



**State of Hawaii
Drinking Water Treatment
Revolving Loan Fund**

Financial Statements

June 30, 2005

**Submitted by
The Auditor
State of Hawaii**

**State of Hawaii
Drinking Water Treatment Revolving Loan Fund
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Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2005, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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.

As discussed in Note 2, the financial statements referred to above include only the financial activities of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund, and are not intended to present fairly the financial position, results of operations, and cash flows of the State of Hawaii, Department of Health, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund as of June 30, 2005, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2005 on our consideration of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters.

The Fund's management has not presented the management's discussion and analysis for the year ended June 30, 2005 that accounting principles generally accepted in the United States of America require to supplement, although not to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The supplementary information presented on pages 14 through 17 is presented for purposes of additional analysis and are not a required part of the Fund's financial statements. Such information has been subjected to the auditing procedures applied in the audit of the Fund financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the Fund financial statements taken as a whole.

PricewaterhouseCoopers CP

Honolulu, Hawaii
October 28, 2005

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Net Assets
June 30, 2005

Assets

Current assets

| | |
|--|----------------|
| Cash held in State Treasury | \$ 14,727,422 |
| Loan fees receivable | 105,776 |
| Accrued interest on loans | 40,350 |
| Other accrued interest | 33,114 |
| Due from other funds | 275,000 |
| Due from federal government | 1,351,142 |
| Current maturities of loans receivable | <u>772,893</u> |

Total current assets 17,305,697

Loans receivable, net of current maturities 13,038,017

Capital assets, net of accumulated depreciation of \$495,937 213,255

Total assets \$ 30,556,969

Liabilities and Net Assets

Current liabilities

| | |
|--|------------------|
| Accounts payable and other accrued liabilities | <u>\$ 64,780</u> |
|--|------------------|

Total current liabilities 64,780

Net assets

| | |
|----------------------------|---------|
| Invested in capital assets | 213,255 |
|----------------------------|---------|

| | |
|-------------------------|-------------------|
| Restricted - expendable | <u>30,278,934</u> |
|-------------------------|-------------------|

Total net assets 30,492,189

Total liabilities and net assets \$ 30,556,969

The accompanying notes are an integral part of these financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2005

| | |
|------------------------------|----------------------|
| Operating revenues | |
| Interest income from loans | \$ 181,344 |
| Administrative loan fees | 437,045 |
| Total operating revenues | <u>618,389</u> |
| Operating expenses | |
| State program management | 414,796 |
| Administrative | 343,695 |
| Water protection | 203,680 |
| Small systems | 97,500 |
| Total operating expenses | <u>1,059,671</u> |
| Operating loss | (441,282) |
| Nonoperating revenues | |
| State contributions | 1,611,000 |
| Federal contributions | 1,425,039 |
| Other interest income | 364,214 |
| Other income | 240 |
| Total nonoperating revenues | <u>3,400,493</u> |
| Change in net assets | 2,959,211 |
| Net assets at July 1, 2004 | <u>27,532,978</u> |
| Net assets at June 30, 2005 | <u>\$ 30,492,189</u> |

The accompanying notes are an integral part of these financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Cash Flows
Year Ended June 30, 2005

| | |
|--|----------------------|
| Cash flows from operating activities | |
| Interest income from loans | \$ 181,382 |
| Administrative loan fees | 436,054 |
| Principal repayments on loans | 730,131 |
| Disbursement of loan proceeds | (941,992) |
| Personnel costs | (318,594) |
| Payments to vendors | (612,345) |
| Net cash flows used in operating activities | <u>(525,364)</u> |
| Cash flows from noncapital financing activities | |
| State contributions | 1,611,000 |
| Federal contributions | 1,283,844 |
| Other income | 240 |
| Net advances to other funds | (55,000) |
| Net cash flows provided by noncapital financing activities | <u>2,840,084</u> |
| Cash flows from capital and related financing activities | |
| Purchased equipment | (31,132) |
| Net cash flows used in capital and related financing activities | <u>(31,132)</u> |
| Cash flows from investing activities | |
| Other interest | 335,728 |
| Net cash flows provided by investing activities | <u>335,728</u> |
| Net increase in cash | 2,619,316 |
| Cash balance at July 1, 2004 | <u>12,108,106</u> |
| Cash balance at June 30, 2005 | <u>\$ 14,727,422</u> |
| Reconciliation of operating loss to net cash used in operating activities | |
| Operating loss | \$ (441,282) |
| Adjustments to reconcile operating loss | |
| Depreciation expense | 166,356 |
| Other | (89,581) |
| Change in assets and liabilities | |
| Loans receivables | (211,861) |
| Accrued interest on loans | 38 |
| Loan fees receivable | (991) |
| Accounts payable and other accrued liabilities | 51,957 |
| Net cash used in operating activities | <u>\$ (525,364)</u> |

The accompanying notes are an integral part of these financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

1. Establishment and Purpose of the Fund

The 1996 Amendments to the Safe Drinking Water Act (the "Act"), provide for the U.S. Environmental Protection Agency ("EPA") to make capitalization grants to states for the purpose of providing loans and other types of financial assistance to public water systems for drinking water infrastructure, including construction of public drinking water systems.

In 1997, the State of Hawaii ("State") Legislature established the Drinking Water Treatment Revolving Loan Fund (the "Fund") to receive federal capitalization grants from the EPA. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to public drinking water systems for the construction of drinking water treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years, with the first repayment of principal and interest occurring no later than one year after the notice to proceed for construction or the final agreement date, whichever is later.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the funds of the Department that is attributable to the transactions of the Drinking Water Treatment Revolving Loan Fund and are not intended to present the financial position, results of operations or cash flows of the State of Hawaii, Department of Health.

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds. Accordingly, the Fund has adopted all GASB pronouncements, and all Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989, which do not contradict or conflict with existing GASB pronouncements.

Revenues are reported when earned and expenses are reported when a liability is incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Fund are interest income and administrative loan fees on loans made to county governments. Federal grants, state matching funds and interest income from sources other than loans are reported as nonoperating income.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash in State Treasury

All monies of the Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

The State requires that the depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

Effective in fiscal 2005, the State was required to implement the disclosure requirements of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("Statement No. 40"). Statement No. 40 requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Fund. However, since all of the Fund's monies are held in the State cash pool, the types of investments and related interest rate, credit, and custodial risks are not determinable at the fund level.

Loans Receivable

Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period.

Administrative Loan Fees

In May 2000, the Department implemented an administrative loan fee program to pay for the Fund's administration, including employee salaries and benefits. The administrative fee for all loans is 3.25% of the outstanding loan balance.

Capital Assets

Capital assets consist principally of equipment, and are recorded at cost, or if donated, at appraised value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis (three to seven years) over the estimated useful lives of the respective assets.

Net Assets

The Fund's net assets are classified into two net asset categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

- Restricted expendable: Net assets whose use by the Fund are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

Administration Costs

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

Fund Accounts

The Fund consists of the State revolving fund ("SRF") and non-SRF activity. The SRF activity consists exclusively of federal capitalization grant loans, state matching contributions, principal loan repayments, and interest from loans and other earning assets. Non-SRF activity consists of administration loan fees and federal set aside funds.

Expenses

The statement of revenues, expenses, and changes in net assets presents expenses on a functional basis. The natural classifications of expenses are presented in the supplemental schedule of expenses.

New Accounting Pronouncements

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2004. Management does not believe this Statement will have a material effect on its financial statements.

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postretirement Benefits Other Than Pension Plans*. This Statement establishes uniform standards of financial reporting by state and local governmental entities for other post employment benefit plans ("OPEB plans"). OPEBs refer to post employment benefits other than pensions. The provisions of this Statement are effective for the State of Hawaii for the year beginning after December 15, 2005. Management has not yet determined the effect this Statement will have on its financial statements.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition and display of other postretirement benefits expense/expenditures and related liabilities (assets), note disclosures and required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management has not yet determined the effect this Statement will have on its financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

3. Loans Receivable

At June 30, 2005, loans receivable from government entities were as follows:

| | |
|---|----------------------|
| Five loans receivable from the County of Hawaii, due in semi-annual payments including interest at 1.01% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. | \$ 2,905,355 |
| Seven loans receivable from the County of Kauai, due in semi-annual payments including interest at .46% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. | 4,829,353 |
| One loan receivable from the County of Maui, due in semi-annual payments including interest at 1.55%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. | <u>6,076,202</u> |
| | 13,810,910 |
| Less current portion | <u>772,893</u> |
| Noncurrent portion | <u>\$ 13,038,017</u> |

Loans mature at various dates through 2025. The scheduled principal payments on loans maturing in subsequent years are as follows:

| | |
|------------|----------------------|
| 2006 | \$ 772,893 |
| 2007 | 796,370 |
| 2008 | 806,786 |
| 2009 | 817,918 |
| 2010 | 828,644 |
| Thereafter | <u>9,788,299</u> |
| | <u>\$ 13,810,910</u> |

Accrued interest on loans amounted to \$40,350 at June 30, 2005. Interest income from loans amounted to \$181,344 for the year ended June 30, 2005.

Management believes that all loans will be repaid according to the loan terms; accordingly, no provision for uncollectible amounts has been recorded.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

At June 30, 2005, the following amounts were committed to be loaned out under existing loan agreements:

| | |
|-----------------------------|----------------------|
| City and County of Honolulu | \$ 24,779,092 |
| County of Hawaii | 1,168,109 |
| County of Kauai | 4,177,192 |
| County of Maui | 6,963,440 |
| | <u>\$ 37,087,833</u> |

4. Contributed Capital

The Fund is capitalized by grants from the EPA and matching funds from the State. Through June 30, 2005, the EPA has awarded \$58,746,600 to the State, of which \$16,074,767 has been drawn for loans and administrative expense. The following summarizes the EPA capitalization grants awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2005:

| Budget Period | Amount | Total Draws at June 30, 2004 | Total 2005 Cash Draws | Funds Available |
|---------------------|----------------------|------------------------------------|--------------------------|----------------------|
| 12/05/97 — 09/30/05 | \$ 12,558,800 | \$ 11,341,402 | \$ 118,048 | \$ 1,099,350 |
| 09/24/98 — 09/30/06 | 7,121,300 | 2,341,193 | 981,920 | 3,798,187 |
| 02/04/00 — 09/30/07 | 7,463,800 | 1,009,328 | 140,028 | 6,314,444 |
| 02/26/01 — 06/30/08 | 7,757,000 | 75,000 | 43,848 | 7,638,152 |
| 09/01/02 — 09/30/08 | 7,789,100 | 24,000 | - | 7,765,100 |
| 10/01/03 — 06/30/11 | 8,052,500 | - | - | 8,052,500 |
| 04/04/04 — 06/30/11 | 8,004,100 | - | - | 8,004,100 |
| | <u>\$ 58,746,600</u> | <u>\$ 14,790,923</u> | <u>\$ 1,283,844</u> | <u>\$ 42,671,833</u> |

Through June 30, 2005, the Fund was in compliance with the 20% matching requirement. The required State match through June 30, 2005 amounted to \$11,749,320, of which \$3,968,748 has been utilized and \$7,780,582 is available to be loaned out at June 30, 2005.

5. Capital Assets

Summary of capital assets at June 30, 2005 is as follows:

| | Balance at June 30, 2004 | Additions | Retirements/ Transfers | Balance at June 30, 2005 |
|-------------------------------|-----------------------------|--------------------|---------------------------|-----------------------------|
| Equipment | \$ 588,471 | \$ 139,088 | \$ (18,367) | \$ 709,192 |
| Less accumulated depreciation | 329,572 | 184,732 | (18,367) | 495,937 |
| | <u>\$ 258,899</u> | <u>\$ (45,644)</u> | <u>\$ -</u> | <u>\$ 213,255</u> |

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

6. Due from Other Funds

Advances to other government agencies at June 30, 2005 were as follows:

| | |
|---|-------------------|
| Environmental Management, Public Water System Supervision | \$ 225,000 |
| Environmental Management, Environmental Resources Office | <u>50,000</u> |
| | <u>\$ 275,000</u> |

7. Employee Benefit Plans

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. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS 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 contributory 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. Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, or highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State general fund.

Most covered employees of the contributory option are required to contribute 7.8 percent of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the remaining period of 29 years from July 1, 2000.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits and other aspects of the ERS is also not available on a department or agency basis.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

ERS issues a Comprehensive Annual Financial Report (“CAFR”) that includes financial statements and required supplementary information, which may be obtained from the following address:

Employees’ Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

Post-retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to Chapter 87, HRS, provides certain health care and life insurance benefits to all qualified employees. For employees hired before July 1, 1996, the State pays the entire monthly health care premium for those retiring when ten or more years of credited service, and 50 percent of the monthly premium for those retiring with fewer than ten years of credited service. For employees hired after June 30, 1996, and retiring with fewer than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50 percent of the retired employees’ monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and retiring with at least 15 years but fewer than 25 years of service, the State pays 75 percent of the retired employees’ monthly Medical or non-Medicare premium; and for those retiring with over 25 years of service, the State pays the entire health care premium. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 is also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement for the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis.

Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependants.

8. Commitments and Contingencies

Insurance Coverage

Insurance coverage is maintained at the State level. The State is self-insured for substantially all perils including workers’ compensation. Expenditures for workers’ compensation and other insurance claims are appropriated annually from the State’s general fund.

The Department is covered by the State’s self-insured workers’ compensation program for medical expenses of injured Department employees. However, the Department is required to pay temporary total and temporary partial disability benefits as long as the employee is on the Department’s payroll. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities may be re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

Workers’ compensation benefit claims reported as well as incurred but not reported were reviewed at year end. The estimated losses from these claims are not material.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2005

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

Supplementary Information

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Cash Receipts, Disbursements and Cash Balance
June 30, 2005

| | |
|---------------------------------------|---------------|
| Receipts | |
| Principal repayments on loans | \$ 730,131 |
| Interest income from loans | 181,382 |
| State contributions | 1,611,000 |
| Federal contributions | 1,283,843 |
| Administrative loan fees | 436,054 |
| Other interest | 335,728 |
| Repayments from other funds | 220,000 |
| Other income | 240 |
| Total receipts | 4,798,378 |
| Disbursements | |
| Disbursement of loan proceeds | 941,992 |
| State program management | 370,543 |
| Administrative | 341,822 |
| Water protection program | 184,705 |
| Small systems | 65,000 |
| Advances to other funds | 275,000 |
| Total disbursements | 2,179,062 |
| Excess of receipts over disbursements | 2,619,316 |
| Cash balance at June 30, 2004 | 12,108,106 |
| Cash balance at June 30, 2005 | \$ 14,727,422 |

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Net Assets
June 30, 2005

| | SRF Activity | Non-SRF Activity | Total |
|---|----------------------|---------------------|----------------------|
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents in State Treasury | \$ 14,350,127 | \$ 377,295 | \$ 14,727,422 |
| Loan fees receivable | - | 105,776 | 105,776 |
| Accrued interest on loans | 40,350 | - | 40,350 |
| Other accrued interest | 33,114 | - | 33,114 |
| Due from other funds | - | 275,000 | 275,000 |
| Due from federal government | 766,205 | 584,937 | 1,351,142 |
| Current maturity of loans receivable | 772,893 | - | 772,893 |
| Total current assets | <u>15,962,689</u> | <u>1,343,008</u> | <u>17,305,697</u> |
| Loans receivable, net of current maturities | 13,038,017 | - | 13,038,017 |
| Capital assets, net of accumulated depreciation | - | 213,255 | 213,255 |
| Total assets | <u>\$ 29,000,706</u> | <u>\$ 1,556,263</u> | <u>\$ 30,556,969</u> |
| Liabilities and Net Assets | | | |
| Current liabilities | | | |
| Accounts payable and other accrued liabilities | \$ - | \$ 64,780 | \$ 64,780 |
| Total current liabilities | - | 64,780 | 64,780 |
| Net assets | | | |
| Invested in capital assets | - | 213,255 | 213,255 |
| Restricted | 29,000,706 | 1,278,228 | 30,278,934 |
| Total net assets | <u>29,000,706</u> | <u>1,491,483</u> | <u>30,492,189</u> |
| Total liabilities and net assets | <u>\$ 29,000,706</u> | <u>\$ 1,556,263</u> | <u>\$ 30,556,969</u> |

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Revenues, Expenses and Changes in Net Assets
June 30, 2005

| | SRF Activity | Non-SRF Activity | Total |
|------------------------------|----------------------|---------------------|----------------------|
| Operating revenues | | | |
| Interest earnings from loans | \$ 181,344 | \$ - | \$ 181,344 |
| Administration loan fees | - | 437,045 | 437,045 |
| Total operating revenues | <u>181,344</u> | <u>437,045</u> | <u>618,389</u> |
| Operating expenses | | | |
| State program management | - | 414,796 | 414,796 |
| Administrative | - | 343,695 | 343,695 |
| Water protection | - | 203,680 | 203,680 |
| Small systems | - | 97,500 | 97,500 |
| Total operating expenses | <u>-</u> | <u>1,059,671</u> | <u>1,059,671</u> |
| Operating income (loss) | 181,344 | (622,626) | (441,282) |
| Nonoperating revenues | | | |
| State contribution | 1,611,000 | - | 1,611,000 |
| Federal contribution | 807,531 | 617,508 | 1,425,039 |
| Other interest earnings | 364,214 | - | 364,214 |
| Other income | - | 240 | 240 |
| Total nonoperating revenues | <u>2,782,745</u> | <u>617,748</u> | <u>3,400,493</u> |
| Changes in net assets | 2,964,089 | (4,878) | 2,959,211 |
| Net assets at July 1, 2004 | <u>26,036,617</u> | <u>1,496,361</u> | <u>27,532,978</u> |
| Net assets at June 30, 2005 | <u>\$ 29,000,706</u> | <u>\$ 1,491,483</u> | <u>\$ 30,492,189</u> |

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Expenses
June 30, 2005

| | SRF Activity | Non-SRF Activity | Total |
|--|-----------------|---------------------|--------------|
| Professional services | \$ - | \$ 336,690 | \$ 336,690 |
| Personnel | - | 319,280 | 319,280 |
| Depreciation | - | 166,356 | 166,356 |
| Services rendered by other state agencies | - | 112,938 | 112,938 |
| Repairs and maintenance | - | 78,572 | 78,572 |
| Travel | - | 39,475 | 39,475 |
| Non-state employee services on a fee basis | - | 25,000 | 25,000 |
| Rental | - | 11,359 | 11,359 |
| Equipment – small tool and supplies | - | 9,657 | 9,657 |
| Training | - | 9,010 | 9,010 |
| Telephone | - | 5,795 | 5,795 |
| Advertising and printing | - | 3,012 | 3,012 |
| Utilities | - | 1,703 | 1,703 |
| Office and other supplies | - | (75,603) | (75,603) |
| Miscellaneous | - | 16,427 | 16,427 |
| Total | \$ - | \$ 1,059,671 | \$ 1,059,671 |

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund, as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud 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 over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

We noted certain matters that we reported to management of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund in a separate letter dated October 28, 2005.

This report is intended solely for the information and use of the Auditor; the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's management; the State of Hawaii, Department of Health's management; and the United States Environmental Protection Agency. However, this report is a matter of public record and distribution is not limited.

Prue Waterhouse Cooper CP

Honolulu, Hawaii
October 28, 2005

**Report of Independent Auditors on Compliance
with the Requirements Applicable to the
Environmental Protection Agency's Drinking Water State Revolving Fund Program
in Accordance with *Government Auditing Standards***

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 2005.

We have also audited the Fund's compliance with requirements governing:

- Allowability for Specific Activities
- Allowable Costs/Cost Principles
- Cash Management
- State Matching
- Period of Availability of Funds and Binding Commitments
- Program Income
- Reporting
- Subrecipient Monitoring, and
- Special Tests and Provision

that are applicable to its major federal program for the year ended June 30, 2005. The management of the State of Hawaii, Drinking Water Treatment Revolving Loan is responsible for the Fund's compliance with these requirements. Our responsibility is to express an opinion on those requirements based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the State of Hawaii, Drinking Water Treatment Revolving Loan Fund complied, in all material respects, with the requirements governing types of activities and types of service and types of

costs allowed or unallowed; matching; level of effort or earmarking requirements; special reporting requirements; special tests or provisions, and claims for advances and reimbursements that are applicable to its major Federal financial assistance program for the year ended June 30, 2005.

This report is intended solely for the information and use of the Auditor; the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's management; the State of Hawaii, Department of Health's management; and the United States Environmental Protection Agency. However, this report is a matter of public record and distribution is not limited.

PricewaterhouseCoopers CP

Honolulu, Hawaii
October 28, 2005