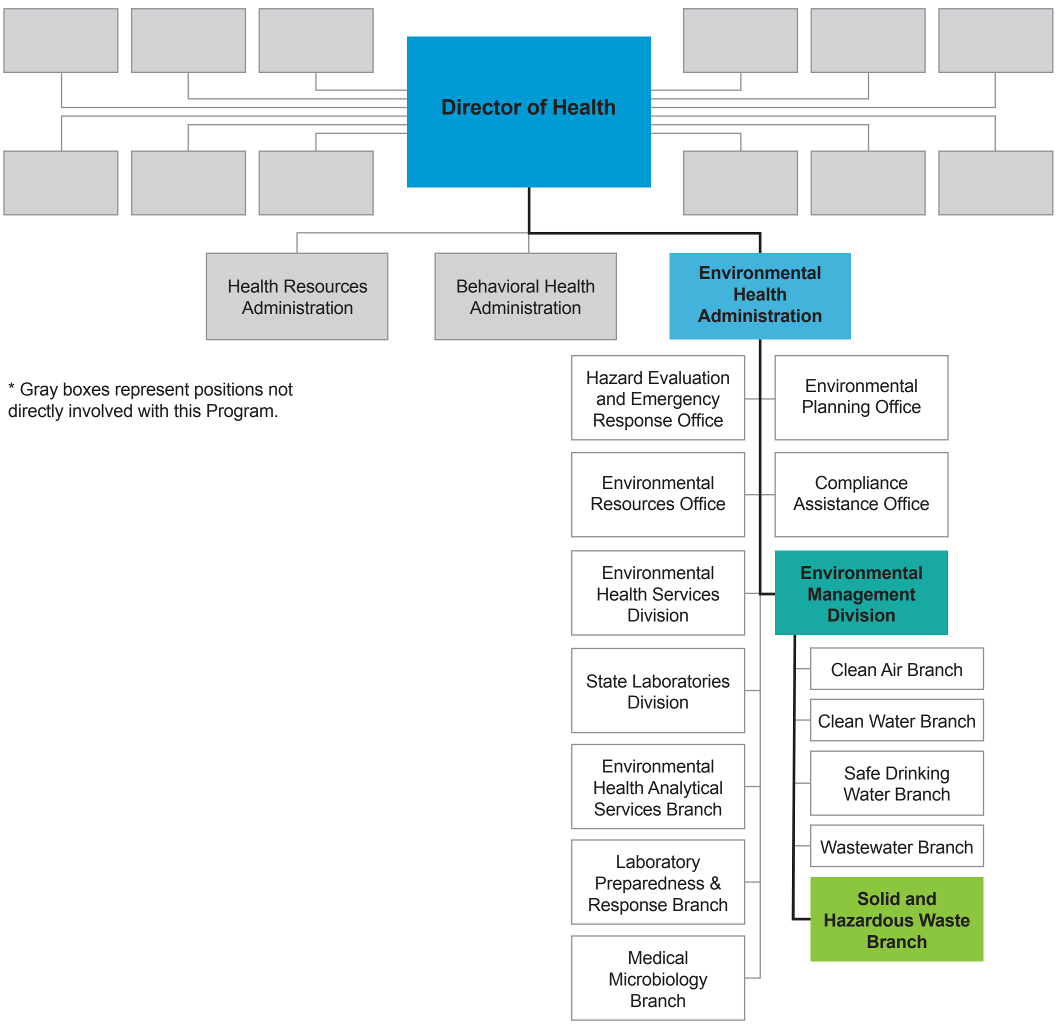
In 2002, the Hawai'i Legislature established the Program through House Bill No. 1256, H.D. 2, S.D. 2, C.D. 1, which became Act 176, Session Laws of Hawai'i 2002. The act, codified in Chapter 342G, Part VIII, HRS, also created the Special Fund to hold the deposits and handling fees collected by distributors, and to pay redemption centers for the deposits redeemed by customers and the handling fees to which they are entitled. In the act's preamble, the Legislature found recycling is an important part of an integrated solid waste management system, which can protect and preserve environmental resources and reduce economic costs to residents and businesses. The Legislature also noted a need to expand participation in recycling programs and to minimize the costs to those participating. 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 to recover 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.[2]

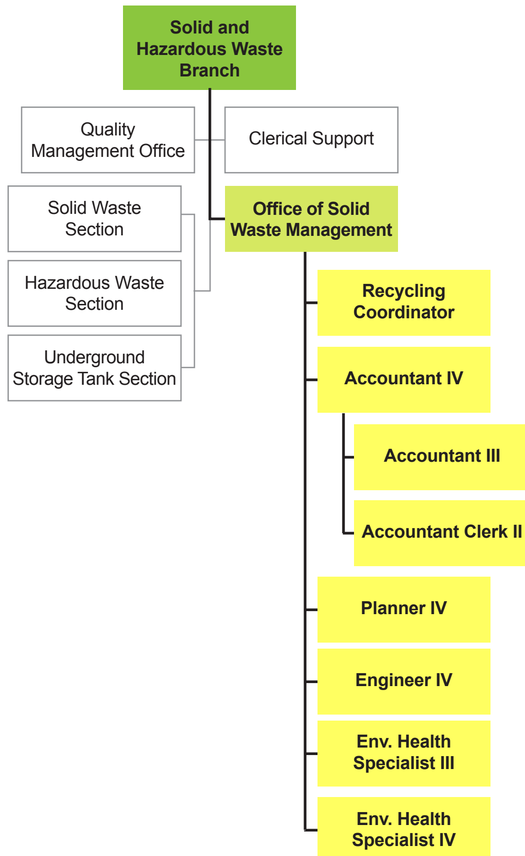
DOH's Environmental Management Division, Solid and Hazardous Waste Branch, Office of Solid Waste Management (Office of Solid Waste Management) is responsible for the implementation and administration of the Program as well as the Special Fund.

[2] The other ten states that had a beverage container recycling program when Act 176 was enacted were California, Connecticut, Delaware, Iowa, Maine, Massachusetts, Michigan, New York, Oregon, and Vermont.

Eight positions are authorized for the Program, consisting of a Recycling Coordinator, Accountant IV, Engineer IV, Accountant III, Account Clerk II, Planner IV, Environmental Health Specialist III, and Environmental Health Specialist IV. The positions are funded by the Special Fund. All eight positions report to the Solid Waste Management Coordinator.

Exhibit 1
Department of Health Organization Chart





Source: Department of Health

Distributors and Collection of the Deposits

Individuals and organizations that manufacture beverages in "deposit beverage containers"[3] or that import filled containers from outside of the state to sell to retailers or directly to consumers are "deposit beverage distributors" under Chapter 342G, HRS,[4] and must register with the department. Distributors pay both a container fee of $0.05 and a handling fee of $0.01 to the Program for each container manufactured or imported, which are deposited in the Special Fund. Distributors pass the cost of those fees to the consumer or to secondary dealers such as

[3] Section 342G-101, HRS, defines "deposit beverage container" to mean "the individual, separate, sealed glass, polyethylene terephthalate, high density polyethylene, or metal container less than or equal to sixty-eight fluid ounces, used for containing, at the time of sale to the consumer, a deposit beverage intended for use or consumption in this State." The term does not apply to containers holding milk and other dairy products; cooking additives, sauces and condiments; or drugs, medical food and infant formulas, among other things.

[4] Airlines and shipping companies that only transport containers are excluded from the definition of deposit beverage distributor. (Section 342G-101, HRS)

grocery retailers and convenience stores, which in turn pass those costs to their customers.[5]

Distributors must submit a Distributor Report Form to the department that includes the number of containers imported or distributed by different material types, as well as the amount of the container deposit and handling fees owed to the department for those containers. Distributors that import or distribute more than 100,000 containers each year must file the report monthly; distributors that annually import or distribute 100,000 or fewer containers file the report semi-annually. The distributors' employees who sign the forms certify that information, to the best of their knowledge, is "true, accurate, and complete" and that they are aware that there are penalties for submitting false information.

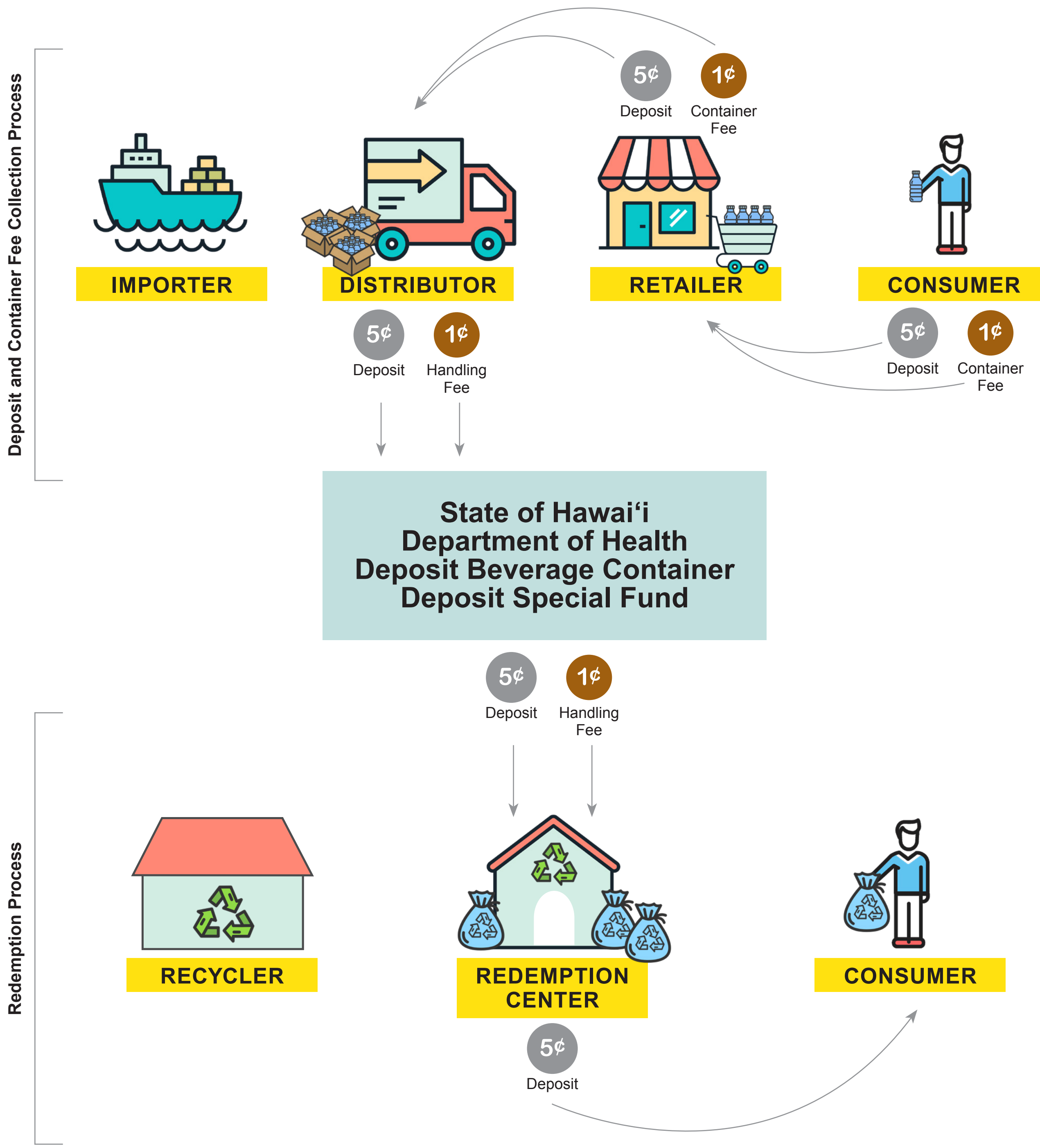
Distributors are also required to maintain records reflecting the beverages in containers they manufacture and import, which must be available for inspection by the department.

The Redemption Process

The $0.05 per container deposit fee is refunded to consumers when they redeem their empty containers at state-certified redemption centers. The number of redemption centers throughout the state has been on a continuous decline. As of June 2020, there were 62 redemption centers, which was down from 76 redemption centers as of June 2016 and 112 redemption centers as of June 2012. Exhibit 3 provides a breakdown of redemption centers on each island as of June 2020.

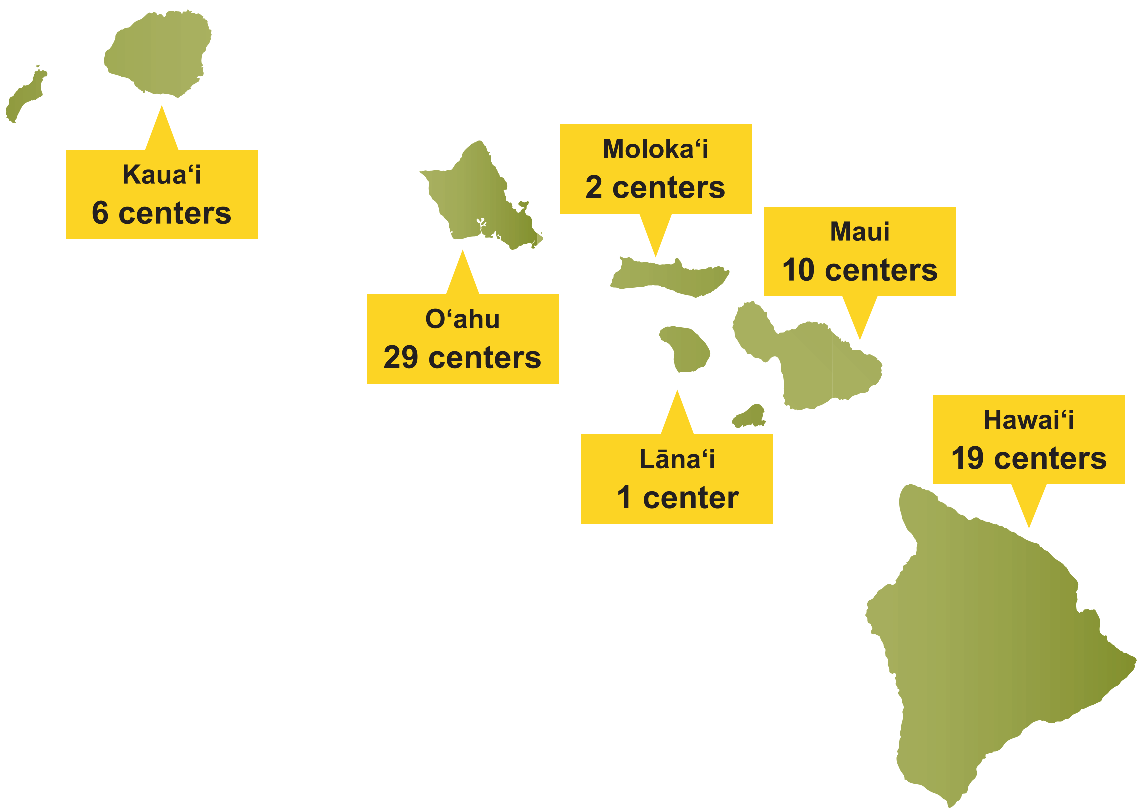
[5] Commercial passenger vehicle companies are exempted from this process by Section 342G-101.5, HRS. These companies, which include airlines and cruise operators, do not have to pay the deposit or container fees for beverages sold or delivered if the beverage is intended for use and consumption on the commercial passenger vehicle.

Exhibit 2
How the System Works



Source: KMH LLP

Exhibit 3
Redemption Centers in Hawaiʻi



Source: Department of Health

The department pays redemption centers for deposits refunded to consumers; the redemption centers are also paid a handling fee for each container processed.

When determining the container deposit fees to be paid to consumers, redemption centers can weigh redeemed containers in excess of 200 in lieu of counting, using Program-provided rates for different material types to calculate the number of redeemed containers. The Program establishes these segregated rates from statewide statistical studies of redeemed containers. The number of beverage containers per pound by material type must be posted at all redemption centers. Exhibit 4 shows the current segregated rates. Redemption centers then deliver the empty containers to recycling facilities.

Exhibit 4
Hawai'i Deposit Beverage Container Rates for Weighing[6]

Aluminum	Bi-Metal	Glass	Plastic (mixed sizes, 68 oz or less)	Plastic (small sizes, 17 oz or less)
$1.60/lb	$0.295/lb	$0.12/lb	$0.94/lb	$1.315/lb
32 containers per pound	5.9 containers per pound	2.4 containers per pound	18.8 containers per pound	26.3 containers per pound

Source: Department of Health

To receive reimbursement of the deposits refunded to consumers, redemption centers submit to the department a form (the *5¢ Deposit Refund Request Form* (DR-1)) at least twice a month. For each material type redeemed by each customer, redemption centers report the amount refunded to that customer and the quantity or weight of the containers, among other things. Redemption centers must certify "under penalty of law" that the information submitted is "true, accurate, and complete." However, the department does not require redemption centers to provide any supporting records with their requests for reimbursement of the deposits refunded to customers. The department pays redemption centers from the Special Fund.

Redemption centers are required to submit a second form to DOH (the *Handling Fee Request Form* (HR-1)) to collect the handling fee the State pays for containers delivered to recyclers. That form requires redemption centers to provide, among other things, the weight ticket, container number, or trailer number of the shipment to the recycler; the total container weight of each material type; and the name and address of the recycling facility that received the materials from the redemption center. As with Form DR-1, the redemption center employee signing the form must certify that, to the best of their knowledge, the information is "true, accurate, and complete." Redemption centers are also required to provide the department with proof of receipt of the materials by the recycler. Handling fees are paid from the Special Fund.

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[6] The segregated rates during FY2020 have been in effect since early December 2010. Redemption centers may not issue refunds for beverage containers redeemed without the HI-5¢ marking.

Only in Hawai'i

In most states, responsibility for the financing and administration of beverage container deposit programs lies with the private sector.

ONLY 10 STATES currently have beverage container deposit programs. In most states, responsibility for container collection and recycling, including most financial transactions and administration, lies with the private sector. In these systems, retailers are required to accept returned empty bottles and cans from consumers, and distributors and manufacturers are directly responsible for the collection from retailers, processing, and recycling of their containers.

In Oregon and Iowa, distributors keep all unclaimed deposits, while in Connecticut, Massachusetts, New York, Maine, Michigan, and Vermont, distributors and bottlers are required to turn over all or a portion of unclaimed deposits to the state.

Hawai'i and California take active roles in their beverage container deposit programs, collecting and distributing payments from a state-managed fund while overseeing collection and recycling activities. But state involvement has its trade-offs, the first being cost.

According to a 2015 analysis of California's Beverage Container Recycling Program by California's Legislative Auditor's Office, programs in Oregon, Connecticut, Vermont, Massachusetts, Iowa, and Michigan each employ three or fewer state staff. In contrast, California's program had 137 positions at the time; however, the analysis points out that states with significantly fewer state staff have limited knowledge of beverage container recycling rates and rely on private data to determine program compliance and success. In addition, California's program performs other activities such as data collection and enforcement, administers grant programs, and invests in the development of new recycling technology and collection methods.

DOH's Office of Solid Waste Management has eight positions dedicated to the Program; however, unlike California, Hawai'i's program neither collects its own data to determine program compliance and success, nor does it conduct enforcement activities to ensure compliance.

The Deposit Beverage Container Deposit Special Fund

Section 342G-104, HRS, established the Special Fund in the state treasury. As of June 30, 2020, the Special Fund balance was $50.3 million, an increase of $5.7 million from June 30, 2019. In the same fiscal year, the Program's container deposit liability decreased to $2.0 million. All told, the Program had $55.7 million equity in cash, cash equivalents, and investments in the state treasury at June 30, 2020.

The container deposit fees and handling fees paid by distributors for each eligible container sold or imported into the state are deposited in the Special Fund. Interest accrued on the fund balance provides additional revenue. In FY2020, the revenue in the Special Fund totaled $27.6 million.

Special Fund expenditures in FY2020 were $21.9 million, which included payments to redemption centers for deposits paid to consumers for each container redeemed as well as a handling fee for each container. The Special Fund also funds the Program staff salaries and other Program costs.

Pursuant to Section 342G-104(b), HRS, the department is allowed to use the money in the Special Fund for (1) administrative, audit, and compliance activities associated with collection and payment of the deposits and handling fees; (2) recycling education and demonstration projects; (3) recyclable market development activities; (4) handling and transportation of the deposit beverage containers to end-markets; (5) personnel to oversee the implementation of the Program, including permitting and enforcement activities; and (6) associated office expenses. The Legislature also expressly empowered DOH to contract for the services of a third-party to administer the Program.

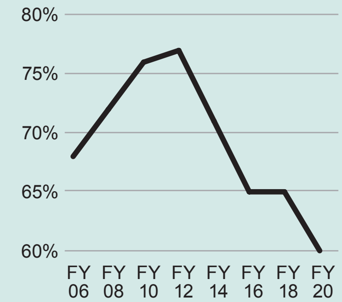
For the last several years, the Program has experienced a significant decline in the percentage of containers being redeemed, falling from a high of 79 percent in FY2010 to 60 percent in FY2020. Referred to as the "redemption rate," this key performance measure of the Program's success in moving beverage containers out of the waste stream into the recycling stream is determined by dividing the number of deposit beverage containers redeemed by the number of deposit beverage containers sold. It also determines the handling fee charged to customers.

Additional information on the Special Fund can be found in the Program's financial statement, which begins on page 25.

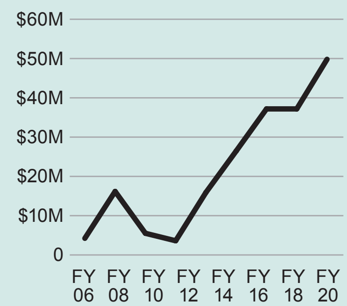
Deposit, No Return

As redemption rates fall, the balance of the Deposit Beverage Container Deposit Special Fund continues to grow.

Redemption Rates



Fund Balances



Declining redemption rates (the percentage of deposit beverage containers sold that are redeemed by consumers) over recent years has resulted in a growing Deposit Beverage Container Deposit Special Fund. As of June 30, 2020, the fund's balance hit $50.3 million, an all-time high. Considering the program's significant administrative needs, we suggest that the department ask the Legislature to consider allowing a certain amount of the fund be used to support additional program-related expenses.

Source: Department of Health and KMH LLP

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 our eighth review of the Program. We contracted the certified public accounting firm of KMH LLP to assist us in conducting this financial and program audit.

Objectives

1. To determine actions the Program has taken to implement recommendations included in Report No. 19-08.

2. Make recommendations for improvements as appropriate.

Scope and Methodology

In addition to our walkthrough procedures performed in conjunction with the financial statement audit of the Special Fund, we interviewed the Deputy Director of Environmental Health, the Solid and Hazardous Waste Branch Chief, the Solid Waste Coordinator, and the Recycling Coordinator. We also reviewed a memorandum prepared by the Office of Solid Waste Management about a compliance testing pilot project; however, according to the Solid Waste Coordinator, the Program has not adopted the pilot project procedures or taken any other actions to address Report No. 19-08's recommendations.

What we reported in 2019 (our most recent past audit of the Program)

In Report No. 19-08, we found – as we had in six previous reports – that the Program was essentially an honor system, relying upon reports from distributors and redemption centers to account for the number of containers in the system and the number of containers redeemed. We reported that DOH had not developed procedures to verify the accuracy and completeness of data reported by either distributors or redemption centers. Specifically, the department still had no means to determine the accuracy of the deposits and handling fees paid by distributors to DOH or the refunds paid by redemption centers to customers. DOH was simply accepting that the number of containers distributors said they manufactured or imported into the state and the deposits redemption centers said they paid to customers were accurate.

In report after report, concern has been expressed that the Program is passively administered and that the lack of meaningful procedures or controls to provide reasonable assurance as to the accuracy of numbers submitted by distributors and redemption centers made the Program vulnerable to fraud, waste, and abuse. In 2019, we again found the amounts that distributors reported to the department on the Monthly Distribution Report Forms were inaccurate, with some distributors underpaying their respective container deposits and handling fees.

Because the Program was not verifying distributor data, we performed a limited review of a small sample of 24 distributors' records to determine whether those distributors were maintaining records required by Chapter 342G, HRS. We found exceptions with six distributors' reporting. Specifically, we identified differences between the number of containers reported on the Distribution Report Forms submitted monthly to the department and the distributors' supporting records comprised of invoices and schedules provided to support the distribution values. One distributor did not respond to our request for supporting records or schedules; two others could not provide information on container counts, handling fees, and deposit amounts. As a result, testing of the accuracy of distributor records could not be completed.

On the back end of the deposit-redemption process, redemption centers are responsible for both refunding deposits to consumers and reporting the number of bottles redeemed in order to collect reimbursements from the Program. In October 2018, we performed 15 unannounced visits to 10 different redemption centers located throughout the state. Auditors redeemed a variety of containers during each visit, conducting a very limited "secret shopper" test of the redemption process. We also checked signage and other operational requirements, including the segregation rates, to verify compliance with Title 11,

2015: Was It the Whole Story?

BEVERAGE DISTRIBUTORS are required by law to report the number of deposit beverage containers sold/distributed and pay the corresponding container deposit ($0.05) and handling ($0.01) fees to the Special Fund on a monthly basis. However, since DOH has no system or process to verify the accuracy and integrity of these numbers, when errors are found, it must rely on the distributors themselves to determine the scope of the error and the corresponding repayment to the State.

In 2015, we reviewed distributor receipts and found that one distributor — Whole Foods Market, Inc. (Whole Foods) — underpaid beverage container deposits and fees *for more than six years*, which went undetected by the department. For the six years it had been operating in Hawai'i, Whole Foods had been paying DOH $0.06 per case instead of $0.06 per container, underpaying the Program by $1.38 per case.

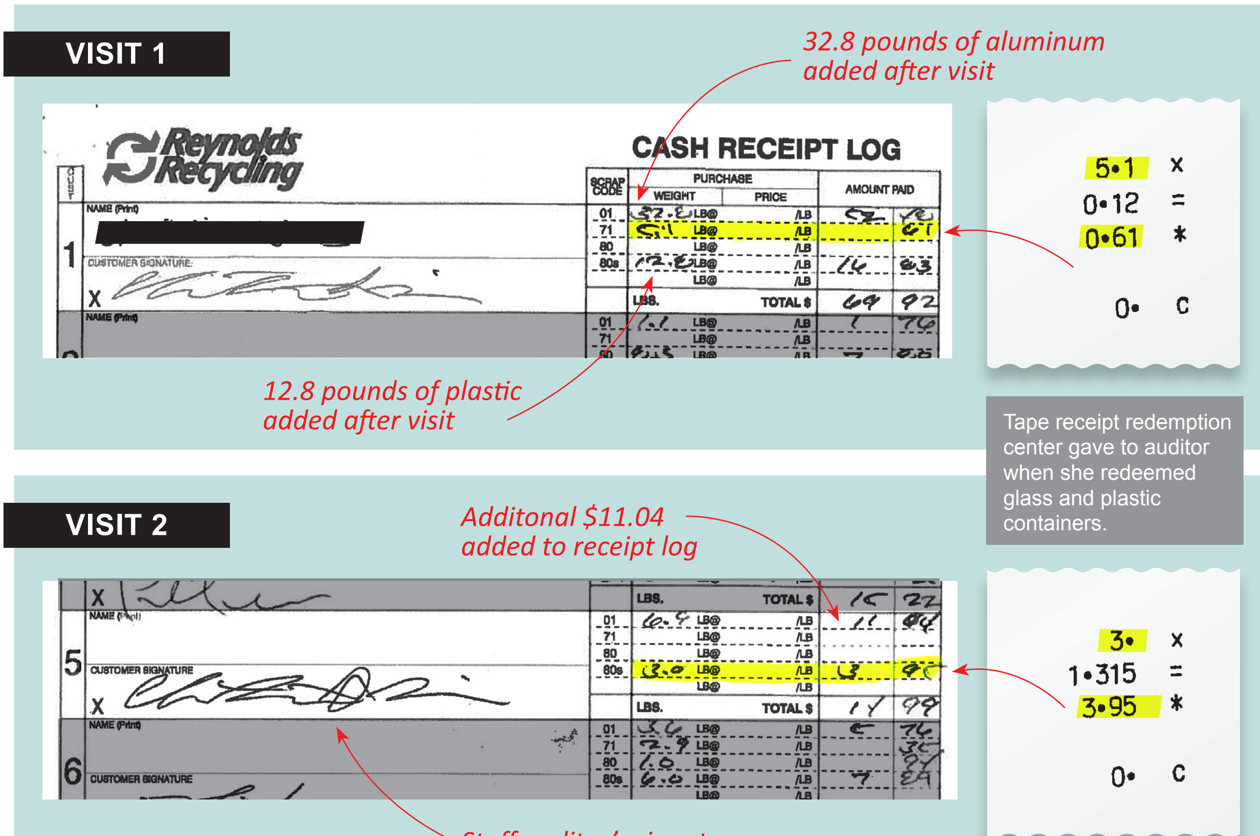
However, the Department of the Attorney General advised that the Program was only able to collect on underpayment for the last two years but not the prior four, which, according to Whole Foods, amounted to $46,198. Since DOH had no way to verify the number of beverage containers that had been sold, it had no basis to confirm or refute the amount of Whole Foods' corresponding underpayment in the two-year period or over the entire six years.

Chapter 282, Hawai'i Administrative Rules. After the redemption centers submitted their respective DR-1 forms to the department for reimbursement of the refunds paid to customers, we requested copies of the redemption transaction logs that supported the DR-1 form from the redemption centers that we visited. Those records were compared to the amounts the auditors were paid for the bottles they redeemed, tracing the transaction back through the redemption centers' supporting redemption transaction logs.

One redemption center – the Reynolds Recycling location at 1106 University Avenue, which was one of the redemption centers that the auditor happened to visit twice – provided the Program with handwritten Cash Receipts Logs that did not match our auditor's receipts or the amount the auditor was paid. At that redemption center, our auditor was required to sign a Cash Receipts Log, which listed the amounts of the different types of bottles that the auditor redeemed and amounts paid to the auditor by the redemption center. (See Exhibit 5 on page 15) The auditor also was given a cash receipt.

On October 2, 2018, our auditor was paid $0.61 for 5.1 pounds of glass bottles redeemed, which is consistent with the cash receipt that was given to the auditor; however, the Cash Receipts Log provided by the redemption center – which includes the auditor's signature – reflected that 32.8 pounds of aluminum cans and 12.8 pounds of plastic containers were also redeemed and that our auditor was paid $69.92.

Exhibit 5
Redemption Center Altered Cash Receipt Logs to Receive Higher Program Reimbursements



Source: Department of Health, KMH

As a result, instead of $0.61 that was actually paid to our auditor, the redemption center requested reimbursement of $69.92, which was paid by the Program.

Two days later, our auditor redeemed three pounds of plastic containers and was paid $3.95. But, 6.9 pounds of aluminum cans were added to the redemption center's Cash Receipts Log, adding $11.04 to the total for which the redemption center requested reimbursement. The redemption center was reimbursed $14.99 instead of $3.95. In both instances, the Cash Receipts Logs were altered after the auditor had visited the location to reflect additional containers of different material types than that which our auditor redeemed.

In November 2018, we reported the redemption center's actions to DOH management, including the then-DOH director, during a meeting convened to specifically discuss the fraudulent overpayments the audit had uncovered. DOH referred the matter to the Department of the Attorney General, which, according to DOH, declined to prosecute the redemption center or the redemption center's employee. According to the Solid and Hazardous Waste Branch Chief, the department does have civil and administrative penalties it can levy, but it did not do so since the Department of the Attorney General did not pursue the matter.

What We Recommended in 2019

Because distributors can pass on container costs to retailers or customers, distributors have an inherent incentive to underreport their distribution or sales of containers. Distributors can collect deposits and handling fees from retailers or customers and not remit those amounts to DOH. Based on our limited testing, we reported in Report No. 19-08, as we have in prior reports, that information submitted by some distributors to the Program on Distribution Report Forms did not align with supporting records for those amounts, and that those distributors underpaid the required container deposit fees and handling fees.

Similarly, redemption centers are reimbursed container deposits and paid handling fees based on their self-reported number of redeemed containers. The redemption centers also have an incentive and the opportunity to overreport the number of containers being redeemed to maximize payments. In Report No. 19-08, we reported actual fraudulent overpayments to one redemption center.

To address the Program's fundamental flaws and persistent issues, we offered recommendations we believed the department could reasonably implement considering its resources at the time. These included recommendations that DOH: (1) audit both distributors and redemption centers' reports; (2) consider enforcement actions against distributors and redemption centers for inaccurate reporting; (3) require distributors to develop and submit for department approval an internal control process to ensure the accuracy of the data entered on the Distribution Report Form; (4) require distributors to obtain an independent audit every two years; and (5) require redemption centers to install reverse vending machines or other mechanical devices at locations to reduce the opportunities for error and fraud.

For the recommendation that the department audit selected distributors and redemption centers' reports, we suggested that DOH develop a risk-based process to select the reports to audit, considering a variety of risk factors, such as the amount of money transacted, prior audit findings, and the frequency of the distributor or redemption center's prior audits. Auditors also recommended that distributors be required to submit supporting records, such as schedules of invoices, shipping documents, and point-of-sale reports, to DOH on a regular basis. These audits could be performed by additional personnel or external consultants hired to perform this function. Section 342G-104, HRS, allows the Program to use moneys in the Special Funds for, among other things, "administrative, audit, and compliance activities." The statute also expressly authorizes DOH to "contract for the services of a third party to administer [the Program]."

What actions have the department and the Program taken to date to address the risks associated with self-reporting and specific discrepancies identified in Report No. 19-08?

During an initial meeting with the Program, management conceded that the Program had done little to address the findings in Report No. 19-08. According to management, the Program and its processes remain unchanged, despite the actual fraud that was reported. DOH's administration of the Program continues to be passive, principally dependent on the self-reported information from distributors and redemption centers – both of which have inherent financial incentives to either under or over report – to be accurate and timely in their self-reporting, to deposit the correct amounts in the Special Fund, and to obtain reimbursement of amounts actually paid. And, more importantly, without ***any*** controls, the Program continues to be at risk for fraud, waste, and abuse.

In addition, none of the discrepancies in distributor reporting were followed up on by the Program. According to the Recycling Coordinator, the Program did not follow up on these discrepancies because the enforcement/investigator position that would perform these enforcement activities was vacant at the time. While we recognize that the Program has had vacancies and turnover in its staff, including the Solid Waste Coordinator position, we have reported the very same types of reporting discrepancies for years.

The Recycling Coordinator also told us that the only penalties that the Program does assess is for late payments by distributors. The amounts of the penalties are based on the annual total of what they paid to the Program in a previous year. Program staff were unclear as to what civil or monetary penalties could be assessed against distributors and redemption centers for discrepancies since there may be no precedence. However, the department promulgated administrative rules in 2007 which include provisions that allow DOH to assess administrative penalties for violation of Chapter 342G, HRS, and to order offending distributors and redemption centers to take corrective action. And, given that we have repeatedly reported errors by distributors and redemption centers – errors that have actual financial consequences to the Program – the department's failure to develop policies and procedures to carry out Program responsibilities, including enforcement actions for violations of statutory requirements, is inexcusable. DOH must be accountable for its use and oversight of public funds, especially where, as here, the department knows that there is a substantial risk that distributors are underpaying and at least one redemption center was being overpaid.

However, even though it had clear evidence of possible fraud, the Program did not require the redemption center to investigate the incidents itself, reimburse the State for the overpayments, or even develop procedures and controls to prevent possible similar fraudulent reporting from happening again.

The Program did forward the suspected redemption center fraud to the Department of the Attorney General, which declined to prosecute the redemption center or the redemption center's employee. However, even though it had clear evidence of possible fraud, the Program did not require the redemption center to investigate the incidents itself, reimburse the State for the overpayments, or even develop procedures and controls to prevent similar fraudulent reporting from happening again. We note the process of pursuing criminal charges is only one aspect of enforcement; the department has other enforcement tools to assess fines and compel corrective action.

Why has there been little action taken in response to recurring findings?

According to DOH and Program officials, the Program has been significantly understaffed, especially in key positions such as the Solid Waste Coordinator, who is responsible for the day-to-day operations of the Program, as well as several accounting positions. While the Deputy Director for Environmental Health acknowledged that the previous Solid Waste Coordinator had been in the position for more than five years (and there for at least two audits of the Program), adequate time to address the Program's chronic issues, those problems were not addressed.

We note that the core findings of this and the seven previous audit reports – the overreliance on self-reported data from distributors and redemption centers – are foundational and systemic issues that Program staff (no matter how few) can address on their own. Oversight here should not be ignored simply because the Program is short-staffed, especially in this case where the statute explicitly authorizes the department to use the Special Fund to "[f]und administrative, audit, and compliance activities" and to "contract for the services of a third party to administer the [Program]."

DOH's reluctance or disinterest to take on such a task may be because management does not believe the Program should be its responsibility. According to the Deputy Director for Environmental Health, the prior DOH Director believed that the department should not be administering the Program in the first place and that those duties should be contracted out. However, the department is responsible for administering the Program, and until the Legislature amends that responsibility, DOH must be accountable for the Program's shortcomings. DOH's passive oversight – i.e., relying entirely on distributors and redemption centers to accurately report the number of containers sold or redeemed, respectively – has allowed some distributors and some redemption centers to improperly enrich themselves, whether intentional or not, at the expense of the State. DOH and Program management must prioritize addressing the audit findings and other Program improvements; starting with the DOH Director, they must clearly convey the importance and urgency of addressing the Program shortcomings to other managers and Program staff.

What does the Department plan to do?

Significant action has not been implemented to address the findings and concerns raised in Report No. 19-08. However, the Solid Waste Coordinator provided us with a memorandum describing a "compliance testing pilot project" the Coordinator started in July 2020. The pilot project memorandum was not officially reviewed, but the Solid Waste Coordinator assured us that the Branch Chief and Deputy Director "certainly know" about the pilot project. But, more to the point, we question not only the efficacy but even the relevance of the pilot project's labor intensive reviews and other proposed procedures that are intended to ensure proper compliance by the redemption centers.

According to the Solid Waste Coordinator's memorandum, Program staff cross-referenced the customer-signed receipts for May 2020 from one of the smallest redemption centers with that redemption center's daily reports and Form DR-1, *5¢ Deposit Refund Request Form*, "to ensure that the receipt data is accurately recorded." That review uncovered that the department had underpaid the redemption center by approximately $18. Program staff then reviewed the same redemption center's records for June 2020, finding a few instances of double-entries and other discrepancies totaling approximately $110. The memorandum states that staff reviewed the same redemption center's August records and found "a measurable reduction in the number of errors in the Daily Reports and related August reimbursement request."

Although the pilot project is reviewing the transactions of one of the Program's smallest redemption centers, the memorandum states that, if successful, this review could address Report No. 19-08's findings and be replicated at other redemption centers. Given the current staffing, staff would perform similar reviews of *one redemption center per quarter*. As of June 30, 2020, there were 62 redemption centers in the state, meaning it will take Program staff more than 15 *years* to perform the testing of every redemption center. It is our understanding that the Program staff have not started reviewing any of the other redemption centers' records.

We do not see this review as a meaningful process to address the audit findings. The pilot program simply is not an effective or efficient process, especially given the Program's limited staffing. First, it is unrealistic for the Solid Waste Coordinator to expect his staff to compare every customer-signed receipt with the redemption center's daily reports and reimbursement request: according to the Solid Waste Coordinator's memorandum, some redemption centers average hundreds or even thousands of customers every day. Second, and more importantly, such reviews may identify relatively immaterial inputting errors, like what the Program staff uncovered during the pilot project, but is very unlikely to uncover more significant issues, such as the actual fraud that we reported in 2018.

As we have repeatedly stated, the core issue is that the department relies entirely on self-reported information from distributors and redemption centers about the number of containers sold and redeemed, respectively. Comparing the redemption center's daily reports and the redemption center's reimbursement requests does not address that substantial risk to the Program; the pilot program is only reviewing numbers that the redemption center self-reported on different reports. We were only able to identify the fraudulent overpayment by comparing the receipt that the redemption center provided to a consumer (e.g., our auditor), which Program staff does not collect from consumers. The redemption center's daily log containing the customers' signatures had been altered after the fact to add containers of different types of materials; the altered daily log matched the redemption center's reimbursement request submitted to DOH. Without the receipt given to the auditor with the payment of the redeemed container deposits, the redemption center's fraud would not have been detected.

The memorandum also mentions two other potential solutions and ideas that the Program is considering: contracting for third-party auditing of distributor records and an electronic management system for vendor reporting.

According to the memorandum, the department had developed a Request for Proposals (RFP) to solicit proposals for "compliance testing assistance" from third-party contractors, but because of the pandemic, the Solid Waste Coordinator decided that the RFP "would need to be revised to comply with new social-distancing requirements." However, the Program does not expect to issue the RFP. According to the memorandum, "[a] significant amount of time and effort goes into successful contract procurement and management: developing an effective RFP; managing the procurement process (including coordinating and seating a review panel); drafting a contract; onboarding the awarded contractor; managing, reviewing, and approving contract deliverables; managing the contract budget; and reviewing and approving contactor invoices. Personnel costs to oversee these tasks can negate potential cost savings from a competitive RFP."

We disagree with the Solid Waste Coordinator's belief that the cost to contract for and oversee a third party to administer the Program or to audit distributor and redemption center records will somehow be negated by the cost of the third party, which is unclear and certainly unsupported by the Program's history. From the Program's inception nearly 20 years ago, the department's administration of the Program has been "passive," consisting primarily of depositing funds submitted by distributors and paying amounts requested by redemption centers. However, we have repeatedly found significant underpayments by distributors and fraudulent overpayments to redemption centers. DOH must be accountable to its oversight of public funds. The Legislature explicitly empowered the department to contract for the services of a third party to administer the Program, and DOH can use the Special Fund to pay for those services as well as to fund audit and compliance activities to effectively oversee the Program.

The memorandum also states that the Office of Solid Waste Management is "in the process of developing a cloud-based electronic data management and warehouse system" to store all Program data. The department's Environmental Health Administration has executed a contract with a software developer, and the Office of Solid Waste Management has submitted paperwork to begin working with the developer. While the electronic system hopefully will improve the Program's management of its data, we note that it will not address the audit findings.

According to the memorandum, the "most significant long-term solution" for the department is to fully staff the Program's positions. While we agree that this is important, we reiterate that in the interim the Program can use the Special Fund to contract for a third party to administer the Program as well as to audit distributors and redemption centers. As previously noted, as of June 30, 2020, the Special Fund balance was $50.3 million, an increase of $5.7 million from June 30, 2019. Therefore, the Program has more than enough money to pay for a third party to administer the Program until the Program can properly administer itself. We believe that DOH should do so immediately because after more than 15 years and 8 audits, the State can no longer afford further DOH inaction.

We have recommended that the department develop a risk-based process to identify the distributors and redemption centers whose records should be audited. Audits do not review each transaction or

2013: Beyond Redepmption

IN REPORT NO. 13-08, published in November 2013, we found that, from FY2010 through FY2012, the Program paid $6.2 million in deposit refunds for almost 7.5 million pounds of containers that could not be accounted for. In other words, we identified a 7.5 million-pound difference between the amount of containers redemption centers claimed to have received from consumers and the amount they actually shipped to recyclers. In FY2010 alone, the program overpaid more than $4 million in deposit refund fees for more than 4.3 million pounds of unaccounted for material. Further, we found that a single redemption center, RRR Recycling, accounted for a difference of more than two million pounds of claimed containers, which resulted in it receiving about $2.2 million in potential overpayments of deposit fees.

Since RRR Recycling was unable to account for the difference in the weights it reported, DOH declined to pay the handling fees for the claims. However, the department did not require RRR Recycling to return any of the $2.2 million in overpayments for deposit refunds because it did not have the staff to investigate the matter.

compare every receipt with other records. Audits examine processes and internal controls that an organization has developed to provide reasonable assurance that its accounting records, which are the foundation of the organization's financial statements, are presented fairly and accurately. Auditors perform "testing" of a limited number of transactions – not all – to confirm that the processes and controls are being followed and that transactions are recorded appropriately. As we have recommended previously, the department should require distributors and redemption centers to develop and submit to the department an internal control process to provide reasonable assurance in the accuracy of the reports submitted to the department as well as to obtain a financial audit for years ending in odd numbers.

We continue to believe that DOH can significantly improve its administration of the Program by simply requiring distributors to periodically provide their supporting records, such as schedules of invoices, shipping documents, and point-of-sale reports, and to require redemption centers to provide information from recyclers with their requests for reimbursement.

Conclusion

The Department of Health has done little to nothing to address its Deposit Beverage Container Program's significant and fundamental problems. According to the Solid Waste Coordinator, it will take the Program about five years to address Report No. 19-08's findings, but note that the department has been aware of these perennial issues for going on 15 years now.

According to the Deputy Director for Environmental Health, the prior DOH Director believed that the department should not be administering the Program in the first place and that those duties should be contracted out. While in an interview, the Deputy Director indicated the department is not in the business of doing accounting or counting pennies, again we note the department has been tasked by the department to do so.

If the department believes that the administration of the Program is not aligned with its current capabilities, it should hire a third party to administer the Program until the Program can properly administer itself. We recommend DOH do so as soon as possible.

Recommendations

1. Department of Health (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, including Report Nos. 19-08, 17-02, and 15-02. DOH management should update and revise the objectives as appropriate.

2. DOH management should 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.

3. Program management should develop an action plan that details the specific measures that address the findings reported in Report Nos. 19-08, 17-02, and 15-02 and identifies additional resources that may be required. The action plan should also feature a corresponding timeline for implementation of the identified measures, including dates of deliverables and milestones. At a minimum, the action plan should include:

    a. A process to select distributor and redemption center reports submitted to the Program to audit on a periodic basis. That process should be risk-based and the Program should consider factors such as the number of transactions, prior findings reported in our audit reports as well as by distributor and redemption center's independent financial auditors, and the frequency of the distributor or redemption center's financial audits. Program management should retain an independent auditing organization, as authorized under 342G-104(b)(1), HRS, to perform the audits if the Program does not have sufficient staff or expertise to perform that work.

    b. A requirement for distributors to periodically submit records that support the information contained in the Monthly Distribution Report Form, such as schedule invoices, shipping documents, and point-of-sale records. The records may allow the Program to identify differences in the Monthly Distribution Report Forms.

   c. A process to consider and initiate administrative enforcement actions, as appropriate.

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.

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.

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.

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 type generated by the certified recycling facility. While we recognize that the materials redeemed may not be the same materials received by the recycling facility during the period, Program management should consider whether it can reasonably account for such differences. The purpose of reconciling the weights is to provide a certain level of assurance about the accuracy of the number of containers the redemption center has claimed to have redeemed and for which it has been reimbursed by the Program.

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.

Financial Statement Audit

KMHLLP

A Hawaii Limited Liability Partnership

Independent Auditor's Report

To the Auditor
State of Hawai'i

Report on the Financial Statements

We have audited the accompanying 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, 2020, 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.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2020, and the change in its financial position and the budgetary comparison thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

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, 2020, and the respective 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.

Other Matters

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 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 is 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 December 15, 2021 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 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
December 15, 2021

Department of Health

State of Hawai`i

Deposit Beverage Container Deposit Special Fund
Balance Sheet - Governmental Fund
June 30, 2020

Assets

Equity in Cash and Cash Equivalents and Investments in State Treasury	$ 55,651,854
Accounts Receivable	166,016
Interest Receivable	91,937
Total assets	$ 55,909,807

Liabilities and Fund Balance

Liabilities:	
Vouchers and contracts payable	$ 3,299,780
Accrued wages and employee benefits	33,621
Unearned revenue	200,000
Beverage container deposits	2,046,895
Total liabilities	5,580,296
Fund Balance--	
Committed to Deposit Container Program	50,329,511
Total liabilities and fund balance	$ 55,909,807

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, 2020

Revenues:	
Deposit beverage container fees	$ 7,921,811
Unredeemed deposits	18,864,489
Interest income	874,639
Total revenues	27,660,939
Expenditures:	
Handling and redemption fees	20,713,091
Operating expenditures	1,174,775
Administrative expenditures	54,729
Total expenditures	21,942,595
Change in fund balance	5,718,344
Fund Balance at July 1, 2019	44,611,167
Fund Balance at June 30, 2020	$ 50,329,511

See accompanying notes to the financial statements.

Department of Health
Deposit Beverage Container Deposit Special Fund
State of Hawai`i
Budgetary Comparison Statement
For the Fiscal Year Ended June 30, 2020

	Budgeted Amounts			
	Original	**Final**	**Actual on Budgetary Basis**	**Variance Favorable (Unfavorable)**
Revenues--				
Current-year Funds	$ 71,207,053	$ 71,207,053	$ 58,455,057	$ (12,751,996)
Expenditures--				
Environmental Health Administration	71,207,053	71,207,053	69,973,369	1,233,684
Deficiency of revenues under expenditures	$ -	$ -	$ (11,518,312)	$ (11,518,312)

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, 2020

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, 2020, 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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

addition, the amounts for deposits of $0.05 are deferred when collected, and the amount estimated to be forfeited is recognized as revenue at the end of the fiscal year.

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, 2020, the DBC Fund's portion of these accruals was as follows:

Total fund balance on the modified-accrual basis of accounting	$ 50,329,511
Capital assets used in governmental activities are not financial resources and therefore are not reported as an asset in the governmental funds	12,799
Compensated absences reported in the statement of net position do not require the use of curret financial resources and are not reported as liabilities in the governmental funds	(543,169)
Total net assets on the full accrual basis of accounting	$ 49,799,141

At June 30, 2020, the DBC Fund's portion of the department-wide activities is not materially different from the DBC Fund's activity.

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. 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.

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, 2020, 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, 2020.

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. Deferred Outflows/Inflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and will not be recognized as an outflow of resources (expense/expenditure) until that time. Deferred inflows of resources represent an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The DBC Fund does not have any items that qualify for reporting in these categories.

8. 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.

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

Notes to Financial Statements
June 30, 2020

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.

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.

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

Notes to Financial Statements
June 30, 2020

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

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 2020, to the change in fund balance presented in conformity with U.S. GAAP follows:

Deficiency of revenues under expenditures - actual on a budgetary basis	$ (11,518,312)
Current year's appropriations encumbered at June 30, 2020	20,650,053
Expenditures for liquidation of prior fiscal year encumbrances	(6,363,814)
Accruals and other adjustments	2,950,417
Change in fund balance - U.S. GAAP basis	$ 5,718,344

NOTE D - BEVERAGE CONTAINER DEPOSITS

The changes to the beverage container deposits liability during fiscal year 2020 were as follows:

Balance as of July 1, 2019	$ 2,976,891
Increase: Deposits Received from distributors	48,657,827
Decrease: Payments made to recycling centers, net of refunds	(30,723,334)
Decrease: Unredeemed deposits recognized as revenue	(18,864,489)
Balance as of June 30, 2020	$ 2,046,895

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 Hawai‘i, ERS’s, and EUTF’s Comprehensive Annual Financial Reports (CAFR), or the audited financial statements of the Department. The State’s CAFR can be found at the DAGS website: http://ags.hawaii.gov/reports/financial-reports/. The ERS CAFR can be found at the ERS website: http://ers.ehawaii.gov/resources/financials/. The EUTF CAFR can be found at the EUTF website: http://eutf.hawaii.gov/reports/.

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, 2020, 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, 2020.

Covid-19 Developments

On March 4, 2020, in response to a new disease commonly known as COVID-19 caused by a novel strain of coronavirus, Hawaii Governor David Y. Ige (the Governor) proclaimed the spread of COVID-19 in Hawai‘i to be a disaster and declared a state of emergency in Hawai‘i. Several emergency proclamations have been issued. The coronavirus and actions taken to mitigate it have had and are expected to continue to have an adverse impact on the economies and financial markets of many countries, including the State of Hawai‘i. It is unknown how long these conditions will last and what the financial effect will be to the DBC Fund.

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, 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, 2020, 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 December 15, 2021.

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) 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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund'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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described below, that we consider to be a significant deficiency:

1003 Bishop Street Suite 2400 Honolulu, HI 96813 Telephone: 808-526-2255 Fax: 808-536-5817 www.kmhllp.com

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. 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.

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 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*.

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 auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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
December 15, 2021

Office of the Auditor's Comments on the Department of Health's Response to the Audit Findings

WE PROVIDED A DRAFT OF THIS REPORT to the Department of Health (DOH) and met via video conference with the Deputy Health Director, Deputy Director of Environmental Health, Solid Waste Coordinator, and DOH's Administrative Services Officer to discuss our audit findings. DOH provided its written response to the draft report, which is reproduced in its entirety as Attachment 1.

As we expressed during that meeting, we are encouraged by DOH's efforts to fill vacant Program positions and to address issues identified in Report No. 19-08 as well as the previous seven audits. However, we note that most of those efforts were initiated after the period of this audit (July 2018 through June 2020). While we look forward to learning more about these actions and auditing the improvements to the administration of the Program that they may bring, we do not believe revisions to the draft report are warranted.

In its response, DOH states it "strongly disagrees" with our "opinion" that it has done little to address long-standing Program issues, findings that have been reiterated in report after report. DOH's and the Program's inaction in addressing previous audit findings and implementing previous recommendations is fact, not opinion. As we stated in the report, DOH and Program management admitted in our initiation meeting of this audit, and throughout the audit, that it had not taken any formal action – and very little informal action – to address the findings or to implement the recommendations in Report No. 19-08.

It is that admission by management that prompted a different approach for this audit. Instead of conducting limited and selective testing of distributor and redemption center compliance – which is management's responsibility – and coming to the same conclusion as we had in previous audits, we redirected our review to ascertain why DOH has not addressed the long-standing findings.

While the department also states that some DOH employees who we interviewed are no longer with the department and that opinions of previous employees/administrations may not necessarily reflect the opinions of DOH's current management team, these interactions appear to have been productive since DOH notes that some of its recent efforts were undertaken or revised as a result of our discussions with current Program management. Moreover, as noted above, the audit examines the Program's operations, generally, during July 2018 through June 2020. The DOH managers and staff who we interviewed for this report were employed by the department during the audit period.

Finally, we agree with DOH that the public's trust is hard to earn and easy to lose, and it will take time and significant effort to restore the public's trust in the Program. We are encouraged by the department's newfound commitment to improving the Program operations, and we look forward to reviewing and verifying the results of future efforts.

DAVID Y. IGE
GOVERNOR OF HAWAII

ELIZABETH A. CHAR, M.D.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P. O. BOX 3378
HONOLULU, HI 96801-3378

In reply, please refer to:
File:

December 10, 2021

Mr. Leslie H. 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 2020 Financial and Program Audit of the Department of Health's (DOH) Deposit Beverage Container (DBC) Program (draft 2020 DBC Program Audit).

Due to exigent circumstances, DOH recognizes that the draft 2020 DBC Program Audit, which covers July 2018 to June 2020, is only being published now. Please note that some interviewees cited in the draft 2020 DBC Program Audit are no longer with DOH, notably the Director of Health and Deputy Director of the Environmental Health Administration, and the opinions held by former DOH administrators may not necessarily reflect the opinions of DOH's current management team.

DOH acknowledges that there are issues identified in the draft 2020 DBC Program Audit that need to be addressed, however DOH strongly disagrees with the opinion that DOH has been passive and has done little to address the issues identified. Recommendations prescribed in the 2018 DBC Program Audit and the draft 2020 DBC Program Audit have been implemented or are in the process of being implemented, including: addressing staffing issues; developing a solicitation to review distributor reports and ensure proper payment to the State; requiring redemption center fraud prevention plans with certification applications; increasing materials inventory inspections at redemption centers and reconciling reported redemption amounts with documented weight tickets from independent end users; and developing a data management system, among other activities.

Specifically, since the March 2019 publication of the 2018 DBC Program Audit, DOH's Office of Solid Waste Management (OSWM), which oversees the DBC Program, has undertaken the following activities to address identified issues:

Leslie H. Kondo
December 10, 2021
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Recruiting and Staffing
When the 2018 DBC Program Audit was published in March 2019, only six of eighteen positions in OSWM were filled. OSWM's supervisor would depart shortly after, leaving just five staff to manage all of OSWM's responsibilities (in addition to the DBC Program, OSWM manages the State's Electronic Waste Recycling Program, the State's Glass Advance Disposal Fee Program, and other State solid waste planning activities).

Since then, DOH has made a concerted effort to address the severe staffing shortfall. In the past two years, OSWM onboarded an account clerk, three accountants, two planners, a senior inspector, and a new supervisor. The time and effort to conduct recruiting efforts, fill these vacant positions, and train new hires in two years is a significant accomplishment.

Unfortunately, Act 88, SLH 2021 defunded two special-funded vacant inspector positions and eliminated a third vacant inspector position that was being redescribed into a supervising inspector. DOH has requested to restore the funding for the two defunded positions and will request creating a new supervising inspector position as OSWM's inspection section is filled.

The addition of the senior inspector has substantially increased existing enforcement activities, but filling the remaining vacant positions, particularly the vacant inspector positions, is foundational to meeting the audit recommendations. A fully-staffed enforcement section can perform significantly more inspections at redemption centers, expeditiously resolve complaints, and conduct enforcement actions on redemption centers and distributors.

DOH has rightly been focused on staffing needs first as it directly improves program performance. DOH continues to assemble a knowledgeable, skilled, and dedicated team to administer the DBC Program and therefore is not seeking the services of a third-party assistant to administer the Program at this time. DOH recognizes the option if the need arises in the future.

Distributor Reporting Analysis and Review
As recommended in the 2018 DBC Program Audit, DOH is currently developing a scope of services to solicit a contractor to assist DOH with developing a risk-based framework to identify monthly and semi-annual distributors for additional report reviews. Once this framework is developed, the contractor will be expected to work with DOH to analyze these distributor reports, receipts, shipping manifests, and other relevant documents to ensure the fidelity of the reports submitted to DOH and ensure that proper payment has been remitted. The contractor will also be expected to assist DOH with developing a

training manual and provide guidance to current DBC Program accounting staff for future implementation by the DBC Program without the need for outside contractor assistance. DOH anticipates that the selected contractor will be on board by mid-2022.

Redemption Center Receipt Review
In July 2020 DOH began a pilot project to review all customer receipts and cross-reference with redemption center logs and redemption center reimbursement requests. Amidst the COVID-19 pandemic, and with an uncertain economic and budgetary outlook from the impact of the pandemic, DOH felt that this approach could have the potential to address an issue identified in the 2018 DBC Program Audit internally without the cost of soliciting the services of a third-party contractor. As this was a pilot project, DOH understood that implementing other controls would be warranted if results from the pilot project were not commensurate with efforts. A couple of small redemption centers were identified, and customer receipts from those redemption centers were reviewed. Per discussion with the State Auditor in May 2021, it was agreed that the value of the findings from the pilot project were outweighed by the effort expended and DOH ended the pilot project based on feedback from the State Auditor.

Redemption Center Fraud Prevention Plans
Also arising from the discussion with the State Auditor in May 2021, DOH revised its redemption center certification applications to require that all redemption center applicants submit an operational plan that describes methods to ensure that all customer receipts correlate with collected deposit beverage containers to prevent fraud. This requirement applies to all new redemption center certification applications, and existing certified redemption centers are required to submit fraud prevention plans when renewing expired certifications. DOH inspectors are responsible for enforcing that the fraud prevention plans are submitted, are actionable, and are implemented by the redemption center.

Redemption Center Inventory Inspections
Beginning in July 2021, DOH has increased the frequency of inventory inspections at redemption centers to document and track the amount of deposit beverage containers collected by the redemption centers. What was once an annual inspection is now performed on every redemption center on a quarterly basis. Inventories (i.e., bales of redeemed deposit beverage containers and corresponding estimated weights) documented by DOH inspectors are then cross-referenced by the DBC Program accountants to help verify reported redemptions. In addition, DBC Program accountants perform reconciliations between reported redemptions and documented weight tickets from independent end users to provide a certain level of assurance about the accuracy of the number of containers that are claimed.

Leslie H. Kondo
December 10, 2021
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Data Management and Reporting
In January 2021, DOH entered into an agreement with the DOH Environmental Management Division's software vendor to update and facilitate the DBC Program's data management and reporting functions. The first phase, which recently concluded, developed a foundational "warehouse" to store and interface with all OSWM program data and implement mapping functions. The second phase, which has just begun, is to develop a mobile application for DOH and county inspectors to use while inspecting redemption centers and retailers. The mobile application feature is expected to be completed by mid-2022. Future phases include developing an online portal for distributor reports and payments in 2022, and the digitization of redemption center reporting after the distributor reporting component is completed. DOH is also exploring how to implement recording individual customer transactions that would be reported directly to DOH at the point of redemption. When implemented successfully, this will reduce extra data reporting and transcription efforts by the redemption centers and DOH, and will prevent the manipulation of data from the point of redemption through DOH reimbursement to the redemption center.

Other Audit Recommendations
DOH will be implementing the following activities to address other draft 2020 DBC Program Audit recommendations:

- The DBC Program is developing a plan to address the findings from the draft 2020 DBC Program Audit that includes implementation timelines and identifies resources needed, if applicable.

- In 2022 OSWM will begin the process of updating its Integrated Solid Waste Management Plan (the Request for Proposals to solicit assistance with the update is currently being drafted), and a component of that update includes reviewing existing administrative rules that govern OSWM's recycling programs and developing proposed revisions as necessary. This includes assessing and updating existing distributor and redemption center reporting requirements in Hawaii Administrative Rules Chapter 11-282, "Deposit Beverage Container Recycling."

- As mentioned, as part of its distributor report review solicitation, the awarded contractor shall assist DOH with developing a training manual. DBC Program accounting procedures are also being reviewed and updated, and enforcement procedures will be updated as the section is staffed, and roles defined.

Other DBC Program Activities

DOH has also implemented the following activities to improve the DBC Program:

- DOH has prioritized maintaining the public's access to certified redemption centers. In the past two years, DOH has executed a contract to ensure continuous access on the Island of Lānaʻi for the next five years, worked with a partner to open a redemption center in Kahuku, and is currently working with a partner to fill a void in Windward Oʻahu. Providing the public with convenient access to redeem deposit beverage containers will improve the DBC Program's redemption rate.

- Finding No. 2019-001, in the June 30, 2019 DOH financial audit, identified a material weakness with the DBC Program's financial reporting efforts. DOH promptly addressed the issue and per the June 30, 2020 DOH financial audit, the State Auditor recognized that the 2019 finding was no longer applicable.

Despite the impact of COVID-19 on the State's economy, and specifically the uncertainty surrounding spending limits and budget reductions in 2020, DOH has unceasingly focused on improving the DBC Program with the tools at its disposal. DOH continues to make a substantial investment in its staff and its efforts to improve the DBC Program's performance and address issues identified by the State Auditor.

DOH recognizes that trust is hard to earn and easy to lose. It will take time and significant effort to regain the public's trust after years of perceived inaction, and DOH is committed to improving the DBC Program to restore the public's trust. DOH has every expectation that the 2022 DBC Program Audit will reflect the efforts DOH is making today, and that upon review DOH was anything but passive.

DOH thanks you for your efforts and for the opportunity to comment on the draft 2020 DBC Program Audit. If you have any follow-up questions, please contact me at (808) 586-4410.

Sincerely,

ELIZABETH A. CHAR, M.D.
Director of Health