
Financial Audit of the Department of Agriculture

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

Report No. 94-22
December 1994



THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.
2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.
3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.
4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.
5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.
6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.
7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.
8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.
9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.



THE AUDITOR STATE OF HAWAII

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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Department of Agriculture

Summary

The Office of the Auditor and the certified public accounting firm of Coopers & Lybrand L.L.P. conducted a financial audit of the Department of Agriculture for the fiscal year July 1, 1993 to June 30, 1994. The audit examined the department's financial records and its systems of accounting and internal controls and tested these for compliance with applicable laws and regulations.

In the opinion of Coopers & Lybrand L.L.P., the department's financial statements present fairly its combined financial position and the combined results of its operations for the fiscal year ended June 30, 1994. All are in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P. noted no matters involving the internal control structure and its operation that they considered to be material weaknesses as defined in the report on the internal control structure. They also noted, with respect to items tested, that the department has complied, in all material respects, with laws and regulations applicable to the department.

We are pleased to note that the department has implemented most of our 1988 recommendations. The department, however, still needs to strengthen its loan administration and adhere to procedures in its policies and procedures manual. We found also that moneys held in a trust fund should be returned to the general fund and two funds should be repealed.

With respect to internal controls over loan processing, we found that: supervisory reviews of information entered into the computer are needed, the same individual who authorizes changes to loan account information makes the changes, loan payment statements could be improved to facilitate departmental processing, and requirements in administrative rules and the policies and procedures manual are not being followed.

We also found that \$3 million held in the Hamakua Sugar Loan Guaranty Trust Fund should not be so held and the Agricultural Park Special Fund and Irrigation System Revolving Fund are not self sustaining.

Recommendations and Response

We recommend the department transfer to the general fund the \$3 million held in the Hamakua Sugar Loan Guaranty Trust Fund and that any additional receipts of the fund also be transferred to the general fund. We also recommend that the Agricultural Park Special Fund and the Irrigation System Revolving fund be repealed and cash balances in the funds be transferred to the general fund. The programs can be supported through general fund appropriations.

Further, we recommend that the department strengthen its loan administration procedures by: conducting supervisory reviews of information entered into the computer, separating the duties of authorizing changes to accounts and making those changes, modifying the computer program to generate its loan payment statements, establishing procedures to determine whether financial institutions are complying with Hawaii Administrative Rules for participatory loans, and following loan administration procedures in its manual.

The department agrees with our recommendation that \$800,000 appropriated to the Hamakua Sugar Loan Guaranty Trust Fund be transferred to the general fund. It disagrees however that the \$2.2 million in fees earned on the loan guaranty should be returned to the general fund. It cites an inter-departmental memorandum of agreement as authority to keep the bulk of the moneys to replenish the Agricultural Loan Revolving Fund for loans to the company. We point out that emergency loans to the Hamakua Sugar Company were made possible by additional general fund appropriations to the revolving fund. The appropriation to the Hamakua Sugar Loan Guaranty Trust Fund was for a different purpose and its earnings should not be transferred to the revolving fund based upon an inter-departmental memorandum of agreement. Any cash infusions to the revolving fund should be made through legislative appropriations. Any other disbursements to other departments would be an avoidance of the appropriations process. We stand by our recommendation that the earnings of the trust fund be returned to the general fund.

The department agrees with our recommendations to improve controls over loan processing. The department disagrees with our recommendation to repeal two funds and return cash balances to the general fund. The department does not agree with the criterion of self-sustainability. This criterion, however, of self-sustainability is based on government financing theory. We continue to stand by it and our analysis of the two funds. The department also provided additional information not provided during the audit and an attachment to its letter that caused us to make changes to our report draft. The department's attachment is not included in this report but is available for inspection at our office.

Marion M. Higa
State Auditor
State of Hawaii

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A Report to the
Governor
and the
Legislature of
the State of
Hawaii

Conducted by

The Auditor
State of Hawaii
and
Coopers & Lybrand
L.L.P.

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 94-22
December 1994

Foreword

This is a report of the financial audit of the Department of Agriculture for the fiscal year July 1, 1993 to June 30, 1994. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct post audits of all departments, offices, and agencies of the State. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Coopers & Lybrand L.L.P.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Agriculture.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the State of Hawaii Department of Agriculture. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Coopers & Lybrand L.L.P.

The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct post audits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions.

Background

In the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959), the Legislature created the Department of Agriculture. Section 26-16, Hawaii Revised Statutes, describes the department's responsibilities as follows:

The department shall promote the conservation, development, and utilization of agricultural resources in the State; assist the farmers of the State and others engaged in agriculture by research projects, dissemination of information, crop and livestock reporting service, market news service, and any other means of improving the well-being of those engaged in agriculture and increasing the productivity of the lands, and administer the programs of the State relating to animal husbandry, entomology, farm credit, development and promotion of agricultural products and markets, and the establishment and enforcement of the rules on the grading and labeling of agricultural products.

Organization of the Department

The Board of Agriculture establishes broad operating policies for the department. The board consists of eight members: one from each of the counties of Hawaii, Maui, and Kauai; four at-large; and the chairperson of the Board of Land and Natural Resources who serves as an ex-officio voting member. The members are appointed by the governor with the advice and consent of the Senate. The governor selects one member as the chairperson of the board. The chairperson of the Board of Agriculture serves as a full-time administrator, performing such duties and exercising such powers and authority as delegated by the board.

A number of statutorily established advisory committees advise and assist the department in developing policies or revising laws and regulations. The members of the committees are appointed by the

governor. Active committees include advisory committees on agricultural products, flowers and foliage, markets, pesticides, and plants and animals.

Offices and divisions

The offices and divisions that carry out the programs of the department are as follows:

Administrative Services Office. Provides support services to the department in the areas of personnel, fiscal, budget and management, office services, motor pool, facilities management, information processing and office automation.

Planning and Development Office. Formulates and implements general and special plans for agriculture and agricultural parks, reviews and comments on land use applications, and assists in developing diversified agricultural industries.

Agricultural Loan Division. Administers the loan programs of the department designed to promote the agricultural development of the State by stimulating, facilitating, and granting loans to qualified farmers and agriculturists. It also provides loans in participation with private lenders and guarantees loans made by private lenders.

Agricultural Resource Management Division. Develops and manages the State's irrigation water program and manages the agricultural park program. The division also administers agriculture-related facilities that are either state owned or under the department's jurisdiction.

Animal Industry Division. Responsible for the detection, control, and prevention of diseases among livestock and poultry. The division conducts animal disease surveillance and epidemiology, laboratory diagnosis, meat and poultry inspection, animal and bird importation inspection, voluntary meat grading, and brand registration. It also operates the animal quarantine station.

Marketing Division. Provides services and enforces regulations designed to improve the efficiency of agricultural production and marketing. It collects and publishes agricultural statistical data and is responsible for programs to improve the market quality of agricultural, horticultural, and processed commodities. It provides for the inspection and grading of processed foods, the enforcement of labeling requirements, and the promotion of fair trade and honesty in the marketing of agricultural products.

Measurement Standards Division. Responsible for assuring equitable transactions relating to weights and measures, packaging and labeling, petroleum products, and odometers. It assures that state standards

conform to federal standards in weights and measures and determines length, volume, and mass standards through comparisons with the National Bureau of Standards.

Plant Industry Division. Protects agricultural industries and natural resources from the entry and establishment of detrimental insects, weeds, and other pests. It also assures the safe and efficient use of pesticides in Hawaii.

Objectives of the Audit

1. Report on the fair presentation of the financial statements of the department.
 2. Assess the adequacy, effectiveness, and efficiency of the department's systems and procedures for financial accounting, internal control, and financial reporting; and recommend improvements.
 3. Ascertain whether expenditures and other disbursements have been made and all revenues and other receipts have been collected and accounted for in accordance with federal and state laws, rules, and policies and procedures.
 4. Ascertain the extent to which recommendations contained in Chapters 4 and 5 of the State Auditor's Report No. 88-13 "Financial Audit of the Department of Agriculture for the Fiscal Year Ended June 30, 1987," have been implemented.
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Scope and Methodology

We audited the financial records and transactions and the related systems of accounting and internal controls of the Department of Agriculture for the fiscal year July 1, 1993 to June 30, 1994. Included were all fund types and account groups, except the general fixed assets account group. We also reviewed for compliance with applicable laws and regulations those transactions, systems, and procedures tested.

The audit examined the accounting, reporting, and internal control structure to identify deficiencies and weaknesses and make appropriate recommendations for improvements. Covered were the forms and records, the management information system, and the accounting and operating procedures.

The accountants' opinion as to the fairness of the financial statements presented is that of Coopers & Lybrand L.L.P. The audit was conducted from July 1994 through October 1994 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Practices

Internal controls are steps instituted by management to assure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the Department of Agriculture. We were pleased to note that the department has implemented most of the recommendations contained in our 1988 report. The department, however, still needs to strengthen its loan administration and adhere to procedures in its *"Agricultural Loan Division Policies and Procedures Manual."*

Summary of Findings

1. Three million dollars held in the Hamakua Sugar Loan Guaranty Trust Fund should be returned to the general fund.
2. The department's loan administration procedures should be strengthened.
3. The Agricultural Park Special Fund and Irrigation System Revolving Fund should be repealed.

\$3.0 Million Should Be Transferred to the General Fund

Act 85, SLH 1993, created the Hamakua Sugar Loan Guaranty Trust Fund to deposit reserve money for all loans guaranteed under the Act. The act appropriated \$800,000 to the fund and authorized up to \$8 million in loan guarantees. In 1993 the trust fund was used to guarantee a loan made to harvest the last sugar crop of the Hamakua Sugar Company which has been repaid. The guaranty agreement provided for fees consisting of a stipulated monthly amount and a portion of the net profits of the crop harvest. The fees are being paid from cash sales of the harvested crop. As of June 30, 1994, the department had received \$1,767,655 in fees for providing the loan guaranty. Also fees of more than \$450,000 have been received for crop sales since June 30, 1994.

Since the crop has been harvested, the loan has been repaid, and the loan guaranty expired on November 1, 1994, the \$800,000 appropriated to the trust fund should be returned to the general fund. In addition, all of the \$2.2 million in fees earned to date should be returned to the general fund. Any fees received in the future should also be transferred to the general fund.

Recommendations

We recommend the department immediately transfer to the general fund the \$800,000 appropriation and the \$2.2 million in fees earned by the Hamakua Sugar Loan Guaranty Trust Fund. We also recommend that fees not yet received be transferred to the general fund as they are received.

Internal Controls Over Loan Processing Need Strengthening

Appropriate internal controls would provide assurance that loan transactions are executed in accordance with management's authorization and are properly recorded by the department. We find that better internal controls over loan processing are needed.

Supervisory reviews are needed

Initial loan account information that is entered into the loan computer program does not receive any supervisory review. Since the information is used to generate annual billing statements and calculate the amount of interest and principal due, it is critical that the information entered into the program be correct. A supervisory review of the initial loan account information could detect incorrect information that may remain as standing data in the loan computer program.

Controls over account information should be strengthened

Controls over changes to loan account information are lacking. The department allows the same individual both to authorize and make changes to the loan account information. No separate review is made by another individual. Segregating responsibilities for authorizing, performing, and reviewing changes made to the loan account information would help assure the validity and accuracy of the loan account information. The department should assign someone other than the person making the changes to review and approve the changes.

Loan payment statements could be improved

The agriculture loan computer program is only capable of generating annual payment statements for loans. Monthly payment statements must be prepared manually. More than 30 of these statements are prepared each month. The department should modify the computer program so that it can generate monthly statements.

Also, the statements now being prepared do not clearly identify previous payments, outstanding balances, and currently due principal and interest amounts. This makes it difficult for the department to determine readily the amount of principal and interest to apply to loan payments. Using a more understandable format would reduce the time required to process loan payments.

Controls over loan disbursements should be strengthened

During the year the department issued 21 loans totaling \$3,032,000. Seven of these loans were made in participation with Hawaii financial institutions. Participation agreements with these institutions stipulate that the participating institutions are responsible for administering the loans and ensuring compliance with Hawaii Administrative Rules relating to loans. For example, Section 4-8-19 requires that loan proceeds be disbursed only after the loan is properly secured. The department has not established any procedures to determine whether the participating financial institutions are in compliance with the rules. During our testing, we found that a financial institution had disbursed a \$594,000 participation loan to the borrower before the loan was secured by a property lien duly recorded with the Bureau of Conveyances.

The department should establish procedures to verify whether participating financial institutions are complying with loan procedures (i.e., date for recording lien instruments and subsequent loan fund disbursement); or, at least to periodically review the institutions' loan administration procedures for compliance with the rules.

Required annual reports are not received

Section 25201 of the department's *Agricultural Loan Division Policies and Procedures Manual* requires borrowers to submit annual financial statements to the department. As was the case in 1988, we find that the department still fails to enforce this policy. The department does request annual financial statements from the borrowers. But, after the initial request, the department makes no further efforts to obtain current annual financial statements from borrowers unless they have poor repayment histories. Sound loan administration practices would include periodic reviews of borrowers' financial condition. Submission of annual reports by borrowers' would enable the department to conduct the required review.

Required inspections are not being performed

Section 25102 of the manual requires an initial on-farm visit and inspection within three months of the loan disbursement. In addition, Section 25801 of the manual requires staff to document the visit in the loan file. We found that these procedures are not being consistently followed. Sound loan administration practices require timely initial visits to ensure that loan funds are being used for the intended purposes. The visits should be properly documented in the loan files.

Recommendation

We recommend that the department strengthen its loan administration procedures by:

- a. Conducting supervisory reviews of loan account information entered into the computer;

- b. Separating the duty of making changes to loan account information from reviewing and authorizing the changes;
- c. Modifying the computer loan program so that it can generate monthly statements that clearly reflect the application of previous payments, the resulting outstanding balances, and the currently due principal and interest amounts;
- d. Establishing procedures to determine whether participating institutions are in compliance with Hawaii Administration Rules for the participatory loans; and
- e. Following loan administration procedures in its manual requiring submission of annual financial statements by borrowers and conducting and documenting the required on-farm visits.

Agricultural Park Special Fund and Irrigation System Revolving Fund Should Be Repealed

In our report 91-10, *Review of Special and Revolving Funds of the Departments of Accounting and General Services, Agriculture, and Budget and Finance*, we identified three criteria to be used to determine whether a special or revolving fund should be continued. These criteria are the extent to which the fund:

1. Continues to serve the purpose for which it was originally created;
2. Reflects a clear link between the benefit sought and charges made upon the users or beneficiaries of the program, as opposed to serving primarily as a means to provide the program or users with an automatic means of support which is removed from the normal budget and appropriations process; and
3. Demonstrates the capacity to be financially self-sustaining.

In that report, we recommended that the Agricultural Park Special Fund and Irrigation System Revolving Fund be repealed and the programs funded through the general fund of the State of Hawaii as the funds did not meet the third criterion of being self-sustaining. These funds continue to receive annual appropriations from the State's general fund. For FY1993-94, the Agricultural Park Special Fund received \$65,000 and the Irrigation System Revolving Fund received \$235,000. Financial data (in thousands) for these funds are as follows:

Table 2.1
Agricultural Park Special Fund
Five-Year Financial Summary
Years ended June 30

	1990	1991	1992	1993	1994
Beginning balance	\$72	\$142	\$204	\$261	\$232
Appropriations	—	—	40	49	65
Receipts	89	114	126	118	224
Interest	4	6	6	2	—
Expenditures	(23)	(58)	(115)	(198)	(164)
Ending balance	\$142	\$204	\$261	\$232	\$357

Table 2.2
Irrigation System Revolving Fund
Six-Year Financial Summary
Years ended June 30

	1989	1990	1991	1992	1993	1994
Beginning balance	\$109	\$268	\$595	\$898	\$1,066	\$952
Appropriations	1,115	523	501	400	294	235
Receipts	412	417	477	509	455	469
Interest	12	10	18	26	22	7
Expenditures	(1,426)	(623)	(693)	(767)	(885)	(898)
Other	46	—	—	—	—	—
Ending balance	\$268	\$595	\$898	\$1,066	\$952	\$765

These tables reflect direct receipts and expenditures for the funds. They also include assessments of the Agricultural Park Special Fund for administrative and central services costs for 1993 and 1994.

The two programs have developed millions of dollars of capital improvement projects and are planning more. These projects are not financed through the two funds but have been and continue to be financed through general fund appropriations and general obligation bonds. The State general fund also makes the debt service payments for these bonds.

As these funds have been unable to operate on a self-sustaining basis, we again recommended that the funds be repealed and that the programs be supported through the State of Hawaii general fund.

Recommendations

We recommend that the Agricultural Park Special Fund and the Irrigation System Revolving Fund be repealed and balances in these funds be transferred to the general fund. The programs can be supported through general fund appropriations.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Department of Agriculture for the year ended June 30, 1994. It includes the independent auditors' report and reports on the internal control structure and tests of compliance with laws and regulations. It also displays financial statements of all fund types and account groups administered by the department, together with explanatory notes.

Summary of Findings

In the opinion of Coopers & Lybrand L.L.P., based on their audit, except for the general fixed assets account group, the financial statements present fairly, in all material respects, the financial position of the department as of June 30, 1994, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P. noted no matters involving the internal control structure and its operation that they considered to be material weaknesses as defined in the report on the internal control structure. They also noted, with respect to items tested, that the department has complied, in all material respects, with laws and regulations applicable to the department.

Independent Auditors' Report

To the Auditor
State of Hawaii

We have audited the following financial statements of the State of Hawaii, Department of Agriculture:

Combined balance sheet—all fund types and account groups—
June 30, 1994 (Exhibit A);

Combined statement of revenues, expenditures and changes in
fund balances—all governmental fund types and expendable
trust funds—for the year ended June 30, 1994 (Exhibit B);

Combined statement of revenues and expenditures—budget and
actual (budgetary basis)—general and special revenue fund
types—for the year ended June 30, 1994 (Exhibit C).

These financial statements are the responsibility of the management of the State of Hawaii, Department of Agriculture. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards and *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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with the terms of our engagement, the scope of our audit did not include the audit of the general fixed assets account group and, accordingly, we express no opinion on it.

As discussed in the notes to the financial statements, the general fund accounts of the Department of Agriculture are a part of the State of Hawaii's general fund and our opinion expressed herein, insofar as it relates to the amounts included for the general fund is limited to only the transactions of the Department of Agriculture.

In our opinion, based upon our audit, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the general fixed assets account group, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Hawaii, Department of Agriculture as of June 30, 1994, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining financial statements (Schedules I through III) are presented for purposes of additional analysis and are not a required part of the financial statements of the State of Hawaii, Department of Agriculture. Such information has been subjected to the auditing procedures applied in the audit of the

financial statements, and in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

/s/ Coopers & Lybrand L.L.P.

Honolulu, Hawaii
October 7, 1994

**Report on the
Internal Control
Structure Based
on an Audit of
Financial
Statements
Performed in
Accordance with
Government
Auditing
Standards**

To the Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Department of Agriculture as of and for the year ended June 30, 1994, and have issued our report thereon dated October 7, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *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 of material misstatements.

In planning and performing our audit of the financial statements of the State of Hawaii, Department of Agriculture for the year ended June 30, 1994, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of the State of Hawaii, Department of Agriculture is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal

control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Revenue/Receipts cycle
- Purchases/Disbursements cycle
- Payroll cycle
- Compliance with laws and regulations that would have a material impact on the financial statements

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors and irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the Auditor, State of Hawaii, in Chapter 2 of this report.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department

of Agriculture. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

/s/ Coopers & Lybrand L.L.P.

Honolulu, Hawaii
October 7, 1994

**Report on Tests of
Compliance Based
on an Audit of the
Financial
Statements
Performed in
Accordance with
Government
Auditing
Standards**

To the Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Department of Agriculture as of and for the year ended June 30, 1994, and have issued our report thereon dated October 7, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *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 of material misstatement.

Compliance with laws and regulations applicable to the State of Hawaii, Department of Agriculture is the responsibility of the State of Hawaii, Department of Agriculture's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the State of Hawaii, Department of Agriculture's compliance with certain provisions of laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, the State of Hawaii, Department of Agriculture complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Hawaii, Department of Agriculture had not complied, in all material respects, with those provisions.

This report is intended for the information of the Auditor, State of Hawaii and management of the State of Hawaii, Department

of Agriculture. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

/s/Coopers & Lybrand L.L.P.

Honolulu, Hawaii
October 7, 1994

Descriptions and Definitions

This section provides descriptions of the financial statements audited and definitions of technical terms used in this chapter.

Descriptions of financial statements and schedules

The following is a brief description of the financial statements audited by Coopers & Lybrand. The financial statements are attached at the end of this chapter.

Combined balance sheet—all fund types and account groups (Exhibit A). This statement presents assets, liabilities, and fund balances of all fund types and account groups used by the department on an aggregate basis.

Combined statement of revenues, expenditures and changes in fund balances—all governmental fund types and expendable trust funds (Exhibit B). This statement presents revenues, expenditures, other financing sources (uses) and changes in fund equity for all governmental fund types, and expendable trust funds used by the department on an aggregate basis.

Combined statement of revenues and expenditures—budget and actual (budgetary basis)—general and special revenue funds (Exhibit C). This statement presents a comparison of budgeted and actual revenues, expenditures, and other financing sources (uses) for the general fund accounts and special revenue funds used by the department.

Combining balance sheet—all special revenue funds, June 30, 1994 (Schedule I). This schedule presents assets, liabilities and fund balances of the special revenue funds of the department.

Combining statement of revenues, expenditures and changes in fund balance—all special revenue funds, for the year ended June 30, 1994 (Schedule II). This schedule presents revenues, expenditures and fund balances of the special revenue funds of the department.

Combining statement of revenues and expenditures - budget and actual (budgetary basis)—budgeted special revenue funds, for the year ended June 30, 1994 (Schedule III). This schedule presents the actual revenues and expenditures of the budgeted special revenue funds, compares them to budgeted revenues and expenditures, and presents the variances between them.

Definition of terms

Technical terms are used in the financial statements and in the notes to the financial statements. The more common terms and their definitions are as follows:

Appropriation. An authorization granted by the State Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures.

Allotment. An authorization by the director of finance to a state agency to incur obligations and to make expenditures pursuant to the appropriation made by the State Legislature.

Encumbrance. An obligation in the form of a purchase order or contract which is chargeable to an appropriation, the incurring of which sets aside the appropriation for the amount of the obligation.

Expenditure. The actual disbursement of funds for the payment of goods delivered or services rendered, the obligation to pay for such goods or services having been incurred against authorized funds.

Lapsed appropriation. A lapsed appropriation represents the balance of funds authorized, which is unexpended and uncommitted at the end of the prescribed time period. The balance reverts to the designated fund and is available for appropriation by the State Legislature in the ensuing fiscal year.

Reserve. An account used to earmark a portion of the fund balance to indicate that it is not available for expenditure.

Transfers. The transactions between funds, departments, and/or programs which are approved by the appropriate authority.

Notes to Financial Statements

Explanatory notes which are pertinent to an understanding of the financial statements and financial condition of the funds administered by the department are discussed in this section.

Financial statement presentation

General. The accompanying financial statements of the Department of Agriculture (department) present the financial position of the various fund types and account groups and the results of operations of the various fund types for the year ended June 30, 1994.

Reporting entity. The Department of Agriculture is a department of the State of Hawaii.

Fund accounting. The financial activities are recorded in individual funds classified by type and described in the following sections, each of which is deemed to be a separate accounting entity. The financial position and operations of each fund are accounted for in separate self-balancing accounts which represent the fund's assets, liabilities, equity, revenues and expenditures.

Account groups are used to establish accounting control and accountability for the department's general fixed assets and general long-term obligations. Account groups are not funds as they do not reflect available financial resources and related liabilities.

Governmental fund types. Financial resources which are not accounted for in other funds are accounted for in the general fund. The measurement focus of governmental funds is on determination of financial position and changes in financial position rather than upon net income determination. The budget as adopted by the Legislature provides the basic framework within which the resources and obligations of the general fund are accounted. The general fund of the department is a part of the State's general fund and the accompanying general fund financial statements are limited to and reflect only the appropriations, expenditures, and obligations of the general fund accounts used by the department, and the general fund allotments received by the department.

Financial resources obtained from specific revenue sources and used for restricted purposes are accounted for in special revenue funds.

Fiduciary fund types. Expendable trust funds record transactions related to assets held by the department in a trustee capacity to be expended for designated purposes. Agency funds account for funds held by the department as agent. Agency funds account for cash collected and expended by the department in a custodial capacity.

Account groups. The general fixed assets account group is used to account for all fixed assets of the department. The general long-term debt account group is used to account for accrued vacation and compensation payable for governmental fund types.

Total columns on financial statements. Total columns on the accompanying financial statements are captioned “memorandum only” to indicate that they are presented only to facilitate financial analysis. Data in these columns do not purport to present financial position, results of operations, or changes in fund equity of the department in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation.

Prior period adjustment

The department has restated its previously issued 1993 financial statements to correct the due to State General Fund liability at June 30, 1993 for revenues previously recorded in the department’s financial statements that should have been credited to the State General Fund. The effect of this correction was to increase due to State General Fund liability and decrease fund balance at July 1, 1993 by \$3,187,670.

Summary of significant accounting policies

The accounting policies of the department conform to generally accepted accounting principles as applicable to governmental units. The department’s combined financial statements reflect only its activities. The State Comptroller maintains the central accounts for all state funds and publishes a comprehensive annual financial report for the State annually which includes the department’s financial activities. The following is a summary of the significant accounting policies:

Fund accounting. The accounts of the department are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, equity, revenues and expenditures. The various funds are summarized by type in the accompanying combined financial statements.

Governmental fund types. Governmental funds are those through which the acquisition, use and balances of the department’s expendable financial resources and the related liabilities are accounted. The measurement focus is on the flow of current financial resources. The following are the department’s governmental fund types:

- *General fund.* The general fund is the general operating fund of the department. It is used to account for all financial resources except for those required to be accounted for in another fund. The general fund presented is a part of the State’s general fund and is limited to only those appropriations and obligations of the department.

- *Special revenue funds.* The special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trust funds) that are legally restricted to expenditures for specified purposes.
- *Capital projects funds.* Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary fund types. Fiduciary funds are used to account for assets held by the department in a trustee or agency capacity. These include expendable trust funds which account for cash collected and expended by the department as trustee, and agency funds which account for cash collected and expended by the department in a custodial capacity.

Account groups. Account groups are used to establish accounting control and accountability for the department's general fixed assets and long-term debt. The following are the department's account groups:

- *General fixed assets account group.* This account group is established to account for all fixed assets (principally buildings, other improvements and equipment) of the department.
- *General long-term debt account group.* This account group is established to account for all long-term obligations of the department.

Basis of accounting. The modified accrual basis of accounting is followed by the governmental fund types, expendable trust funds, and agency funds. Under the modified accrual basis of accounting, revenue is recorded when susceptible to accrual (that is, both measurable and available), usually when the appropriations are allotted. Expenditures are generally recognized when the related liability is incurred, except for accumulated unpaid vacation which is recognized as an expenditure when payable from expendable available financial resources.

In applying the susceptible to accrual concept to federal grant revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. Under most of the department's federal programs, moneys must be expended for a specific purpose or project; therefore, revenue is recognized to the extent that expenditures are recognized.

Cash and cash equivalents. Cash reported in the combined balance sheet includes cash in the State Treasury, cash in various Hawaii banks and certificates of deposit where maturities are three months or less.

The State of Hawaii maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the combined balance sheet within cash and cash equivalents. Those funds are pooled with funds from other State of Hawaii agencies and departments and deposited in approved financial institutions by the Director of the State of Hawaii, Department of Budget and Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State of Hawaii by third party custodians. Statutes authorize the department to invest in certificates of deposit and money market accounts.

The Hawaii Revised Statutes authorize the director of finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

Reserved for encumbrances. Encumbrance accounting, under which purchase orders and contractual commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Open encumbrances are reported as reservations of fund balances because the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities.

Fixed assets. Fixed assets (primarily buildings, other improvements and equipment) have been acquired for general government purposes. Assets purchased are recorded as expenditures in the governmental funds and capitalized at cost in the General Fixed Assets Account Group. No depreciation has been provided for general fixed assets.

Accrued payroll and vacation payable. Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end, and is convertible to pay upon termination of employment. In governmental fund types, the amounts expected to be liquidated with expendable available financial resources are accrued in the respective funds, and the amounts payable from future resources are recorded in the general long-term debt account group.

Inventory. Inventory consists of materials and supplies and are recorded as an expenditure when purchased.

Intrafund and interfund transactions. Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them are recorded as operating transfers in the combined financial statements.

Fund balances

Portions of fund balances are reserved for the following:

- Continuing appropriations which are comprised of encumbrances and unencumbered allotment balances. Encumbrances represent outstanding commitments which generally are liquidated in the subsequent fiscal year. Unencumbered allotment balances represent amounts that have been released and made available for encumbrance or expenditures and are legally segregated for a specific future use.
- Loans receivable which are not currently available for expenditure at the balance sheet date.
- Expendable trust fund balances which are restricted to the purpose of the account.

Budgeting and budgetary control

The budget of the department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected as budgeted revenues in Exhibit C are those estimates as compiled by the department. Budgeted expenditures are derived primarily from the General Appropriations Act of 1993 and other specific appropriations acts.

All expenditures of these appropriated funds are made pursuant to the appropriations in the 1993-1994 biennial budget as amended by subsequent supplemental appropriations. The final legally adopted budget in Exhibit C represents the original appropriations, supplemental appropriations, transfers and other legally authorized legislative and executive changes.

Budgetary control is maintained at the appropriation line item as established in the appropriations acts. The Governor is authorized to transfer appropriations within a state agency; however, transfers of appropriations between state agencies generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the department.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The Legislature specifies the lapse date and any other contingencies which may terminate the authorization for other appropriations.

Budgets adopted by the Legislature for the general and special revenue funds are presented in Exhibit C. The department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to the encumbrances of purchase order and contract obligations as expenditures for budgetary purposes. These differences represent departures from generally accepted accounting principles (GAAP). A reconciliation between non-GAAP budgetary actual and GAAP actual is as follows:

	General Fund	Special Revenue Funds
Excess of revenues over expenditures — actual (budgetary basis)	\$ 258,317	\$ 3,213,190
Reserved for encumbrances at fiscal year end	856,825	74,095
Expenditures for liquidation of prior fiscal year encumbrances	<u>(2,149,854)</u>	<u>(450,211)</u>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses - actual (GAAP basis)	<u>\$ (1,034,712)</u>	<u>\$ 2,837,074</u>

Investments

The State Department of Budget and Finance holds investments for the department. Legally authorized investments include obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

These investments are collateralized in accordance with State statutes. At June 30, 1994 the department's investments consisted of:

	Carrying Value
Certificates of deposit	\$ 2,016,357
Repurchase agreements	<u>7,450,000</u>
	<u>\$ 9,466,357</u>

The market value of investments approximates the carrying value which is stated at cost.

Loans receivable

At June 30, 1994, loans receivable consisted of the following:

	General	Special Revenue	Agency
Hawaii Agriculture Loan Program	\$ —	\$ 26,773,411	\$ —
Hawaii Aquaculture Loan Program	—	535,221	—
Hawaii Agricultural Products Loan Program	—	187,221	—
Kauai Task Force	—	—	120,141
North Kohala Task Force	—	—	524,902
Independent Sugar Growers Loan Program	—	—	154,114
Emergency Loan Program	521,495	—	—
Less allowance for doubtful receivables	<u>—</u>	<u>(2,506,151)</u>	<u>(645,043)</u>
	<u>\$ 521,495</u>	<u>\$ 24,989,702</u>	<u>\$ 154,114</u>

The department grants credit in the form of loans to farmers who are located in the State of Hawaii. The loans are collateralized by real estate, equipment, crops and other assets of the borrower.

General fixed assets

General fixed assets account group. Changes in general fixed assets (unaudited) during the year ended June 30, 1994, were as follows:

	Balance, July 1, 1993	Additions	Retirements	Balance, June 30, 1994
Land and land improvements	\$ 237,365	\$ —	\$ —	\$ 237,365
Buildings and other improvements	8,111,927	59,905	—	8,171,832
Equipment	<u>7,882,561</u>	<u>302,538</u>	<u>242,845</u>	<u>7,942,254</u>
	\$ 16,231,853	\$ 362,443	\$ 242,845	\$ 16,351,451

Changes in long-term debt account group

The annual changes to general long-term debt account group as of June 30, 1994 were as follows:

Balance at July 1, 1993	\$ 3,345,734
Net decrease in employee benefits payable	<u>(2,763)</u>
Balance at June 30, 1994	<u>\$ 3,342,971</u>

Changes in assets and liabilities of the agency fund

The agency fund is purely custodial (i.e. assets equal liabilities) and thus does not involve measurement of results of operations. The changes in assets and liabilities of the agency fund for the fiscal year ended June 30, 1994, were as follows:

	Balance, July 1, 1993	Additions	Disbursements	Balance, June 30, 1994
Assets				
Cash and other assets held in trust	<u>\$ 554,632</u>	<u>\$ 168,478</u>	<u>\$ 516,214</u>	<u>\$ 206,896</u>
Liabilities				
Due to individuals and others	<u>\$ 554,632</u>	<u>\$ 168,478</u>	<u>\$ 516,214</u>	<u>\$ 206,896</u>

Retirement benefits

Employees' retirement system. Substantially all eligible employees of the department are members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of

employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Required employer contributions to the ERS are based on actuarially determined rates that should provide sufficient resources to pay member pension benefits when due. The funding method used to calculate the total employer contribution required is the frozen initial liability method, and includes amortization of the accrued unfunded liability of pension benefits and post retirement benefits fixed at \$470 million over a period of twenty-eight years beginning July 1, 1987. The State's policy is to fund its required contribution annually. The department's general fund share of the retirement system expense for the year ended June 30, 1994, was included in the Supplemental Appropriations Act of 1994 as an item to be expended by the Department of Budget and Finance and is not reflected in the department's general fund financial statements. No contributions were required by the department's special revenue funds.

Measurement of assets and actuarial valuations are made for the entire ERS and are not separately computed for individual participating employers such as the department. The disclosures required by Governmental Accounting Standards Board Statement No. 5 are presented in the ERS Comprehensive Annual Financial Report (CAFR). The following data is provided as of June 30, 1993 for the entire ERS from the disclosures contained in the CAFR for the year then ended, the most recent available:

Pension benefit obligation	\$ 6,546,299,200
Net assets available for benefits	<u>4,979,438,200</u>
Unfunded pension benefit obligation	<u>\$ 1,566,861,000</u>

The pension benefit obligation is a standardized measure of the present value of credited projected pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

The entire ERS actuarially determined employer contribution requirements were met as of June 30, 1994.

Post-retirement health care and life insurance benefits. In addition to providing pension benefits, the State provides certain health care and life insurance benefits for retired state employees. Contributions are based upon negotiated collective bargaining agreements and are funded by the State as accrued. The department's general fund share of the expense for post-retirement benefits for the year ended June 30, 1994 has not been separately computed and is not reflected in the department's general fund financial statements.

Commitments and contingencies

Accumulated sick pay. Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a state employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System. Accumulated sick leave at June 30, 1994, aggregated approximately \$10,824,000.

Deferred compensation plan. In 1983, the State established a deferred compensation plan which enables state employees to defer a portion of their compensation. The State of Hawaii, Department of Human Resources Development, has the fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant.

Insurance coverage. The State maintains certain insurance coverages to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. Expenditures for workers' compensation are appropriated annually.

Litigation. The department is involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on the department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's general fund.

Loan guaranty. Act 85, SLH 1993, created the Hamakua Sugar Loan Guaranty Trust Fund to deposit reserve money for all loans guaranteed under the act. The act authorized the department to guaranty loans up to \$8,000,000 made by private lending institutions to the Trustee of the Estate of Hamakua Sugar Company. Pursuant to this guaranty, the department received \$800,000 in reserve money from the State General Fund in 1993. During the fiscal year ended June 30, 1994, the department received \$1,767,655 in consideration of a loan guarantee of \$8,000,000 made to a bank and certain releases and concessions made

by the State for the purpose of completing the final harvest by Hamakua Sugar Company. The \$800,000 and \$1,767,655 are held and accounted for in the department's expendable trust fund at June 30, 1994. The amount borrowed under the loan guaranty amounted to \$4,000,000 at June 30, 1994. The loan guaranty will automatically expire on November 1, 1994. If no other contingency exists, the department is required to transfer to the State General Fund the moneys of \$2,567,655 received through June 30, 1994 plus any additional related moneys received subsequent to June 30, 1994.

STATE OF HAWAII
DEPARTMENT OF AGRICULTURE

Combined balance sheet - all fund types and account groups
June 30, 1994

	Governmental Fund Types			Fiduciary Fund Types		Account Groups		Total (Memorandum Only)
	General	Special Revenue	Capital Projects	Expendable Trust	Agency	General Fixed Assets (Unaudited)	General Long- term Debt	
ASSETS								
Cash	\$1,686,587	\$3,369,999	\$759,585	\$ 854,872	\$ 52,782	\$ --	\$ --	\$ 6,723,825
Investments	--	7,700,000	--	1,766,357	--	--	--	9,466,357
Loans receivable	521,495	24,989,702	--	--	154,114	--	--	25,665,311
Property, plant and equipment	--	--	--	--	--	16,351,451	--	16,351,451
Amount to be provided for retirement of general long-term debt	--	--	--	--	--	--	3,342,971	3,342,971
Total assets	<u>\$2,208,082</u>	<u>\$36,059,701</u>	<u>\$759,585</u>	<u>\$2,621,229</u>	<u>\$206,896</u>	<u>\$16,351,451</u>	<u>\$3,342,971</u>	<u>\$61,549,915</u>
LIABILITIES AND FUND EQUITY								
Liabilities								
Vouchers payable	\$ 797,220	\$ 229,206	\$ --	\$ 34,059	\$ --	\$ --	\$ --	\$ 1,060,485
Accrued wages and employee benefits payable	22,592	8,941	--	--	--	--	3,342,971	3,374,504
Due to others	--	--	--	--	52,782	--	--	52,782
Due to State General Fund	9,950	--	--	--	154,114	--	--	164,064
Deferred revenues	--	147,513	--	--	--	--	--	147,513
Total liabilities	<u>829,762</u>	<u>385,660</u>	<u>--</u>	<u>34,059</u>	<u>206,896</u>	<u>--</u>	<u>3,342,971</u>	<u>4,799,348</u>
Fund equity								
Investment in general fixed assets	--	--	--	--	--	16,351,451	--	16,351,451
Fund balances								
Reserved for encumbrances	856,825	74,095	12,000	--	--	--	--	942,920
Reserved for loans receivable	521,495	24,989,702	--	--	--	--	--	25,511,197
Reserved for amounts held in trust	--	--	--	2,587,170	--	--	--	2,587,170
Reserved for continuing appropriations	--	10,610,244	747,585	--	--	--	--	11,357,829
Total fund equity	<u>1,378,320</u>	<u>35,674,041</u>	<u>759,585</u>	<u>2,587,170</u>	<u>--</u>	<u>16,351,451</u>	<u>--</u>	<u>56,750,567</u>
Total liabilities and fund equity	<u>\$2,208,082</u>	<u>\$36,059,701</u>	<u>\$759,585</u>	<u>\$2,621,229</u>	<u>\$206,896</u>	<u>\$16,351,451</u>	<u>\$3,342,971</u>	<u>\$61,549,915</u>

The accompanying notes are an integral part of the combined financial statements.

STATE OF HAWAII
DEPARTMENT OF AGRICULTURE
Combined statement of revenues, expenditures, and changes in fund balances -
all governmental fund types and expendable trust funds
for the year ended June 30, 1994

	Governmental Fund Types			Fiduciary Fund Type		Total (Memorandum Only)
	General	Special Revenue	Capital Projects	Expendable Trust		
Revenues						
State allotted appropriations	\$16,232,431	--	\$ 376,654	--	\$	\$16,609,085
Intergovernmental	--	1,859,388	--	--	--	1,859,388
Interest	--	1,579,240	--	--	--	1,579,240
Loan repayments	--	5,834,100	--	--	--	5,834,100
Other revenues	<u>3,896,629</u>	<u>1,507,006</u>	--	<u>2,001,882</u>	--	<u>7,405,517</u>
	20,129,060	10,779,734	<u>376,654</u>	<u>2,001,882</u>	--	<u>33,287,330</u>
Expenditures						
Productivity improvement and management assistance	7,741,150	694,831	--	--	--	8,435,981
Product development and marketing	3,134,775	331,689	--	--	--	3,466,464
General support for agriculture	1,779,568	190,512	13,841,790	--	--	15,811,870
Agricultural water development and irrigation services	408,594	683,478	--	--	--	1,092,072
Pollution control	753,482	270,264	--	--	--	1,023,746
Protection of the consumer	1,673,643	1,368,805	--	--	--	3,042,448
Agricultural loans	1,208,984	3,657,380	--	--	--	4,866,364
Expendable trust funds	--	--	--	282,804	--	282,804
	<u>16,700,196</u>	<u>7,196,959</u>	<u>13,841,790</u>	<u>282,804</u>	--	<u>38,021,749</u>
Excess (deficiency) of revenues over expenditures	3,428,864	3,582,775	(13,465,136)	1,719,078	--	(4,734,419)
Lapsed appropriations	(1,187,734)	--	(31,762)	--	--	(1,219,496)
Other	<u>(3,896,629)</u>	--	--	--	--	<u>(3,896,629)</u>
	(1,655,499)	3,582,775	(13,496,898)	1,719,078	--	(9,850,544)
Excess of revenues and other sources over (under) expenditures and other uses						
Other changes in fund balances						
Increase (decrease) in reserve for loans receivables	424,132	(283,077)	--	--	--	141,055
Other	<u>196,655</u>	<u>(462,624)</u>	--	--	--	<u>(265,970)</u>
Excess of revenues and other sources over (under) expenditures, other uses and other changes in fund balance	(1,034,712)	2,837,074	(13,496,898)	1,719,078	--	(9,975,458)
Fund balance at July 1, 1993	5,600,702	32,836,967	14,256,483	868,092	--	53,562,244
Prior period adjustment	<u>(3,187,670)</u>	--	--	--	--	<u>(3,187,670)</u>
Fund balance as restated	2,413,032	32,836,967	14,256,483	868,092	--	50,374,574
	<u>\$ 1,378,320</u>	<u>\$35,674,041</u>	<u>\$ 759,585</u>	<u>\$2,587,170</u>	--	<u>\$40,399,116</u>

The accompanying notes are an integral part of the combined financial statements.

STATE OF HAWAII
DEPARTMENT OF AGRICULTURE

Combined statement of revenues and expenditures--budget and actual
(budgetary basis) - general and special revenue fund types
year ended June 30, 1994

	General Fund			Special Revenue Funds		
	Budget	Actual on Budgetary Basis	Variance - Favorable (Unfavorable)	Budget	Actual on Budgetary Basis	Variance - Favorable (Unfavorable)
Revenues						
State allotted appropriations	\$16,972,378	\$16,509,086	\$(463,292)	--	--	--
Intergovernmental revenues	68,758	68,758	--	2,427,540	1,796,598	(630,942)
Unbudgeted revenues	--	--	--	--	--	--
Interest	--	--	--	1,246,899	1,579,240	332,341
Loan repayments	--	--	--	4,452,182	5,834,100	1,381,918
Other revenues	--	--	--	1,958,115	1,507,006	(451,109)
	<u>17,041,136</u>	<u>16,577,844</u>	<u>(463,292)</u>	<u>10,084,736</u>	<u>10,716,944</u>	<u>632,208</u>
Expenditures						
Productivity improvement and management assistance	7,965,411	7,697,238	268,173	733,209	694,067	39,142
Product development and marketing	3,499,703	3,296,489	203,214	409,188	65,168	344,020
General support for agriculture	1,784,767	1,754,445	30,322	693,261	516,218	177,043
Agricultural water development and irrigation services	409,619	408,857	762	744,226	748,865	(4,639)
Pollution control	774,996	730,776	44,220	406,995	280,125	126,870
Protection of the consumer	1,747,866	1,631,722	116,144	1,398,776	1,350,319	48,457
Agricultural loans	858,774	800,000	58,774	5,699,081	3,848,992	1,850,089
	<u>17,041,136</u>	<u>16,319,527</u>	<u>721,609</u>	<u>10,084,736</u>	<u>7,503,754</u>	<u>2,580,982</u>
Excess of revenues over (under) expenditures	<u>\$ --</u>	<u>\$ 258,317</u>	<u>\$ 258,317</u>	<u>\$ --</u>	<u>\$ 3,213,190</u>	<u>\$ 3,213,190</u>

The accompanying notes are an integral part of the combined financial statements.

**STATE OF HAWAII
DEPARTMENT OF AGRICULTURE**

Schedule I

Combining balance sheet - all special revenue funds
June 30, 1994

	Federal Funds	Agricultural Loans	Animal Industry	Plant Industry	Marketing and Consumer Services	Agricultural Resource Management	Total (Memorandum Only)
ASSETS							
Cash	\$231,357	\$ 2,111,349	\$13,669	\$21,234	\$297,465	\$ 694,925	\$ 3,369,999
Investments	--	7,450,000	--	--	--	250,000	7,700,000
Loans receivable	--	<u>24,989,702</u>	--	--	--	--	<u>24,989,702</u>
Total assets	<u>\$231,357</u>	<u>\$34,551,051</u>	<u>\$13,669</u>	<u>\$21,234</u>	<u>\$297,465</u>	<u>\$ 944,925</u>	<u>\$36,059,701</u>
LIABILITIES AND FUND BALANCE							
Liabilities							
Vouchers payable	82,317	41,212	10,560	19,367	17,833	57,917	229,206
Accrued wages and employee benefits payable	--	--	--	--	8,275	666	8,941
Deferred revenues	<u>147,513</u>	--	--	--	--	--	<u>147,513</u>
Total liabilities	<u>229,830</u>	<u>41,212</u>	<u>10,560</u>	<u>19,367</u>	<u>26,108</u>	<u>58,583</u>	<u>385,660</u>
Fund equity							
Fund balances							
Reserve for encumbrances	--	4,468	1,095	649	18,552	49,331	74,095
Reserve for loans receivable	--	24,989,702	--	--	--	--	24,989,702
Reserved for continuing appropriations	<u>1,527</u>	<u>9,515,669</u>	<u>2,014</u>	<u>1,218</u>	<u>252,805</u>	<u>837,011</u>	<u>10,610,244</u>
Total fund equity	<u>1,527</u>	<u>34,509,839</u>	<u>3,109</u>	<u>1,867</u>	<u>271,357</u>	<u>886,342</u>	<u>35,674,041</u>
Total liabilities and fund equity	<u>\$231,357</u>	<u>\$34,551,051</u>	<u>\$13,669</u>	<u>\$21,234</u>	<u>\$297,465</u>	<u>\$ 944,925</u>	<u>\$36,059,701</u>

**STATE OF HAWAII
DEPARTMENT OF AGRICULTURE**

Combining statement of revenues, expenditures, and changes in fund balances -
all special revenue funds
for the year ended June 30, 1994

	Federal Funds	Agricultural Loans	Animal Industry	Plant Industry	Marketing and Consumer Services	Agricultural Resource Management	Total (Memorandum Only)
Revenues							
State allotted appropriations, net of lapses	\$ --	--	\$237,260	\$269,884	\$299,455	\$ 700,407	\$ 1,507,006
Intergovernmental	1,859,388	--	--	--	--	--	1,859,388
Interest	--	1,579,240	--	--	--	--	1,579,240
Loan repayments	--	5,834,099	--	--	--	--	5,834,099
	<u>1,859,388</u>	<u>7,413,339</u>	<u>237,260</u>	<u>269,884</u>	<u>299,455</u>	<u>700,407</u>	<u>10,779,733</u>
Expenditures							
Productivity improvement and management assistance	189,559	--	233,459	271,813	--	--	694,831
Product development and marketing	29,234	--	--	--	302,455	--	331,689
General support for agriculture	--	--	--	--	--	190,512	190,512
Agricultural water development and irrigation services	--	--	--	--	--	683,477	683,477
Pollution control	270,263	--	--	--	--	--	270,263
Protection of the consumer	1,368,805	--	--	--	--	--	1,368,805
Agricultural loans	--	3,657,381	--	--	--	--	3,657,381
	<u>1,857,861</u>	<u>3,657,381</u>	<u>233,459</u>	<u>271,813</u>	<u>302,455</u>	<u>873,989</u>	<u>7,196,958</u>
Excess (deficiency) of revenues over expenditures	1,527	3,755,958	3,801	(1,929)	(3,000)	(173,582)	3,582,775
Other financing sources	--	--	--	--	--	--	--
Operating transfers in	--	--	--	--	--	--	--
Operating transfers out	--	--	--	--	--	--	--
Excess of revenues and other sources over (under) expenditures and other uses	1,527	3,755,958	3,801	(1,929)	(3,000)	(173,582)	3,582,775
Other changes in fund balances	--	(283,077)	--	--	--	--	(283,077)
Decrease in reserve for loan receivables	--	(462,624)	--	--	(10,370)	12,607	(462,624)
Other	--	--	--	--	--	--	--
Excess of revenues and other sources over (under) expenditures, other uses and other changes in fund balance	1,527	3,010,257	1,564	(1,929)	(13,370)	(160,975)	2,837,074
Fund balance at July 1, 1993	--	31,499,582	1,545	3,796	284,727	1,047,317	32,836,967
Fund balance at June 30, 1994	<u>\$ 1,527</u>	<u>\$34,509,839</u>	<u>\$ 3,109</u>	<u>\$ 1,867</u>	<u>\$ 271,357</u>	<u>\$ 886,342</u>	<u>\$35,674,041</u>

STATE OF HAWAII
DEPARTMENT OF AGRICULTURE

Schedule III

Combining statement of revenues and expenditures -- budget and actual
(Budgetary basis) - budgeted special revenue funds
for the year ended June 30, 1994

	Federal Funds			Agricultural Loans			Animal Industry			Subtotal (Memorandum Only)		
	Budget	Actual on Budgetary Basis	Variance-Favorable (Unfavorable)	Budget	Actual on Budgetary Basis	Variance-Favorable (Unfavorable)	Budget	Actual on Budgetary Basis	Variance-Favorable (Unfavorable)	Budget	Actual on Budgetary Basis	Variance-Favorable (Unfavorable)
Revenues												
State allotted appropriations	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
Intergovernmental revenues	2,427,540	1,796,598	(630,942)	--	--	--	--	--	--	2,427,540	1,796,598	(630,942)
Unbudgeted revenues	--	--	--	--	--	--	--	--	--	--	--	--
Interest	--	--	--	1,246,899	1,579,240	332,341	--	--	--	1,246,899	1,579,240	332,341
Loan repayments	--	--	--	4,452,182	5,834,100	1,381,918	--	--	--	4,452,182	5,834,100	1,381,918
Other revenues	--	--	--	--	--	--	238,951	237,260	(1,691)	238,951	237,260	(1,691)
	<u>2,427,540</u>	<u>1,796,598</u>	<u>(630,942)</u>	<u>5,699,081</u>	<u>7,413,340</u>	<u>1,714,259</u>	<u>238,951</u>	<u>237,260</u>	<u>(1,691)</u>	<u>8,365,572</u>	<u>9,447,198</u>	<u>1,081,626</u>
Expenditures												
Productivity improvement	210,658	186,359	24,299	--	--	--	238,951	235,246	3,705	449,609	421,605	28,004
Product development and marketing	409,188	65,168	344,020	--	--	--	--	--	--	409,188	65,168	344,020
General support for agriculture	1,923	1,923	--	--	--	--	--	--	--	1,923	1,923	--
Agricultural water development and irrigation services	--	--	--	--	--	--	--	--	--	--	--	--
Pollution control	406,995	280,125	126,870	--	--	--	--	--	--	406,995	280,125	126,870
Protection of the consumer	1,398,776	1,350,319	48,457	--	--	--	--	--	--	1,398,776	1,350,319	48,457
Agricultural loans	--	--	--	5,699,081	3,848,992	1,850,089	--	--	--	5,699,081	3,848,992	1,850,089
	<u>2,427,540</u>	<u>1,883,894</u>	<u>543,646</u>	<u>5,699,081</u>	<u>3,848,992</u>	<u>1,850,089</u>	<u>238,951</u>	<u>235,246</u>	<u>3,705</u>	<u>8,365,572</u>	<u>5,968,132</u>	<u>2,397,440</u>
Excess of revenues over (under) expenditures	\$ --	\$ (87,296)	\$ (87,296)	\$ --	\$ 3,564,348	\$ 3,564,348	\$ --	\$ 2,014	\$ 2,014	\$ --	\$ 3,479,066	\$ 3,479,066

STATE OF HAWAII
DEPARTMENT OF AGRICULTURE

Combining statement of revenues and expenditures -- budget and actual
(budgetary basis) - budgeted special revenue funds
for the year ended June 30, 1994

	Plant Industry		Marketing and Consumer Services		Agricultural Resource Management		Total (Memorandum Only)	
	Budget	Variance Favorable (Unfavorable)	Budget	Variance Favorable (Unfavorable)	Budget	Variance Favorable (Unfavorable)	Budget	Variance Favorable (Unfavorable)
Revenues	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --
State allotted appropriations	--	--	--	--	--	--	--	--
Intergovernment revenues	--	--	--	--	--	--	--	--
Unbudgeted revenues	--	--	--	--	--	--	--	--
Interest	--	--	--	--	--	--	--	--
Loan repayments	--	--	--	--	--	--	--	--
Other revenues	283,600	(13,716)	519,148	(219,693)	916,416	(216,009)	1,507,006	(451,109)
	283,600	(13,716)	519,148	(219,693)	916,416	(216,009)	10,716,944	632,208
Expenditures								
Productivity improvement	283,600	11,138	--	--	--	--	733,209	694,067
Product development and marketing	--	--	--	--	--	--	409,188	65,168
General support	--	--	--	--	--	--	--	--
for agriculture	--	--	519,148	197,942	172,190	(20,899)	693,261	516,218
Agricultural water development and irrigation services	--	--	--	--	744,226	(4,639)	744,226	748,865
Pollution control	--	--	--	--	--	--	406,995	280,125
Protection of the consumer	--	--	--	--	--	--	1,398,776	1,350,319
Agricultural loans	283,600	11,138	519,148	197,942	916,416	(25,538)	5,699,081	3,848,992
	283,600	11,138	519,148	197,942	916,416	(25,538)	7,503,754	2,580,982
Excess of revenues over (under) expenditures	\$ --	\$ (2,578)	\$ --	\$ (21,751)	\$ --	\$ (241,547)	\$ --	\$ (3,213,190)

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Agriculture on November 25, 1994. A copy of the transmittal letter to the department is included as Attachment 1. The department's response is included as Attachment 2.

The department agrees with our recommendation that \$800,000 appropriated to the Hamakua Sugar Loan Guaranty Trust Fund be transferred to the general fund. It disagrees however that the \$2.2 million in fees earned on the loan guaranty should be returned to the general fund. It cites an inter-departmental memorandum of agreement as authority to keep the bulk of the moneys to replenish the Agricultural Loan Revolving Fund for loans to the company. We point out that emergency loans to the Hamakua Sugar Company were made possible by additional general fund appropriations to the revolving fund. The appropriation to the Hamakua Sugar Loan Guaranty Trust Fund was for a different purpose and its earnings should not be transferred to the revolving fund based upon an inter-departmental memorandum of agreement. Any cash infusions to the revolving fund should be made through legislative appropriations. Nor should any of the fees earned on the loan guaranty be disbursed to those departments involved in pursuing repayment. The efforts of those departments were already paid for by the general fund. Allowing them to keep the fees earned constitutes an avoidance of the appropriations process. We stand by our recommendation that the earnings of the trust fund be returned to the general fund.

The department agrees with our recommendations to improve controls over loan processing. The department disagrees with our recommendation to repeal two funds and return cash balances to the general fund. The department does not agree with the criterion of self-sustainability that we used in our analysis of the funds. The criterion of self-sustainability is based on government financing theory and we continue to stand by it and our analysis of the two funds. The department also provided additional information not provided during the audit and an attachment to its letter that caused us to make changes to our report draft. The department's attachment is not included in this report but is available for inspection at our office.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

November 25, 1994

COPY

The Honorable Yukio Kitagawa, Chair
Department of Agriculture
1428 South King Street
Honolulu, Hawaii 96814

Dear Mr. Kitagawa:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Department of Agriculture*. We ask that you telephone us by Tuesday, November 29, 1994, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Tuesday, December 6, 1994.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

A handwritten signature in cursive script, appearing to read 'Marion M. Higa'.

Marion M. Higa
State Auditor

Enclosures

BENJAMIN J. CAYETANO
Governor



State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 So. King Street
Honolulu, Hawaii 96814-2512

ATTACHMENT 2

YUKIO KITAGAWA
Chairperson, Board of Agriculture

LETITIA N. UYEHARA
Deputy to the Chairperson

Mailing Address:
P. O. Box 22159
Honolulu, Hawaii 96823-2159
FAX: (808) 973-9613

December 6, 1994

Ms. Marion M. Higa
State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

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OFC. OF THE AUDITOR
STATE OF HAWAII

Dear Ms. Higa:

Thank you for the opportunity to review and respond to the draft report of the "Financial Audit of the Department of Agriculture."

We provide the following comments on your findings and recommendations contained in Chapter 2, Internal Control Practices.

1. **Auditor's Finding: 3.0 Million Should Be Transferred to the General Fund**

We agree that the \$800,000 appropriated by Act 85, SLH 1993 as a reserve for the State-guarantee of the \$8 million loan to Hamakua Sugar Company's Bankruptcy trustee should be returned to the general fund.

We disagree, however, that the balance of monies received by the State of Hawaii, pursuant to that certain court-approved Memorandum of Agreement, dated as of May 28, 1993, by, between, and among the State, the Bankruptcy Trustee, and Western Farm Credit Bank, should be remitted to the general fund.

As a preliminary matter we direct your attention to Section 32, appearing on page 37 of the Memorandum of Agreement, which provides, in part, that:

Any payments made to the State, whether paid as a reimbursement of fees and costs or paid on some other account or matter, from the HSC estate shall first be used to reimburse those State agencies or departments which may have advanced funds to pay for the State's attorneys' fees and costs in connection with the Hamakua bankruptcy proceedings and related litigation and the balance shall be allocated to various State agencies and departments as the Attorney General or other appropriate State officer shall determine.



The agreement clearly contemplates that, initially, all fees and costs expended by various departments (and we believe that all of the fees and costs thus far have been expended by the Department of the Attorney General) are to be reimbursed to the respective departments and that the balance shall be allocated as the Attorney General, or other appropriate State officer, shall direct. We understand that the reason for this later provision is the State was and is a major creditor in the Hamakua Sugar Company bankruptcy proceedings (based on claims held by various different departments), in addition to being a guarantor of the commercial bank loan which financed the final harvest.

The circumstances surrounding the State's involvement in the Hamakua Sugar Company bankruptcy proceedings are complex and cannot be easily summarized. The primary basis for the involvement, however, is the State's position as holder of a \$10 million secured claim predicated on a loan made by the Department of Agriculture to the debtor. The State also holds substantial claims through the Department of Labor and Industrial Relations and the Department of Health, as well as other claims through other departments and agencies. As part of the Memorandum of Agreement, the State modified certain of its claims, transferred its secured claim to Western Farm Credit Bank, reserved other claims, and received certain consideration from the bankruptcy estate and from the Bank. The Memorandum of Agreement, which covered many matters and which permitted the final harvest to proceed, is not the "guarantee agreement" with First Hawaiian Bank whereby the State guaranteed First Hawaiian Bank's loan to the bankruptcy trustee (which he used to get the final harvest started). The monthly payments that the State is entitled to under the Memorandum of Agreement with the bankruptcy estate and Western Farm Credit Bank cannot be characterized as "fees" for having supplied a loan guarantee.

The Department of Agriculture's position is that, in accordance with the Memorandum of Agreement, the funds should be, first, used to reimburse all of the departments and agencies for attorneys' fees, costs and related expenses incurred in connection with the litigation, and, second, the balance should be allocated (as the Attorney General shall direct) to those departments and agencies of the State which have claims against the Hamakua bankruptcy estate. In this regard, the Department of Agriculture and the Department of Labor and Industrial Relations have agreed that a portion shall be allocated to the Department of Labor and Industrial Relations' Workers Compensation Fund. The bulk of the funds, however, should be returned to the Agricultural Loan Division's Special Revolving Fund. The Department's view is that, since the Revolving Fund made the loan to Hamakua Sugar Company, the recovery should be used to replenish the Fund so that it may continue to carry out its statutory purposes.

2. **Auditor's Finding: Internal Controls Over Loan Processing Need Strengthening**

Supervisory Reviews Are Needed

Currently, the loan officers do have the opportunity to review and make changes to the statement before they are sent out to the borrower.

To address the auditor's concern, in the future, after initial loan account information is entered by the clerical staff, supervising loan officer or loan officer in charge of the account will review the information in the loan computer program before any billing statements are generated.

Controls Over Account Information Should Be Strengthened

Currently, changes made to account information for returned checks are based on a copy of the Notice of Adjustment Required for Returned Check from the Department of Budget and Finance which is forwarded by the DOA Fiscal Office. Changes made for credits to the wrong account or with the wrong date of receipt are based on a verbal request by either the clerical staff, loan officers, or division head.

To reduce the number of adjustments for improperly credited accounts, daily batches will be reviewed prior to posting for accuracy as to account numbers and date of receipt. Any adjustments after posting will require a written request.

In the future, transactions for changes to accounts will be entered by one individual and reviewed by another to assure validity and accuracy of the loan account information.

Loan Payment Statements Could Be Improved

The Information and Communication Services Division of the Department of Budget and Finance is in the process of creating a program for recurring billings. This will allow the statements to be generated by the computer monthly. Also, the division has begun using coupon books for new loans which require monthly payments.

In most cases, payments are applied first to interest then to principal as of the date the payment is received. The allocation is done by the computer program and does not require reference to the statement.

The division will consider the possibility of mailing out annual statement to borrowers which reflect the breakdown of interest and principal paid for the year.

Controls Over Loan Disbursements Should Be Strengthened

In the past, the Division relied on the participating financial lenders to comply with standard lending practices which would include disbursement of loan proceeds only after proper recordation of our security interests. In the future, to ensure compliance, the Participation Certificate will be amended to include the date of the document recordation as well as the financial institutions' certification that funds were not disbursed prior to our security being perfected.

Required Annual Reports Are Not Received

We agree with the auditors that reviewing of the financial statements on an annual basis is sound loan administration practice. Our concentration for servicing purposes in the past have been with borrowers with poor repayments. We will make concerted effort to try and obtain annual financial statements for all of our borrowers in the future.

Required Inspections Are Not Being Performed

We believe that the Division is making timely inspections especially during the initial disbursements. The visits are not normally documented in the "Master" file which are kept in the Honolulu office but in the "Field" files out at the various offices. We will provide periodic reminder notices to the Loan Officers that the visits be properly documented.

3. **Auditor's Finding: Department's Computer Equipment Sits Idle**

In 1988, the Department of Agriculture identified the need to expand its computer network to provide more services to the Oahu and neighbor island offices. At that time, the Oahu VS minicomputers were networked together with access to central site's mainframe and VS, and a personal computer at Kona had a leased line connection to the Main Office. The department also determined that VS upgrades were required for the VS to support the growing number of users and applications. Review also identified a need for improved maintenance and protection of the minicomputers and its data. A Project Valuation Assessment (PVA) entitled "Department of Agriculture, Computer System Network" was completed estimating that it would initially cost \$400,000 to implement. (The PVA plan is currently being updated and therefore, a 6/1/91 update of the PVA plan is attached for information.)

The findings indicated that "the department has never received an appropriation for the \$400,000 cost of the network" and "has been purchasing the equipment piecemeal with available funds." On the contrary, the department requested and received the following appropriations by the Legislature to implement the plan in phases as indicated in the PVA:

FB 1989-91 - \$49,412 (Act 316, SLH 1989, as amended by Act 299, SLH 1990)

Equipment purchases included large disk drive, Doelz communication devices, 32 Port Serial Controller, Large VS Cable Concentrator (allowing more users to access the VS) and a 16 port WACS (allowing users to dial-up into the VS, also utilized to create a rotary for neighbor island users to dial into). All purchases were installed and operational within a year of purchase with the exception of four Doelz communication devices.

FB 1991-93 - \$196,815 (Act 296, SLH 1991, as amended by Act 300, SLH 1992)

Software and equipment purchases included UBU for each site (unattended tape backup unit for the VS), VS memory upgrade, X.25 Data Link for each site (allows VS users to access HAWAII FYI (reduces need for individual modems and dial-up lines), modem rack and modems (setting a bank of modems for users to dial up to), Fibronics cards (replacement cards for multiplexer units used to reduce cabling with Main Office and Halawa, UPS for Main Office and Halawa (Uninterrupted Power Supply to protect VS and data in event of power outage or surges, software also provides automatic VS shutdown in event office is unattended), Asynchronous I/O card (additional port), and cables. All equipment purchases were installed and operational within a year of purchase.

In addition to the above appropriations, related other current expense funds were requested and appropriated to accommodate the additional line and equipment maintenance costs.

The findings also indicated that "the department has made expenditures to date of \$85,140 for the computer network hardware and software" and "currently, \$85,000 of purchased equipment is idle since the computer network cannot be used until all of the required equipment has been installed." On the contrary, the \$85,140 only reflects funds expended to network the neighbor islands and implement the Hawaii FYI connection. It does not include approximately \$160,000 in computer network funds appropriated and expended for the VS upgrades, improved maintenance and protection of the minicomputers and its data, and other software and equipment. The department requested and the legislature appropriated a total of approximately \$246,000 over the FB 1989-91 and FB 1991-93. Approximately \$245,000 was expended to purchase the necessary software and hardware to implement the plan in phases.

As indicated above, the majority of software and equipment were installed and operational within a year of purchase. There were four (4) Doelz communication devices (totaling \$35,974) which were not installed within a year of purchase. These devices were purchased for the neighbor islands. Netlink cards supplied by Information and Communication Services Division of the Department of Budget and Finance were unavailable to connect the Doelz devices to the microwave network. These cards which became available in 1993 were to be installed at the State Office Buildings on Maui, Kauai, and Hilo. Currently, the department's Hilo Offices and Maui Offices are operational. The department's Kauai and Kona Offices are scheduled to be operational by early 1995.

Furthermore, the findings indicated that "by continuing to purchase equipment on a piecemeal basis, the department runs the risk that the equipment will become obsolete, broken, or stolen." On the contrary, funds were requested, appropriated and expended in phases over two bienniums rather than on a piecemeal basis with unbudgeted funds. The purchased software and equipment are still applicable and meets the department's current network needs.

We recognize the Auditor's concern and will continue to exercise prudent planning, budgeting and expenditure practices in order to ensure appropriate and cost-effective use of State funds.

4. **Auditor's Finding: The Agricultural Park Special Fund and Irrigation System
 Revolving Fund Should Be Repealed**

In our response to your report 91-10, "Review of Special and Revolving Funds of the Departments of Accounting and General Services, Agriculture, and Budget and Finance," we requested that any action to repeal the fund be deferred in order to allow the department the opportunity to develop both the Irrigation System and Agricultural Park programs and operate the funds on a self sustaining basis. At that time, we had indicated our concern that we did not anticipate that the programs would be able to support major capital improvement projects. We do not agree that the criterion of being self sustaining should include funding capital improvement projects. In order to generate sufficient

Ms. Marion M. Higa
Page 6
December 6, 1994

revenues to fund these capital improvement projects, the department would be required to substantially increase the water and acreage assessment as well as the lease rental fees charged to farmers. These increases would make it difficult for the department to ensure economically viable farm operations, provide water and land at reasonable cost with long term tenure and security from urbanization pressure, and encourage farm production and distribution economies as intended by the legislature when the programs were established.

Since 1991, we have attempted to reduce the general fund support for both of these programs. At the time your office conducted its review for the Fiscal Year 1990, approximately 75% of the Agricultural Park operating program was being supplemented by general funds. In FY 1995, approximately 20% of the operating program will be supplemented by general funds. In the FB 1995-97, the operating program will be entirely self sustaining.

In Fiscal Year 1990, approximately 83% of the Irrigation System operating program was being supplemented by general funds. In FY 1995, approximately 25% of the operating program will be supplemented by general funds which will continue in the FB 1995-97.

Finally, we would like to note that Table 2.1 (Agricultural Park Special Fund Five-Year Financial Summary Years ended June 30) reflects revenues from general fund appropriation but does not correspondingly reflect expenditures of these general funds.

Thank you again for the opportunity to review and respond to your draft report.

Sincerely,


Yukio Kitagawa, Chairperson
Board of Agriculture

Attachment

c: Office of the Governor

CHRL520

