Grant Thornton

Financial Statements and Report of Independent Certified Public Accountants

Department of Education, State of Hawaii

Year ended June 30, 2007

Submitted by
The Auditor
State of Hawaii

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August 14, 2008

Ms. Marion Higa
Office of the Auditor
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audit of the Department of Education (DOE), State of Hawaii, as of and for the year ended June 30, 2007. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Objectives of the Audit

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DOE's financial statements as of and for the fiscal year ended June 30, 2007, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the DOE's basic financial statements.

2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the DOE is entitled have been collected and accounted for in accordance with the laws, rules and regulations, administrative directives, policies and procedures of the State of Hawaii and the federal government.

3. To determine whether the DOE has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws, regulations, contracts, and grants.

4. To determine whether the DOE has complied with the laws, regulations, contracts, and grants that may have a material effect on the basic financial statements and on each major federal financial assistance program.

Scope of the Audit

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2007.

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Ms. Marion Higa
Office of the Auditor
State of Hawaii
August 14, 2008

Organization of the Report

This report is presented in six parts as follows:

- Part I — The basic financial statements and related notes of the DOE as of and for the fiscal year ended June 30, 2007, and our opinion on the basic financial statements.
- Part II — Our report on internal control over financial reporting and on compliance and other matters.
- Part III — Our report on compliance with requirements applicable to each major program and on internal control over compliance.
- Part IV — The schedule of findings and questioned costs.
- Part V — Corrective action plan as provided by the Department of Education, State of Hawaii.
- Part VI — The summary schedule of prior audit findings.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DOE.

Very truly yours,

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PART I

FINANCIAL SECTION

Grant Thornton

Report of Independent Certified Public Accountants

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To the Auditor
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education, State of Hawaii (DOE), as of and for the year ended June 30, 2007, which collectively comprise the DOE's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DOE's management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

The DOE has reported workers compensation claims liability in the amount of $66,893,192 as of June 30, 2007. The DOE was unable to provide sufficient evidential matter supporting the amounts accrued for this estimate; nor were we able to satisfy ourselves as to the recorded amount of this liability by other auditing procedures.

As discussed in note A, the financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2007, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, 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 workers compensation

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To the Auditor
State of Hawaii

claims reserve as discussed in the third paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the DOE, as of June 30, 2007, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund, and the aggregate remaining fund information of the DOE, as of June 30, 2007, and the respective changes in financial position thereof and the respective budgetary comparison for the general and federal funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also have audited the adjustments described in note C to the financial statements that were applied to restate the net assets and fund balances as of July 1, 2006 to correct certain errors. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2006 financial statements of the DOE other than with respect to such adjustments and, accordingly, we do not express an opinion or any other assurance on the 2006 financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 7, 2008, on our consideration of the DOE's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 9 through 17 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the DOE's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements of the DOE. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Grant Thornton LLP

Honolulu, Hawaii
August 7, 2008

Department of Education
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2007

The following management's discussion and analysis provides an overview of the Department of Education's (Department) financial activities for the fiscal year ended June 30, 2007. Readers should also review the basic financial statements and notes to enhance their understanding of the Department's financial performance.

FINANCIAL HIGHLIGHTS

Key government-wide financial highlights for Fiscal Year 2007 are as follows:

- General revenues were $2.261 billion. Program revenues, including federal fund grants, and program reimbursements totaled $286.2 million.

- Total expenses were $2.203 billion, of which 90% or $1.976 billion, was spent for school-related expenditures and 5% or $102.2 million was spent on capital outlays.

- Total assets exceeded liabilities by $1.059 billion (net assets). Land and depreciated capital assets (buildings and improvements, and equipment) comprise 98% of the total net assets.

- Net assets increased by $119.4 million, primarily due to increased legislative appropriations.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements consist of three sections: management's discussion and analysis (this section), basic financial statements and notes, and required supplementary information. These sections are described below.

The basic financial statements include government-wide and fund financial statements, which provide different views of the Department:

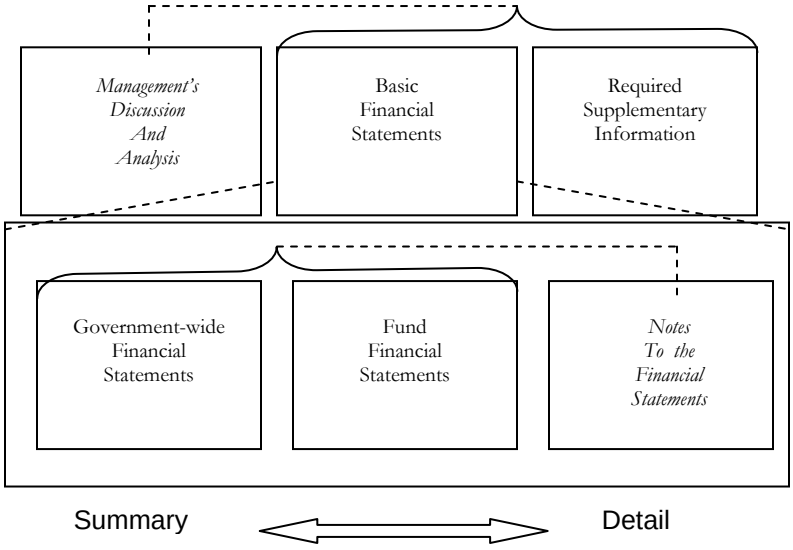
- *Government-wide financial statements* provide both *long-term* and *short-term* information about the Department's *overall* financial position and changes in financial position. The statements are presented on an accrual basis of accounting and consist of the Statement of Net Assets and the Statement of Activities.

- *Fund financial statements* focus on *individual* parts of the Department and report operations in more detail than the government-wide statements. Governmental fund statements include most of the Department's programs and services such as instruction, support services, operation and maintenance of facilities, student transportation, and extracurricular activities and are presented on a modified accrual basis of accounting. Fiduciary funds statements report on agency funds, which are held in a custodial capacity for students' school activities that take place outside of the formal class period and are not requirements for class work or credit. Certain activities, such as depreciation expense, are included in the government-wide financial statements but not on the fund statements. These activities are highlighted in the financial statement's *Reconciliation of the Change in Fund Balances of Governmental Funds to the Statement of Activities*.

Notes are included in the financial statements to explain financial statement information and provide more detailed data. The basic financial statements are followed by a section of required supplementary information. This section further explains and supports the information in the financial statements.

Exhibit A-1 shows how the required parts of this annual report are arranged and relate to one another.

Exhibit A-1



GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets. The largest portion of the Department's net assets (98%, $1.036 billion) reflects its investment in capital assets (e.g., land, buildings, equipment). (See Exhibit A-2.) The Department uses these capital assets to provide instructional and support services to students; consequently, these assets are not available for future spending. The unrestricted net assets of the Department are available for future use to provide program services.

Exhibit A-2
Statement of Net Assets
Fiscal Years 2007 and 2006
(Amounts in millions)

	Governmental activities as of June 30,		2007 – 2006	
	2007	2006 (as restated)	Increase (decrease)	% Change
Assets				
Current	$ 320.6	$ 204.2	$116.4	57%
Non-current (capital assets, net of depreciation)	1,035.9	1,023.2	12.7	1
Total assets	$1,356.5	$1,227.4	$129.1	11%
Liabilities				
Current	$ 214.4	$ 215.6	$ (1.2)	(1)%
Non-current	83.0	72.1	10.9	15
Total liabilities	297.4	287.7	9.7	3
Net assets				
Investment in capital assets	1,035.9	1,023.2	12.7	1
Restricted	23.3	35.1	(11.8)	(34)
Unrestricted	(0.1)	(118.6)	118.5	(100)
Total net assets	1,059.1	939.7	119.4	13
Total liabilities and net assets	$1,356.5	$1,227.4	$129.1	11%

Changes in net assets. Total net assets increased by $119.4 million (see Exhibit A-3). This increase was primarily due to increased legislative appropriations.

Exhibit A-3
Changes in Net Assets
Fiscal Years 2007 and 2006
(Amounts in millions)

	Governmental activities for the year ended June 30,		2007 compared to 2006	
	2007	2006 (as restated)	Increase (decrease)	% Change
Revenues				
State appropriations	$2,260.9	$1,924.4	$ 336.5	17%
Federal funds	238.7	228.2	10.5	5
Other revenues	47.5	47.7	(0.2)	–
Total revenues	2,547.1	2,200.3	346.8	16
Expenditures				
School-related	1,975.7	1,882.8	92.9	6
State and complex area administration	79.0	47.5	31.5	–
Public libraries	45.7	28.3	17.4	61
Capital outlay	102.2	63.6	38.6	61
Other	–	5.5	(5.5)	(13)
Total expenses	2,202.6	2,027.7	174.9	9
Excess revenues over expenses before transfers	344.5	172.6	171.9	100
Transfers	(225.1)	(87.2)	(137.9)	158
Change in net assets	$ 119.4	$ 85.4	$ 34.0	40%

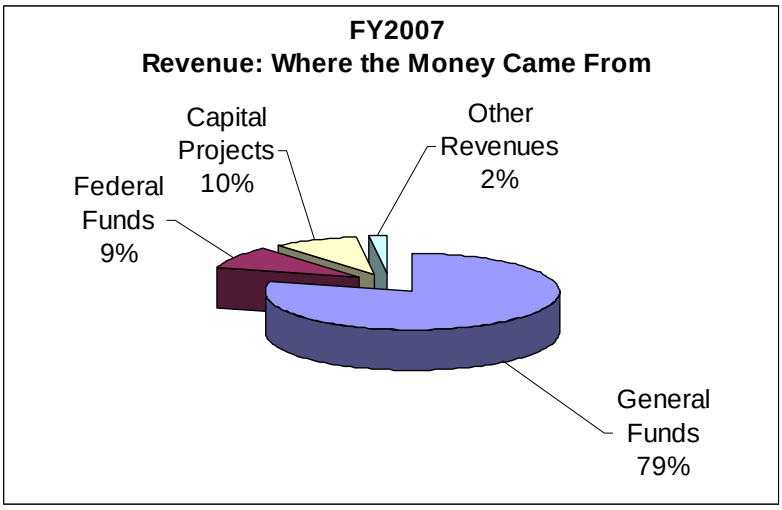
EXPLANATION OF MAJOR DEPARTMENTAL PROGRAMS

The State Budget is organized by major program areas. The Department of Education's major programs are:

- EDN 100 – School-Based Budgeting (weighted student formula, instructional services, curriculum programs, at-risk programs, fringe benefits, and debt service)
- EDN 150 – Comprehensive Student Support Services (special needs assessment, special education services, school-based behavioral health services and other related services required for a free and appropriate public education, autism services, and professional development)
- EDN 200 – Instructional Support (curriculum support, assessment, planning, and school leadership training)
- EDN 300 – State and Complex Administration (Board of Education, Superintendent, Complex Area Superintendents, budget, communications, civil rights compliance, internal audit, business services, human resources, and information technology)
- EDN 400 – School Support (school food services, utilities, repair and maintenance, student transportation)
- EDN 407 – Hawaii State Public Library System*
- EDN 500 – School Community Services (after school child care, adult education)
- EDN 600 – Public Charter Schools

Exhibit A-4 shows the revenues of the Department in summary form. Revenues primarily come from State general funds (State taxpayer monies). Other revenues come from federal grants, special funds to support specific programs such as cafeteria collections for school food services, and donations.

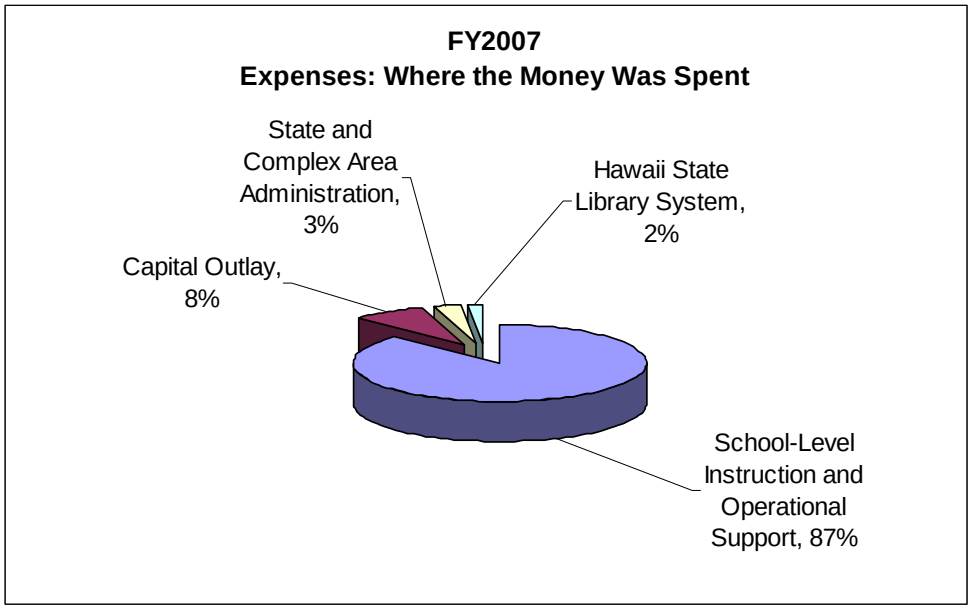
Exhibit A-4



* Note: The Hawaii State Public Library System is included in the Department of Education's combined financial statements since both the Library System and the Department of Education are administratively and legally supervised by the Hawaii State Board of Education.

Exhibit A-5 shows the expenses of the Department in summary form. A total of 87% of the Department's expenditures are for school-level instructional and support programs. Only 3% of the Department's expenditures were for State and complex area administration.

Exhibit A-5



GENERAL FUND BUDGETARY HIGHLIGHTS

- The Department was allotted general funds of $2.024 billion in Fiscal Year 2007. General fund appropriations increased due to an increase in school-related ($188.5M) and an increase in State and complex area administration ($8.4M).

- The law permits the Department to "carryover" up to 5% of appropriations from one fiscal year to the next. Based on State Department of Accounting & General Services (DAGS) balances, the Department carried over $43.6 million (representing 2%) of the Fiscal Year 2007 general fund appropriation for expenditure in Fiscal Year 2008. Carryover funds enable schools to make long-range fiscal plans, save for major purchases for which single year funding may not be sufficient, and provide funds to start the next school year, which occurs within weeks of the beginning of the fiscal year.

FIDUCIARY FUNDS

Fiduciary funds are held for students in a custodial capacity and do not require deposit into the State Treasury. The funds are called "local school funds," which include monies collected and maintained by the school for the students. Examples include yearbook, newspaper fund, student government dues, physical education uniform sales, and excursions. These funds are used for the students for school activities that take place outside of the formal class period and are not required for class work or credit.

Fiduciary fund assets were $18.1 million in Fiscal Year 2007, resulting in a 2.0% increase from the prior fiscal year.

CAPITAL ASSET AND DEBT ADMINISTRATION

The Department's capital improvement program strives to provide facilities that are well placed, sufficient in number, flexible, functional, and creatively designed to accommodate population changes, support educational programs, and promote health and safety of students, employees, and the public. With the passage of Act 51, Session Laws of Hawaii 2004, school construction and school repairs and maintenance functions were transferred from the State Department of Accounting & General Services to the Department of Education. The transfer has resulted in significantly improved services for schools. The Department also has developed improved communications with the State Department of Budget & Finance so that capital funding decisions are clearly understood, and the related construction and repairs and maintenance projects are more efficiently and effectively planned and completed.

Buildings and improvements less than $100,000 are not reported as capital assets. This year's capital improvements included the acceptance of various buildings and classrooms at Keone'ula and Pomaikai Elementary Schools. Please refer to Note F for details of capital assets.

The Department's long-term debt is managed by the Department of Budget and Finance; however, general fund appropriations for interest payment and debt retirement are included in the Department's budget. Interest payments and debt retired were $99.6 million and $124.6 million, respectively, in Fiscal Year 2007, resulting in an $18.1 million (9%) increase from the prior fiscal year. The significant increase in interest payments and debt retirements reflects the State of Hawaii's commitment to numerous school construction projects that will provide the necessary education facilities for our students.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The State's unemployment rate is at higher levels, with the statewide seasonally adjusted unemployment rate being 2.7% for the month of October 2007. One year ago, the State's seasonally adjusted unemployment rate stood at 2.1%, while the seasonally adjusted national unemployment rate was 4.4%.

Cumulative State tax collections for the first five months of fiscal year 2007-08 exceeded $2.2 billion, or $130.7 million more than the corresponding period last year. General excise and use taxes, which are the largest source of revenue for the State and a good measure of economic growth, increased 3.5% in the same period.

The Council on Revenues, in January 2008, estimated that the State general fund growth rate would be 4.9% in fiscal year 2007-08, and 4.1% for fiscal year 2008-09. Actual State general fund tax collections rose by 3.2% in the first five months of fiscal year 2007-08 over the corresponding 2006-07 period. Higher general excise and use tax collections were the primary factors underlying this strong performance. A large part of this increase is attributable to the Honolulu County Surcharge which became effective January 1, 2007. In November 2007, the Council on Revenues forecasted the State's growth at 5.9% in 2008 personal income.

FUTURE EVENTS THAT WILL FINANCIALLY IMPACT THE DEPARTMENT

Fuel prices rose to record levels in fiscal year 2006-07. Those prices resulted in significantly increased costs in areas such as student transportation and electricity during fiscal year 2006-07. Although fuel prices stabilized for a period subsequent to fiscal year 2006-07, the uncertainty of those prices are expected to affect the budget for fiscal year 2007-08 and beyond.

Recent shutdowns of Aloha Airlines, the State's second largest inter-island carrier, and ATA Airlines, the State's third largest trans-Pacific carrier, have also adversely impacted the State's economy.

Continued global fossil fuel demand, skyrocketing fuel prices, coupled with continuing Middle East crises, are expected to further impact the Hawaii economy with likely tourism/visitor industry downturns and projected tax revenue declines. Such decreases will possibly result in near-term budget reductions and budget restrictions for the Department of Education.

In anticipation of budgetary constraints, the Department is reviewing options for adjustments, and has a process in place to present alternatives to the Board of Education for approval.

The Department continues its implementation of the weighted student formula, giving schools increased budgetary decision-making flexibility, authority, and accountability. The Committee on Weights, established by statute, reviews the weighted student formula annually, and makes recommendations to the Board of Education as to improvements or changes to the formula.

In accordance with the No Child Left Behind Act, the Hawaii Department of Education has made substantial progress in reading and mathematics proficiencies, at levels consistent with the State's plan to meet full proficiencies by the year 2013-14. In addition, in school year 2006-07, the number of schools meeting

Adequate Yearly Progress (AYP) was at an all-time high of 182 public schools, representing approximately 65% of the total number of public schools.

The Department's financial reporting goal is to provide its financial information to school-level personnel and the public in a transparent manner. There is a critical need for more financial reports that are easily understood by non-fiscal personnel, and more easily used for financial management. Accordingly, the Department is evaluating whether to replace its financial systems or improve upon its existing systems. This evaluation is expected to be completed by December 2008.

RESTATEMENTS

Various adjustments were made to the beginning net assets of the government-wide financial statements and beginning fund balances of the governmental fund financial statements due to prior year 2006 understatements of capital assets, accrued compensated absences and accrued wages and employee benefits payable. For more information, please refer to note C of the financial statements.

CONTACTING THE DEPARTMENT'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Department's finances for the public, and to demonstrate the Department's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Office of Fiscal Services, Department of Education, P. O. Box 2360, Honolulu, Hawaii 96804. For general information about the Department, please refer to the Department's website.

Department of Education
State of Hawaii

STATEMENT OF NET ASSETS

June 30, 2007

ASSETS	Governmental Activities
CURRENT ASSETS	
Cash	$ 310,653,308
Receivables	
Due from federal government	8,963,816
Accounts receivable	700,349
Due from other agency	298,408
Total current assets	320,615,881
CAPITAL ASSETS, net of accumulated depreciation	1,035,893,583
TOTAL ASSETS	$ 1,356,509,464
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
Vouchers and contracts payable	$ 59,671,903
Accrued wages and employee benefits	115,397,745
Accrued compensated absences	13,378,405
Workers' compensation claims reserve	16,918,326
Deferred revenues	3,005,237
Due to State of Hawaii General Fund	5,077,859
Due to others	978,261
Total current liabilities	214,427,736
ACCRUED COMPENSATED ABSENCES, less current portion	32,992,640
WORKERS' COMPENSATION CLAIMS RESERVE, less current portion	49,974,866
Total liabilities	297,395,242
NET ASSETS	
Investment in capital assets	1,035,893,583
Restricted	23,287,447
Unrestricted	(66,808)
Total net assets	1,059,114,222
TOTAL LIABILITIES AND NET ASSETS	$ 1,356,509,464

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

STATEMENT OF ACTIVITIES

Fiscal Year ended June 30, 2007

Functions/programs	Expenses	Program revenues: Charges for Services	Program revenues: Operating Grants and Contributions	Net revenue (expenses) and change in net assets: Governmental Activities
Governmental activities				
School-related	$ 1,975,730,466	$ 33,241,906	$ 242,569,669	$(1,699,918,891)
State and complex area administration	78,977,835	2,751,210	2,750,386	(73,476,239)
Public libraries	45,729,645	2,548,730	1,190,009	(41,990,906)
Capital outlay	102,162,221	-	-	(102,162,221)
Total governmental activities	$ 2,202,600,167	$ 38,541,846	$ 246,510,064	(1,917,548,257)
General revenues				
State allotted appropriations, net of lapses				1,879,890,886
Nonimposed employee fringe benefits				381,014,732
Unrestricted investment earnings				1,118,188
Total general revenues				2,262,023,806
Transfers out				(225,066,999)
Change in net assets				119,408,550
Net assets at July 1, 2006, as previously reported				916,366,804
Restatement adjustment (note C)				23,338,868
Net assets at July 1, 2006, as restated				939,705,672
Net assets at June 30, 2007				$ 1,059,114,222

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2007

ASSETS	General	Federal	Capital projects	Other	Total
Cash	$ 155,815,344	$ 33,319,025	$ 85,886,620	$ 35,632,319	$ 310,653,308
Receivables					
Due from federal government	-	8,963,816	-	-	8,963,816
Accounts receivable	-	-	-	700,349	700,349
Due from other funds	-	-	-	6,000,000	6,000,000
Due from other agency	-	-	-	298,408	298,408
TOTAL ASSETS	$ 155,815,344	$ 42,282,841	$ 85,886,620	$ 42,631,076	$ 326,615,881
LIABILITIES AND FUND BALANCES					
Liabilities					
Vouchers and contracts payable	$ 31,263,822	$ 9,145,098	$ 17,533,732	$ 1,729,251	$ 59,671,903
Accrued wages and employee benefits payable	108,146,252	5,866,798	229,055	1,155,640	115,397,745
Deferred revenues	-	3,005,237	-	-	3,005,237
Due to State of Hawaii General Fund	5,077,859	-	-	-	5,077,859
Due to other funds	-	-	6,000,000	-	6,000,000
Due to other agency	-	978,261	-	-	978,261
Total liabilities	144,487,933	18,995,394	23,762,787	2,884,891	190,131,005
Fund balances					
Reserved for encumbrances	79,689,554	21,332,682	146,513,068	6,053,268	253,588,572
Reserved for continuing appropriations	41,828,890	-	-	-	41,828,890
Unreserved	(110,191,033)	1,954,765	(84,389,235)	33,692,917	(158,932,586)
	11,327,411	23,287,447	62,123,833	39,746,185	136,484,876
TOTAL LIABILITIES AND FUND BALANCES	$ 155,815,344	$ 42,282,841	$ 85,886,620	$ 42,631,076	$ 326,615,881

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS

June 30, 2007

Total fund balances - governmental funds		$ 136,484,876
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		
Capital assets	$ 2,010,814,579	
Less accumulated depreciation	(974,920,996)	1,035,893,583
Accrued compensated absences liability is not due in the current period and therefore is not reported in the funds.		(46,371,045)
Accrued workers' compensation liability is not due in the current period and therefore is not reported in the funds.		(66,893,192)
Net assets of governmental activities		$ 1,059,114,222

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES -
GOVERNMENTAL FUNDS

Fiscal year ended June 30, 2007

	General	Federal	Capital projects	Other	Total
Revenues					
State allotments, net	$ 2,018,447,273	$ -	$242,458,345	$ -	$ 2,260,905,618
Intergovernmental revenues	-	238,702,148	-	-	238,702,148
Other revenues	-	-	-	47,467,950	47,467,950
	2,018,447,273	238,702,148	242,458,345	47,467,950	2,547,075,716
Expenditures					
School-related	1,621,127,803	245,508,497	-	36,754,790	1,903,391,090
State and complex area administration	71,321,560	3,833,836	-	2,823,781	77,979,177
Public libraries	34,492,546	1,190,009	-	2,362,039	38,044,594
Capital outlay	-	-	175,946,911	-	175,946,911
	1,726,941,909	250,532,342	175,946,911	41,940,610	2,195,361,772
Excess (deficiency) of revenues over expenditures	291,505,364	(11,830,194)	66,511,434	5,527,340	351,713,944
Other financing sources (uses)					
Transfers in (out)	(224,282,599)	-	(784,400)	-	(225,066,999)
NET CHANGE IN FUND BALANCES	67,222,765	(11,830,194)	65,727,034	5,527,340	126,646,945
Fund balances at July 1, 2006, as previously reported	(23,487,381)	35,165,553	(3,569,309)	34,258,631	42,367,494
Cumulative effect of restatement on prior years (note C)	(32,407,973)	(47,912)	(33,892)	(39,786)	(32,529,563)
Fund balances at July 1, 2006 as restated	(55,895,354)	35,117,641	(3,603,201)	34,218,845	9,837,931
Fund balances at June 30, 2007	$ 11,327,411	$ 23,287,447	$ 62,123,833	$ 39,746,185	$ 136,484,876

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

RECONCILIATION OF THE CHANGE IN FUND BALANCES
OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Fiscal year ended June 30, 2007

Net change in fund balances - total governmental funds		$ 126,646,945
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are depreciated over their estimated useful lives.		
Capital assets recorded in the current period	$ 74,160,045	
Loss on disposal of capital assets	(375,355)	
Less current fiscal year depreciation	(61,042,430)	12,742,260
Change in long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		(3,466,629)
Change in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		(16,514,026)
Change in net assets of governmental activities		$ 119,408,550

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -
BUDGET AND ACTUAL - GENERAL FUND

Fiscal year ended June 30, 2007

	Original	Final	Actual on budgetary basis	Variance favorable (unfavorable)
Budgetary fund balance at July 1, 2006	$ 29,791,685	$ 29,791,685	$ 29,791,685	$ -
Revenues				
State allotments	1,947,372,122	2,024,616,515	2,023,811,058	(805,457)
Expenditures				
School-related	1,910,439,138	1,983,957,426	1,940,866,793	43,090,633
State and complex area administration	40,507,908	42,973,348	41,790,134	1,183,214
Public libraries	26,216,761	27,477,426	27,326,288	151,138
	1,977,163,807	2,054,408,200	2,009,983,215	44,424,985
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(29,791,685)	(29,791,685)	13,827,843	43,619,528
Budgetary fund balance at June 30, 2007	$ -	$ -	$ 43,619,528	$ 43,619,528

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -
BUDGET AND ACTUAL - FEDERAL FUND

Fiscal year ended June 30, 2007

	Original	Final	Actual on budgetary basis	Variance favorable (unfavorable)
Revenues				
Federal grants	$ 257,403,645	$ 403,145,295	$ 238,573,653	$(164,571,642)
Expenditures				
School-related	255,448,401	400,145,268	250,869,932	149,275,336
State and complex area administration	590,000	1,240,161	209,797	1,030,364
Public libraries	1,365,244	1,759,866	1,149,239	610,627
	257,403,645	403,145,295	252,228,968	150,916,327
EXCESS (DEFICIENCY) REVENUES OVER EXPENDITURES	$ -	$ -	$ (13,655,315)	$ (13,655,315)

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

STATEMENT OF ASSETS AND LIABILITIES - AGENCY FUNDS

June 30, 2007

ASSETS

Cash and cash equivalents	$ 18,088,977
TOTAL ASSETS	$ 18,088,977

LIABILITIES

Due to student group and others	$ 18,088,977
TOTAL LIABILITIES	$ 18,088,977

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2007

NOTE A – FINANCIAL REPORTING ENTITY

1. Introduction

The Department of Education of the State of Hawaii (DOE), administers the statewide system of public schools and public libraries. Additionally, the DOE is responsible for administering state laws regarding regulation of private school operations through a program of inspection and licensing and the professional certification of all teachers for every academic and non-college type of school. Federal grants received to support public school and public library programs are administered by the DOE on a statewide basis.

The DOE is a part of the executive branch of the State of Hawaii (State). The financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2007, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually which includes the DOE's financial activities.

2. Reporting Entity

The DOE has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the DOE are such that exclusion would cause the DOE's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. The DOE has determined, based on the GASB criteria, that it has no component units.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the DOE have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the GASB.

1. Government-Wide and Fund Financial Statements

The government-wide financial statements report all assets, liabilities, and activities of the DOE as a whole. The fiduciary funds are excluded from the government-wide financial statements because the DOE cannot use those assets to finance its operations. Governmental activities are normally supported by State allotments and intergovernmental revenues.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Government-Wide and Fund Financial Statements (continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the DOE's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds are reported as separate columns in the fund financial statements. Non-major funds are summarized into a single column.

2. Measurement Focus, Basis of Accounting and Financial Statement Presentation

a. Government-Wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded 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.

b. Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the DOE considers revenues to be available if they are collected within 60 days of the end of the current fiscal year.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

2. Measurement Focus, Basis of Accounting and Financial Statement Presentation (continued)

b. Governmental Fund Financial Statements (continued)

Principal revenue sources considered susceptible to accrual include federal grants. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with generally accepted accounting principles since they have been earned and are expected to be collected within sixty days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the DOE.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation and workers' compensation claims which are recorded as an expenditure when utilized or paid. The amount of accumulated vacation and reserve for workers' compensation claims at June 30, 2007 has been reported only in the government-wide financial statements.

c. Fiduciary Funds

Fiduciary Funds—The financial statement of fiduciary funds is reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

3. Fund Accounting

The financial transactions of the DOE are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and non-major funds are combined in one column. Major funds are funds which have total assets, liabilities, revenues or expenditures of the fund that are at least ten percent of the same element for all funds of its fund type or at least five percent of the same element for all governmental funds combined.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Fund Accounting (continued)

a. Governmental Funds

General Fund – The general fund is the general operating fund of the DOE. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Special Revenue Funds – Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes. Special revenue funds include the federal fund which accounts for grants received from the federal government, directly or indirectly.

Capital Projects Fund – The capital projects fund, which includes amounts related to the capital improvement program, is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

b. Fiduciary Fund Type

Agency Funds – Agency funds are used to account for assets held by the DOE on behalf of outside parties, including other governments, or on behalf of individuals. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

4. Cash

Cash and cash equivalents include certificates of deposit with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). The Director of Finance may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account.

Information relating to custodial credit risk of cash deposits and interest rate risk, credit risk, custodial risk, and concentration of credit risk of investments in the State Treasury is available on a statewide basis and not for individual departments or agencies.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Capital Assets

Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Depreciation expense is recorded in the government-wide financial statements. The DOE utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. The DOE has adopted the following capitalization policy:

Asset type	Minimum capitalization amount	Estimated useful life
Land	All	Not applicable
Land improvements	$100,000	15 years
Buildings and improvements	$100,000	30 years
Furniture and equipment	$5,000	7 years
Motor vehicles	$5,000	5 years
Public library materials	All	5 years

6. Deferred Revenues

Deferred revenues at the fund level and government-wide level arise when the DOE receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the DOE has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and revenue is recognized. Deferred revenues consist primarily of federal grant funds.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Accumulated Vacation

Employees are credited with vacation at the rate of 96 to 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.

8. Appropriations

Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are generally allotted annually. General fund allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, unless the DOE receives permission to carryover such funds. The law permits the DOE to carryover up to five percent of general fund appropriations, for school level instruction and comprehensive school support services, from one fiscal year to the next.

9. Program Revenues

Program revenues derive directly from the programs of the DOE or from parties outside of the DOE and are categorized as charges for services, operating grants and contributions, or capital grants and contributions.

Charges for services – Charges for services include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided. Revenues in this category include fees charged for meals served, educational classes, use of facilities, transportation services, and use of library materials.

Operating grants and contributions – Program-specific operating and capital grants and contributions include revenues arising from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program. Governmental grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

10. 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 have been recorded as operating transfers in the basic financial statements.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

11. Risk Management

The DOE is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

12. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE C – RESTATEMENT OF NET ASSETS

Net assets as of July 1, 2006 have been restated for the cumulative effect of understatements of capital assets, accrued compensated absences and accrued wages and employee benefits payable. The net assets as of July 1, 2006 increased by $23,338,868 as a result of an understatement of due from federal government of $1,043,611, an understatement of capital assets of $67,292,507, an understatement of accrued compensated absences of $11,424,076, and an understatement of accrued wages and employee benefits payable of $33,573,174.

The adjustments were to correct errors to record additional intergovernmental revenues due to improper accruals of certain expenses. In addition, adjustments were made to correct errors in capital assets, including construction-in-progress, to record certain parcels of land, buildings, and building improvements not previously recorded, to expense certain construction-in-progress and amounts below the capitalization threshold that were erroneously capitalized, to reclassify completed construction-in-progress to capital assets being depreciated and to record adjustments to the book values of equipment previously capitalized. Accrued compensated absences was also adjusted to correct errors related to amounts being computed based on inaccurate hours and pay rates. Accrued wages and employee benefits payable was adjusted to correct errors related to certain employee groups not being recorded and the effects of a payroll lag. Finally, payments for debt service transferred to the Department of Budget and Finance were reclassified from school level instruction to transfers out.

NOTE C – RESTATEMENT OF NET ASSETS (continued)

The effects of the restatement on the government-wide financial statements were as follows:

Statement of Net Assets

	2006		
	As previously reported	Prior-period adjustment	As restated
Due from federal government	$ 16,816,945	$ 1,043,611	$ 17,860,556
Capital assets, net of accumulated depreciation	955,858,816	67,292,507	1,023,151,323
Total assets	1,159,107,789	68,336,118	1,227,443,907
Current liabilities			
Accrued wages and employee benefits	96,877,579	33,573,174	130,450,753
Accrued compensated absences	5,547,580	1,865,552	7,413,132
Total current liabilities	180,167,459	35,438,726	215,606,185
Accrued compensated absences, less current portion	25,932,760	9,558,524	35,491,284
Total liabilities	242,740,985	44,997,250	287,738,235
Net assets			
Investment in capital assets	955,858,816	67,292,507	1,023,151,323
Restricted	–	35,117,641	35,117,641
Unrestricted	(39,492,012)	(79,071,280)	(118,563,292)
Total net assets	916,366,804	23,338,868	939,705,672
Total liabilities and net assets	1,159,107,789	68,336,118	1,227,443,907

NOTE C – RESTATEMENT OF NET ASSETS (continued)

Statement of Activities

	2006		
	As previously reported	Prior-period adjustment	As restated
Operating grants and contributions			
School-related	$ 225,619,610	$ 1,043,611	$ 226,663,221
Total governmental activities	355,651,679	1,043,611	356,695,290
Expenses			
School-related	2,043,083,171	(160,268,354)	1,882,814,817
State and complex area administration	46,248,546	1,213,949	47,462,495
Capital outlay	63,646,138	33,892	63,680,030
Other	5,503,181	6,654	5,509,835
Total governmental activities	2,186,776,717	(159,013,859)	2,027,762,858
Net expenses and changes in net assets			
School-related	(1,779,531,268)	161,311,965	(1,618,219,303)
State and district administration	(45,359,063)	(1,213,949)	(46,573,012)
Capital outlay	59,118,686	(33,892)	59,084,794
Other	103,043	(6,654)	96,389
Total governmental activities	(1,789,987,577)	160,057,470	(1,629,930,107)
Transfers	118,922,773	(206,116,917)	(87,194,144)
Change in net assets	131,409,271	(46,059,447)	85,349,824

NOTE C – RESTATEMENT OF NET ASSETS (continued)

The effects of the restatement on the governmental fund financial statements were as follows:

	2006		
	As previously reported	Prior-period adjustment	As restated
GENERAL FUND			
Balance Sheet			
Liabilities			
Accrued wages and employee benefits payable	$ 91,790,190	$ 32,407,973	$ 124,198,163
Total liabilities	118,756,034	32,407,973	151,164,007
Fund balances			
Unreserved	(92,805,239)	(32,407,973)	(125,213,212)
Total fund balances (deficit)	(23,487,381)	(32,407,973)	(55,895,354)
Statement of Revenues, Expenditures, and Changes in Fund Balances			
Expenditures			
School-related	$1,736,084,834	$(173,892,022)	$ 1,596,331,792
State and complex area administration	43,559,276	183,077	43,742,353
Total expenditures	1,813,965,909	(173,708,944)	1,640,256,965
Excess(deficiency) of revenues over expenditures	(12,403,760)	173,708,944	161,305,184
Transfers	870,413	(206,116,917)	(205,246,504)
Net change in fund balances	(11,533,347)	(32,407,973)	(43,941,320)

NOTE C – RESTATEMENT OF NET ASSETS (continued)

	2006		
	As previously reported	Prior-period adjustment	As restated
FEDERAL FUND			
Balance Sheet			
Assets			
Receivables	$ 16,816,945	$1,043,611	$ 17,860,556
Total assets	53,064,431	1,043,611	54,108,042
Liabilities			
Accrued wages and employee benefits payable	3,646,350	1,091,523	4,737,873
Total liabilities	17,898,878	1,091,523	18,990,401
Fund balances			
Unreserved	22,889,753	(47,912)	22,841,841
Total fund balances (deficit)	35,165,553	(47,912)	35,117,641
Total liabilities and fund balance	53,064,431	1,043,611	54,108,042
Statement of Revenues, Expenditures, and Changes in Fund Balances			
Revenues			
Inter-governmental revenues	$227,245,090	$1,043,611	$228,288,701
Total Revenues	227,245,090	1,043,611	228,288,701
Expenditures			
School-related	223,972,347	1,091,523	226,640,827
Total expenditures	226,041,170	1,091,523	227,132,693
Excess(deficiency) of revenues over expenditures	1,203,920	(47,912)	1,156,008
Net change in fund balances	1,203,920	(47,912)	1,156,008

NOTE C – RESTATEMENT OF NET ASSETS (continued)

	2006		
	As previously reported	Prior-period adjustment	As restated
CAPITAL PROJECTS FUND			
Balance Sheet			
Liabilities			
Accrued wages and employee benefits payable	$ 15,965	$ 33,892	$ 49,857
Total liabilities	21,412,602	33,892	21,446,494
Fund balances			
Unreserved	(199,009,265)	(33,892)	(199,043,157)
Total fund balances (deficit)	(3,569,309)	(33,892)	(3,603,201)
Statement of Revenues, Expenditures, and Changes in Fund Balances			
Expenditures			
Capital outlay	$ 164,822,203	$ 33,892	$ 164,856,095
Total expenditures	164,822,203	33,892	164,856,095
Excess(deficiency) of revenues over expenditures	(42,057,379)	(33,892)	(42,091,271)
Net change in fund balances	(1,837,313)	(33,892)	(1,871,205)

NOTE C – RESTATEMENT OF NET ASSETS (continued)

	2006		
	As previously reported	Prior-period adjustment	As restated
OTHER FUNDS			
Balance Sheet			
Liabilities			
Accrued wages and employee benefits payable	$ 1,425,074	$ 39,786	$ 1,464,860
Total liabilities	2,813,965	39,786	2,853,751
Fund balances			
Unreserved	33,118,014	(39,786)	33,078,228
Total fund balances (deficit)	34,258,631	(39,786)	34,218,845
Statement of Revenues, Expenditures, and Changes in Fund Balances			
Expenditures			
School-related	$ 35,366,789	$ 30,428	$ 35,397,217
State and complex area administration	635,910	2,705	638,615
Other	5,309,041	6,653	5,315,694
Total expenditures	44,408,444	39,786	44,448,230
Excess(deficiency) of revenues over expenditures	3,282,709	(39,786)	3,242,923
Net change in fund balances	3,930,203	(39,786)	3,890,417

NOTE C – RESTATEMENT OF NET ASSETS (continued)

	2006		
	As previously reported	Prior-period adjustment	As restated
TOTAL GOVERNMENTAL FUNDS			
Balance Sheet			
Assets			
Receivables	$ 16,816,945	$ 1,043,611	$ 17,860,556
Total assets	203,248,973	1,043,611	204,292,584
Liabilities			
Accrued wages and employee benefits payable	96,877,579	33,573,174	130,450,753
Total liabilities	160,881,479	33,573,174	194,454,653
Fund balances			
Unreserved	(235,806,737)	(32,529,563)	(268,336,300)
Total fund balances (deficit)	42,367,494	(32,529,563)	9,837,831
Total liabilities and fund balance	203,248,973	1,043,611	204,292,584
Statement of Revenues, Expenditures, and Changes in Fund Balances			
Revenues			
Inter-governmental revenues	$ 227,245,090	$ 1,043,611	$ 228,288,701
Total Revenues	2,199,263,216	1,043,611	2,200,306,927
Expenditures			
School-related	1,995,423,970	(172,770,071)	1,822,653,899
State and complex area administration	44,687,052	185,782	44,872,834
Capital outlay	164,822,203	33,892	164,856,095
Other	5,491,860	6,654	5,498,514
Total expenditures	2,249,237,726	(172,543,743)	2,076,663,983
Excess(deficiency) of revenues over expenditures	(49,974,510)	173,587,354	123,612,844
Transfers	41,737,973	(206,116,917)	(164.378,944)
Net change in fund balances	(8,236,537)	(32,529,563)	(40,766,100)

NOTE D – BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration, and revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and federal funds are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii. 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 State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations such as those related to the federal funds.

However, Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to five percent each of any appropriation at the end of the fiscal year except for appropriations to fund certain financing agreements. These carryover funds, to the extent not expended or encumbered, lapse at June 30 of the first fiscal year of the next fiscal biennium. As of June 30, 2007, general funds carried over amounted to approximately $43,620,000, representing 2% of appropriations.

For purposes of budgeting, the DOE's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The DOE's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrances of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grant accruals and deferrals. These differences represent a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2007.

	General	Federal
Excess (deficiency) of revenues over expenditures and other uses – actual on a budgetary basis	$ 13,827,843	$(13,655,315)
Reserved for encumbrances at fiscal year end	79,689,554	21,332,682
Expenditures for liquidation of prior fiscal year encumbrances	(39,526,173)	(18,909,377)
Net accrued revenues and expenditures	13,231,541	(598,184)
Budgeted transfers out	224,282,599	–
Excess (deficiency) of revenues over expenditures and other uses – GAAP basis	$291,505,364	$(11,830,194)

NOTE E – CASH AND CASH EQUIVALENTS

1. Custodial Credit Risk

   Cash and deposits with financial institutions are collateralized in accordance with State statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

   The DOE also maintains cash in banks which is held separately from cash in the State Treasury. As of June 30, 2007, the carrying amount of total bank deposits was approximately $7,325,000 and the corresponding bank balances were approximately $15,556,000. Of this amount, approximately $4,014,000 is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by the DOE's agent. The uninsured and uncollateralized balance at June 30, 2007 was approximately $11,542,000.

2. Interest Rate Risk

   As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

3. Credit Risk

   The State's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating.

4. Custodial Risk

   For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping, certain types of securities to collateralized repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

5. Concentration of Credit Risk

   The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

NOTE F – CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance June 30, 2006 (previously reported)	Prior-period adjustment	Balance July 1, 2006 (as restated)	Additions	Deductions	Balance June 30, 2007
Governmental activities						
Capital asset, not being depreciated						
Land	$ 61,246,260	$ 22,955,486	$ 84,201,746	$ –	$ –	$ 84,201,746
Land improvements	6,014,060	–	6,014,060	–	–	6,014,060
Construction in progress	122,357,072	(22,613,879)	99,743,193	64,504,030	98,748,605	65,498,618
Total capital assets not being depreciated	189,617,392	341,607	189,958,999	64,504,030	98,748,605	155,714,424
Capital assets, being depreciated						
Land improvements	76,895,423	456,404	77,351,827	6,002,075	–	83,353.902
Building and improvements	1,463,905,493	83,337,035	1,547,242,528	90,765,961	–	1,638,008,489
Furniture and equipment	72,574,094	(4,949,684)	67,624,410	6,668,370	4,034,868	70,257,912
Public library materials	68,899,079	–	68,899,079	4,968,214	10,387,441	63,479,852
Total capital assets being depreciated	1,682,274,089	78,843,755	1,761,117,844	108,404,620	14,422,309	1,855,100,155
Less accumulated depreciation for:						
Land improvements	54,167,736	45,640	54,213,376	3,120,557	-	57,333,933
Building and improvements	761,313,851	12,883,194	774,197,045	45,715,282	-	819,912,327
Furniture and equipment	50,553,954	(1,035,979)	49,517,975	5,832,518	3,659.513	51,690,980
Public library materials	49,997,124	–	49,997,124	6,374,073	10,387,441	45,983,756
Total accumulated depreciation	916,032,665	11,892,855	927,925,520	61,042,430	14,046,954	974,920,996
Governmental activities, net	$ 955,858,816	$ 67,292,507	$1,023,152,323	$111,866,220	$99,123,960	$1,035,893,583

Depreciation expense was charged to functions as follows:

	Governmental activities
School-related	$52,934,977
State and complex area administration	713,413
Public libraries	7,387,818
Other	6,222
Total depreciation expense	$61,042,430

NOTE G – LONG-TERM LIABILITIES

The change in the long-term liabilities during the fiscal year ended June 30, 2007 was as follows:

	Accrued compensated absences	Workers' compensation claims
Balance at June 30, 2006, as previously reported	$ 31,480,340	$50,379,166
Prior period adjustment	11,424,076	–
Balance at June 30, 2006, as restated	42,904,416	50,379,166
Additions	22,269,932	23,275,172
Reductions	(18,803,303)	(6,761,146)
Balance at June 30, 2007	$46,371,045	$66,893,192
Due within one year	$13,378,405	$16,918,326

The compensated absences and workers' compensation liabilities have been paid primarily by the general fund in the past.

NOTE H – FUND BALANCE

1. Reserved for Encumbrances

   Reserved for encumbrances represent the portion of the fund balance that is segregated for expenditure on vendor performance.

2. Reserved for Continuing Appropriations

   Reserved for continuing appropriations represent unencumbered allotment balances that have been released and made available for encumbrance or expenditure and are legally segregated for a specific future use.

NOTE I– LEASE COMMITMENTS

The DOE leases equipment from third party lessors under various operating leases expiring through 2015. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2007 were as follows:

	Amount
Year ending June 30,	
2008	$ 5,900,000
2009	3,800,000
2010	2,000,000
2011	1,300,000
2012	700,000
2012-2015	300,000
	$14,000,000

Total rent expense related to the above leases for the year ended June 30, 2007 amounted to approximately $7,400,000.

NOTE J – RETIREMENT BENEFITS

1. Employees' Retirement System

Substantially all eligible employees of the DOE are required by Chapter 88, Hawaii Revised Statutes (HRS), to become 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. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan 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 plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively.

NOTE J – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

Both plans 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 is based on the three highest paid years of service excluding the vacation payment.

On July 1, 2007, a new hybrid contributory plan became effective pursuant to Act 170, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 after 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. All members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006, are required to join the hybrid plan.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the DOE hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the DOE is required to contribute to both options at an actuarially determined rate. The portion of the contributions related to the DOE's general and special revenue funds are recorded as an expenditure of the respective funds in the financial statements. Contributions by the DOE for the fiscal year ended June 30, 2007, 2006, and 2005 were approximately $156,527,000, $148,810,000, and $92,159,000. The contribution rates for the fiscal years ended June 30, 2007, 2006, and 2005 were $13.75%, 13.75%, and 9.14%, respectively.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to Section 87A of the Hawaii Revised Statutes, provides certain health care and the life insurance benefits to retired state employees. Contributions are financed on a pay-as-you-go basis. The DOE's general fund and special revenue fund share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2007 was approximately $91,280,000 and $5,710,000, respectively, and is included in the basic financial statements.

3. 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 non available to employees until termination, retirement, death, or unforeseeable emergency.

NOTE J – RETIREMENT BENEFITS (continued)

3. Deferred Compensation Plan (continued)

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 does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or the DOE's basic financial statements.

NOTE K – RISK MANAGEMENT

The DOE is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally is at risk for the first $250,000 per occurrence of property losses and the first $4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is $100 million ($40 million for earthquake and flood) and the annual aggregate for general liability losses per occurrence is $10 million. The State also has an insurance policy to cover medical malpractice risk in the amount of $20 million per occurrence with no annual aggregate limit. The State is generally self-insured for automobile claims.

The DOE is self-insured for workers' compensation and automobile claims. The DOE's estimated reserve for losses and loss adjustment costs include the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The DOE believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

NOTE L – COMMITMENTS AND CONTINGENCIES

1. Construction Contracts

The DOE is committed under contracts awarded and orders placed for construction, expenses, supplies, etc. These commitments amounted to approximately $165,946,000 as of June 30, 2007.

NOTE L – COMMITMENTS AND CONTINGENCIES (continued)

2. Litigation

The DOE is a party to various legal proceedings. Although the DOE and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the DOE because any judgments against the DOE are judgments against the State and would be paid by legislative appropriation of the State General Fund and not by the DOE.

NOTE M – FOOD DISTRIBUTION PROGRAM

The DOE receives food commodities from the U.S. Department of Agriculture, Food and Nutrition Service (FNS), under the Federal Food Distribution Program. The DOE School Food Services Branch distributes the food to qualifying schools, charitable organizations, and nonprofit summer camps for children. The total value of the amount of food which the DOE is entitled to receive is determined in part by the number of meals served under the National School Lunch Program. The DOE's allocation balance is reduced as the DOE receives the food commodities. The amount charged to the DOE allocation balance is based upon the FNS's cost to purchase the commodities. The bonus commodities do not reduce the DOE's allocation balance.

The following is a summary of the value of the food commodities received by the DOE during the fiscal year ended June 30, 2007. The value of the bonus commodities is based upon the estimated costs provided by the FNS in the *Current Commodity File* report dated June 30, 2007.

	Amount
Basic allocation	$2,565,662
Bonus commodities	49,604
	$2,615,266

NOTE N – TRANSFERS FOR DEBT SERVICE

Act 160, SLH 2006, Section 45 provided general fund appropriation to pay for debt service on general obligation bonds issued for the DOE and transferred to the financial administration program of the State Department of Budget and Finance. Appropriation for debt service amounted to $224,282,599 for the year ended June 30, 2007.

In July 2007, the DOE transferred $226,612,463 to the financial administration program of the State Department of Budget and Finance pursuant to Act 213, SLH 2007, Section 85.

SUPPLEMENTARY INFORMATION

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal year ended June 30, 2007

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures [1]	Amount provided to subrecipient
U.S. Department of Agriculture				
Food Donation [2]	10.550	--	$ 2,615,266	$ -
Child Nutrition Cluster:				
School Breakfast Program	10.553	--	6,476,324	406,261
National School Lunch Program	10.555	--	33,587,798	1,201,912
Special Milk Program for Children	10.556	--	5,921	5,921
Summer Food Service Program for Children	10.559	--	548,840	546,840
Subtotal Child Nutrition Cluster			40,618,883	2,160,934
Child and Adult Care Food Program	10.558	--	5,202,936	5,163,650
State Administrative Expense for Child Nutrition	10.560	--	781,390	-
Passed-through State Department of Land and Natural Resources				
Urban Forestry - Hokulani Elementary	10.675	05 DG-11052021-110	16,474	-
Team Nutrition Training Program	CNTN-05-HI-1	--	6,428	-
Total U.S. Department of Agriculture			49,241,377	9,485,518
U.S. Department of Defense				
National Defense Authorization Act P.L. 102-484	650009	--	1,837,634	-
Troops To Teachers - DOD FY06	000913	--	5,889	-
Troops To Teachers - DOD FY07	000913	--	101,393	-
Passed-through State Department of Defense				
Joint Venture Education Forum	000913	--	2,149,778	-
Total U.S. Department of Defense			4,094,694	-
U.S. Department of Commerce				
Coastal Services Center	11.473	--	56,251	-
Total U.S. Department of Commerce			$ 56,251	$ -

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2007

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Interior				
Passed-through State Governor's Office				
Economic, Social and Political Development of the Territories	15.875	GR 270 094	$ 170,786	$ -
Total U.S. Department of the Interior			170,786	-
U.S. Department of Transportation				
Passed-through State Department of Transportation				
State and Community Highway Safety	20.600	AL06-02 (13-S-01)	15,604	-
		AL07-02 (09-S-01)	21,181	
		AL06-02 (10-S-01)	12,696	
		AL07-02 (07-S-01)	44,394	-
Total U.S. Department of Transportation			93,875	-
National Science Foundation				
Education and Human Resources	47.076	--	1,824,028	-
Passed-through Maui Economic Development Board				
Hands-On Science for Maui (Project SEED)	ESI-9253304	ESI-9253304	1,321	-
Total National Science Foundation			$ 1,825,349	$ -

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2007

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Education				
Adult Education - State Grant Program	84.002	--	$ 2,336,361	$ -
Title I - Grants to Local Educational Agencies	84.010	--	54,196,539	-
Migrant Education - State Grant Program	84.011	--	698,422	-
Title I - Program for Neglected and Delinquent Children	84.013	--	138,090	-
Special Education - Grants to States	84.027	--	37,663,820	-
Impact Aid	84.041	--	43,400,567	-
Byrd Honors Scholarships	84.185	--	162,000	-
Safe and Drug-Free School and Communities - State Grants	84.186	--	1,496,712	-
Education for Homeless Children and Youth	84.196	--	206,537	-
Even Start - State Educational Agencies	84.213	--	572,194	-
Even Start - Migrant Education	84.214	--	370,893	-
Fund for the Improvement of Education	84.215	--	1,617,388	-
Charter Schools	84.282	--	769,451	736,407
Twenty-First Century Community Learning Centers	84.287	--	4,853,146	-
State Grants for Innovative Programs	84.298	--	1,009,183	-
Education Technology State Grants	84.318	--	3,107,121	-
Special Education - State Personnel Development	84.323	--	367,321	-
Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	84.326	--	1,331,523	-
Advanced Placement Program	84.330	--	49,317	-
Comprehensive School Reform Demonstration	84.332	--	578,839	-
Reading First State Grants	84.357	--	3,146,795	-
Native Hawaiian Education	84.362	--	2,031,441	-
Expanding Pathways to Hawaii's Leadership	84.363	--	183,779	-
English Language Acquisition Grants	84.365	--	1,804,076	-
Mathematics and Science Partnerships	84.366	--	724,874	-
Improving Teacher Quality State Grants	84.367	--	16,056,098	-
Grants for State Assessments and Related Activities	84.369	--	6,383,697	-
Common Core of Data Survey Project	500000-07	--	61,616	-
NAEP State Coordinator	650040-07	--	156,422	-
			185,474,222	736,407
Passed-through Office of the State Director for Vocational Education				
Vocational Education - Basic Grants to States	84.048	V048A040011	11,587	-
		V048A050011	1,680,994	-
		V048A060011	798,300	-
			2,490,881	-
Tech-Prep Education	84.243	V243A040011	16,791	-
		V243A050011	92,690	-
			109,481	-

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2007

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
Passed-through State Department of Human Services Rehabilitation Services -Vocational Rehabilitation				
Grants to States	84.126	MOA-DHHS	$ 68,613	$ -
Safe and Drug-Free Schools and Communities				
State Grants	84.186	S186B020012	62,055	-
		DHS-04-OYS-1633 S3	3,491	-
			65,546	-
Passed-through Alu Like, Inc.				
Native Hawaiian Vocational Education	84.259	VE-06-01	109,026	-
		VE-06-04	66,414	-
		VE-06-02	35,637	-
			211,077	-
Passed-through University of Hawaii				
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	P334S000195-04	47,426	-
		P334S050013	516,721	-
			564,147	-
Native Hawaiian Special Education	84.221	CO10147-mod#4	1,475,590	-
Passed-through Georgia State Department of Education				
Enhanced Assessment GRT - Georgia DOE FY07	84.368	--	517	-
Passed-through Idaho State Department of Education				
Enhanced Assessment GRT - Idaho DOE FY07	84.368	--	4,073	-
Passed-through State Department of Health				
Peer Education Counselors PEP	ASO 07-120	ASO 07-120	12,157	-
Passed-through University of Oregon				
Special Education - Personnel Development to Improve Services and Results for Children with Disabilities	84.325	--	(1,379)	-
Total U.S. Department of Education			$ 190,474,925	$ 736,407

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2007

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Health and Human Services				
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Other Important Health Problems	93.938	--	$ 469,611	$ -
Passed-through State Department of Human Services				
Temporary Assistance for Needy Families	93.558	DHS-06-BESSD-3117	1,457,761	-
		DHS-06-BESSD-3117 SA1	839,787	-
		DHS-06-BESSD-3118	137,368	-
		DHS-06-BESSD-3118 SA1	73,225	-
			2,508,141	-
Child Care and Development Block Grant	93.575	G0100HICCD2	368,613	-
Paths Program - County of Hawaii FY07	495000	DHS-07-OYS-4134	7,875	-
Teen Pregnancy Prevention Trng-DHS FY06	650703	DHS-06-BESSD-3048	116	-
Teen Pregnancy Prevention Trng-DHS FY07	650703	DHS-06-BESSD-3048 SA1	84,525	-
Total U.S. Department of Health and Human Services			3,438,881	-
Corporation for National and Community Service				
Passed-through State Department of Labor				
Learn and Serve America - School and Community Based Programs	94.004	03KSPHI001	65,763	-
Total Corporation for National and Community Service			65,763	-
TOTAL FEDERAL GRANT FUND EXPENDITURES			$ 249,461,901	$ 10,221,925

[1] The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

[2] Expenditures for the Food Donation Program (CFDA 10.550) are based on the value of food commodities received.

[3] Other identifying number used if no CFDA number available.

PART II

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

Grant Thornton

Report of Independent Certified Public Accountants
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*

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To the Auditor
State of Hawaii

We have audited the financial statements of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2007, and have issued our report thereon dated August 7, 2008, which included explanatory paragraphs describing the restatement of the net assets and fund balances as of July 1, 2006, and a scope limitation related to the DOE's workers compensation claims reserve as of June 30, 2007. 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 DOE's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in items 2007-01 to 2007-05 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

Grant Thornton LLP
U.S. member firm of Grant Thornton International Ltd

To the Auditor
State of Hawaii

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be presented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we considered items 2007-01 to 2007-05 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the DOE's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 2007-13.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton LLP

Honolulu, Hawaii
August 7, 2008

PART III

AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

Grant Thornton

Report of Independent Certified Public Accountants
on Compliance with Requirements Applicable to Each Major Program
and on Internal Control Over Compliance in Accordance with
OMB Circular A-133

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To the Auditor
State of Hawaii

Compliance

We have audited the compliance of the Department of Education of the State of Hawaii (DOE) with the types of compliance requirements described in the Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The DOE's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the DOE's management. Our responsibility is to express an opinion on the DOE's compliance 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the DOE's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the DOE's compliance with those requirements.

As described in items 2007-09 to 2007-13 in the accompanying schedule of findings and questioned costs, the DOE did not comply with the following requirements:

Program title	Type of compliance requirement	Reference number
Adult Education (84.002)	Procurement, Suspension, and Debarment	2007-13
Vocational Education (84.048)	Period of Availability; Procurement, Suspension, and Debarment	2007-09; 2007-13

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Even Start (84.213)	Procurement, Suspension, and Debarment	2007-13
Native Hawaiian Education (84.362)	Procurement, Suspension, and Debarment	2007-13
Special Education (84.027)	Earmarking; Allowable Costs/Cost Principles; Procurement, Suspension, and Debarment	2007-10; 2007-11; 2007-13
Title I Grants to Local Educational Agencies (84.010)	Special Tests and Provisions; Procurement, Suspension, and Debarment	2007-12; 2007-13

Compliance with such requirements is necessary, in our opinion, for the DOE to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the DOE complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007.

The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2007-14.

Internal Control Over Compliance

The management of the DOE is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the DOE's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

To the Auditor
State of Hawaii

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2007-06, 2007-07 and 2007-08 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 2007-06 and 2007-07 to be a material weaknesses.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton LLP

Honolulu, Hawaii
August 7, 2008

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Education
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Fiscal year ended June 30, 2007

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Qualified.

Internal control over financial reporting:

- Material weakness(es) identified? √ yes __ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? __ yes √ none reported

Noncompliance material to financial statements noted? __ yes √ no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? √ yes __no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? √ yes __ none reported

Type of auditor's report issued on compliance for major programs: Qualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? √ yes __ no

Department of Education
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Fiscal year ended June 30, 2007

Identification of major programs:

CFDA number	Name of federal program
84.048	Vocational Education
84.369	Grant for State Assessments and Related Activities
84.362	Native Hawaiian Education
84.287	Twenty First Century Community Learning Centers
84.213	Even Start
84.011	Migrant Education
84.010	Title I Grants to Local Educational Agencies
84.002	Adult Education
	Special Education Cluster
84.027	Special Education – Grants to States
84.173	Special Education – Preschool Grants
	Child Nutrition Cluster
10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children

Dollar threshold used to distinguish between type A and type B programs: $3,000,000

Auditee qualified as low-risk auditee? __ yes √ no

Section II – Financial Statement Findings

Finding 2007-01 – Error Corrections

Criteria: The Committee of Sponsoring Organization of the Treadway Commission's "Internal Control – Integrated Framework" defines internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

The term "reliability" as used with financial reporting objectives involves the preparation of financial statements that are fairly presented in conformity with generally accepted or other relevant and appropriate accounting principles and regulatory requirements for external purposes. Fair presentation is defined as:

- The accounting principles selected and applied have general acceptance,
- The accounting principles are appropriate in the circumstances,
- The financial statements are informative of matters that may affect their use, understanding and interpretation,
- The information presented in classified and summarized in a reasonable manner, that is, it is neither too detailed not too condensed, and
- The financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practical to attain in financial statements.

Condition/Context: The net assets and fund balances of the DOE as of July 1, 2006 were restated to reflect the correction of certain assets, liabilities, revenues and expenses. The correction of these errors was the result of lack of periodic reconciliation of the DOE accounts in a timely manner as well as lack of established policies and procedures over financial reporting.

The Accounting Section has been challenged mainly due to the lack of sufficient staff resources. This contributed to the delay in performing timely periodic reconciliation of the DOE's accounts, including cash held outside the State Treasury. The lack of periodic account reconciliations, including the thoroughness of subsequent review and approval of such reconcilations, could affect the accuracy of financial information provided to management and may jeopardize decisions based

on such information. Furthermore, the probability that additional errors will occur and go undetected is greatly increased. Finally when accounts have not been reviewed and reconciled during the year, attempts to perform year-end account analyses can become a time-consuming and costly process.

In addition, since the DOE's financial statements report the financial position and changes in financial position of the DOE, communication between the Accounting Section and other sections and branches within the Office of Fiscal Services and Office of Business Services (e.g., Vendor Payment, Payroll, Facilities Development, and Facilities Maintenance) needs to be improved. Since the DOE keeps its records on a cash basis, accurate, timely information is needed by the Accounting Section from the other sections and branches within the DOE in order to prepare its financial statements, including accruals for receivables from the federal government and other receivables and liabilities for accruals of vouchers payable, accrued wages and employee benefits payable, accrued compensated absences, and workers' compensation claims. Information is also needed to properly record its property and equipment transactions during the year, particularly due to the activity in construction in progress.

Cause: The above finding was caused primarily by management oversight and lack of sufficient staff resources.

Effect: We proposed adjustments to net assets and fund balances as of July 1, 2006 for the cumulative effect of understatements of property and equipment, accrued compensated absences and accrued wages and employee benefits payable. The net assets as of July 1, 2006 increased by $23,338,868 as a result of an understatement of due from federal government of $1,043,611, an understatement of capital assets of $67,292,507, an understatement of accrued compensated absences of $11,424,076, and an understatement of accrued wages and employee benefits payable of $33,573,174. In addition, depending on a number of factors, amounts reported in the future maybe materially misstated.

Recommendation: We recommend that management ensure that all transactions in the DOE's financial statements are properly reported in accordance with generally accepted accounting standards in the United States of America. We also recommend that the Accounting Section assess its control processes, procedures and resources and consider undertaking a restructuring of functions in the accounting and financial management area. The objective of this assessment will be for management to determine whether its resources are adequate to maintain proper controls weighting its risks in connection with costs and benefits. The following are important factors to consider in the assessment:

- Proper segregation of duties
- Proper authorization and monitoring of accounting functions
- Backup systems and levels of redundancy

The function of the Accounting Section and Internal Audit should be one of financial management as well as maintaining the internal control of the DOE. Management should determine whether this function and objectives could be achieved with the capabilities of its current resources.

To ensure that appropriate actions steps are taken, we suggest that the DOE designate an individual to direct the efforts in implementing improvements in the financial reporting process. To facilitate this process, a work plan and implementation schedule should be prepared that would detail the requirements, persons responsible for the implementation and timetable. This individual should submit periodic assessments to management on the implementation progress of the proposed plan. This will enable management to monitor the progress of the Accounting Section's progress and provide for greater accountability.

As part of the implementation plan, the Accounting Section should continue to improve the management of its financial records by strengthening its monitoring process to ensure that there are adequate resources and training, appropriate assignment of responsibilities, appropriate prioritization of accounting duties, establishment of appropriate fiscal procedures, and follow-through in executing fiscal procedures.

We recommend that reconciliations for the DOE's accounting records be completed in a timelier manner. Timely reconcilations should be assured by establishing a realistic schedule and having completion monitored by a designated individual. A staff accounting person (rather than a supervisor) should be assigned to reconcile balances on a routine basis. This would allow supervisors to perform review activities, thereby improving the control system within the Accounting Section. In addition, all reconciliations should be reviewed by a designated individual to ensure accuracy and completeness, and to verify that reconciled items are properly handled. This should be evidenced by having the reviewer initial the reconciliation.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2007-02 – Accounting for Compensated Absences

Criteria: GASB Statement 16, Accounting for Compensated Absences requires that vacation leave and benefits with similar characteristics should be recorded as a liability when earned by employees if the following conditions are satisfied:

- Compensated absence is earned on the basis of services already performed by employees.
- It is probable that the compensated absence will be paid in a future period.

Condition/Context: The vacation and sick leave balance of the DOE are reported to the State Comptroller annually. As a result of omitting certain employee groups and erroneous assumptions in determining pay rates for its employees the accrued compensated absence balance as of June 30, 2006 was understated by approximately $11.4 million. In addition, due to the process used to accumulate the data to be reported, several errors were noted (e.g., incorrect pay rates, improper hours used).

Cause: The above finding was caused primarily by management oversight and the manual process used to gather the data.

Effect: The net assets as of July 1, 2006 decreased by $11,424,076 due to the understatement of accrued compensated absences. In addition, depending on a number of factors, amounts reported to the State Comptroller in the future may be materially misstated.

Recommendation: We recommend that the amounts of vacation and sick leave balances being reported are reviewed and validated against personnel and payroll records to ensure accuracy and completeness before reporting the balances to the State Comptroller.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2007-03 – Improve Compensating Controls for Inadequate Segregation of Duties over Agency Funds

Criteria: Agency funds are used to account for assets held by the DOE on behalf of outside parties or on behalf of individuals. These funds are also known as local school funds.

When staffing limits the extent of segregation of duties, the principal or administrator should provide for compensating controls at each school or office. As stated in the Financial Management System (FMS) User Policy and Process Flow Guide, these compensating controls would include:

1. Conducting periodic unannounced cash counts of the school or office petty cash fund.
2. Verifying that the monthly reconciliations between the bank statement and the school's register are being performed. The reviewer should sign both documents if the reconciliation is completed.
3. Inspecting checks outstanding for more than six months ("stale" checks), during the review of the monthly bank reconciliation. These checks should be canceled.

4. Checking if cash receipts are deposited daily. The dates on the Official Receipts Form 239(s) should be the same as the bank deposit slip date.

5. The principal or administrator should prepare a report of the reviews conducted during the year indicating the areas reviewed, the date of the reviews, and discrepancies found. Also, the report should be kept on file for audit purposes.

Condition/Context: The school administrative services assistant (SASA) or account clerk generally performed most, if not all, the cash functions at schools. Although all of the above compensating controls should be present at these schools, documentation for some of them did not exist.

Cause: The above finding was caused primarily by management oversight, lack of sufficient training and sufficient staff resources.

Effect: In the absence of compensating controls the lack of segregation of duties may result in funds being lost, unrecorded or misused.

Recommendation: We recommend that the DOE ensure that schools perform the above compensating controls because staffing limitations do not provide for segregation of duties. Adequate compensating controls will minimize the chance of undetected errors or defalcations.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2007-04 – Agency Fund Bank Reconciliations

Criteria: Agency funds are used to account for assets held by the DOE on behalf of outside parties or on behalf of individuals. These funds are also known as local school funds.

Monthly bank reconciliations are essential in maintaining an accurate cash balance. The bank reconciliation may also uncover possible bank and/or bookkeeping errors. Furthermore, failure to timely resolve reconciling items increases the chances of misstating the school's funds.

Condition/Context: Of the 258 schools, we selected 103 local school fund account bank reconciliations for the month of June 2007 to be reviewed. We noted thirty-five (35) schools where either the cash on hand or investment balances on the reconcilations did not agree to the Principal's Financials Report as of June 30, 2007.

Cause: The above finding was caused primarily by management oversight, lack of sufficient training and sufficient staff resources.

Effect: The Principal's Financial Report was overstated by approximately $527,000. We proposed and management recorded the adjustment for this amount. In addition, depending on a number of factors, amounts reported in the future may be materially misstated.

Recommendation: To ensure the accountability, accuracy and propriety of a school's cash, we recommend that bank reconciliations be performed on a monthly basis with proper and timely reviews by the principal or designee. Also, all reconciling items should be resolved in a timely manner. Outstanding checks that are past the six-month void date should be canceled.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2007-05 – Risk Financing

Criteria – GASB Statement 30 Risk Financing Omnibus, requires that claims liabilities, including IBNR (incurred but not reported claims), should be based on the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. Claims liabilities should include specific, incremental claim adjustment expenditures/expenses.

Condition/Context: The DOE has reported a liability for its workers compensation claims in the amount of $66,893,192 as of June 30, 2007. The DOE utilized a model that was developed in 1998 to determine the estimated liability as of June 30, 2007. Some of the factors and assumptions used in determining the estimated liability were last updated in 2003. The DOE was not able to provide sufficient evidential matter supporting the adequacy of amounts accrued for this estimate; nor were we able to satisfy ourselves as to the adequacy of the recorded amount of this liability by other auditing procedures.

Effect: The scope of our audit was restricted and the report on audited the financial statements was qualified accordingly.

Recommendation: We recommend that the DOE maintain historical data and other evidence supporting the estimate of the liability reserve for workers compensation claims. In addition, due to the significance and uncertainty inherent in this estimate we recommend the use of an outside loss reserve specialist in reviewing the reasonableness of the DOE's loss reserve estimate.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Section III – Federal Award Findings and Questioned Costs

Finding 2007-06 – Internal Controls – Cash Management

U.S. Department of Education
Adult Education (84.002); Vocational Education (84.048); Migrant Education (84.011) Twenty-First Century Community Learning Centers (84.287); Even Start (84.213); Native Hawaiian Education (84.362); Special Education (84.027); Grants for State Assessments (84.369); Title I Grants to Local Educational Agencies (84.010)
Award Year: 2006-2007

Criteria: 2007 Office of Management and Budget Circular A-133 Part 6 *Internal Controls*. Also, 31 CFR 205.33 states that "A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB Circular A-102."

Condition/Context: We noted numerous instances in nine of the 10 major programs tested where an estimated payroll amount is being claimed for reimbursement for payroll costs incurred but not yet posted to the DOE's financial management system. While proper support for the estimates were maintained, these amounts were not reconciled to actual amounts in a subsequent drawdown request.

Furthermore, we noted instances in five programs noted above where estimated amounts were claimed for other expenditures to be paid out. The DOE was unable to provide supporting documentation for these estimates and could not provide documentation that these reimbursements were disbursed within a reasonable amount of time after receipt. A summary of unsupported estimated expenditures by program noted during our testing follows:

Special Education	$ 808,993
Adult Education	12,064
Grants for State Assessments	1,050,976
Even Start	78,957
Vocational Education	314,963
Totals	$2,265,953

In the Grants for States Assessments Program, the DOE was unable to locate a letter of credit worksheet dated July 20, 2006 in the amount of $2,580,900 to support their drawdown request.

In the Special Education program, we noted the program maintained a $3.1 million excess cash balance for the draw period ending May 3, 2007, and did not net the draw with its excess cash balance.

We also noted that for Vocational Education, all 12 of the letter of credit worksheets to support the DOE's drawdown amounts did not contain documentation of being reviewed. For Even Start, we noted three of six drawdown worksheets contained no evidence of reviews.

Lastly, for the Adult Education program, we noted an unsupported "cash adjustment" in the amount of $212,000. DOE personnel noted that this may have been due to an overdraw on a prior claim for reimbursement. Rather than return overdrawn cash, the amount of a subsequent drawdown request was reduced by the amount overdrawn.

Cause: The above conditions were caused primarily by management oversight due to high turnover in the Accounting Section of the Office of Fiscal Services.

Effect: The DOE's lack of supporting documentation for estimated other expenditures and cash adjustments do not comply with the objectives of the requirements for cash management – to drawdown amounts for only actual and immediate needs of the program.

As described in the first paragraph of Conditions/Context, estimated payroll amounts are not reconciled to actual. Since actual payroll amounts are not reported on the DOE's financial management system in which reimbursement claims are derived from until the following month, this may potentially cause a situation where excess cash may be held by the program for up to 30 days.

Failure to improve cash management procedures may lead to future restrictions on drawdowns. For example, the US DOE may require some or all of the affected programs to be placed on a program specific Treasury-State Agreement, in which the US DOE would subject the programs to scheduled cash draws and increased scrutiny.

Questioned costs: None.

Recommendations: The 2006 audit noted similar findings. Predecessor auditors recommended the DOE "should improve its cash management procedures to increase the predictability of disbursements and time drawdowns of federal funds to comply with the U.S. Department of Education's requirement to expend funds within three working days."

We further recommend the DOE consider some of the following measures in addressing this issue.

- Develop and implement a written policy related to cash drawdowns to maintain consistency among programs.
- Maintain a schedule when cash draws are to be made. For example, one program could draw every other Monday, another program every other Wednesday, and so forth.
- Implement a policy where estimated payroll amounts greater than $50,000 (or other amount as appropriate) are reconciled to actual as soon as information is available.
- Require all adjustments that affect claims for reimbursement include notations for reasons for adjustment.
- For large programs that claim large estimated payroll expenditures, schedule the cash draws to coincide with pay dates, to improve the accuracy of payroll claims.
- Improve cash management files to include support for all columns on the drawdown worksheet. Notations should be made to any deviations from attached support.
- Maintain adequate documentation to support estimated other expenditure amounts. This includes original request from program staff and managers, purchase orders and/or invoices, and a follow-up on whether the funds claimed were expended within the required three business days.
- Ensure that all worksheets that support drawdowns are reviewed for accuracy and compliance and such reviews are appropriately documented.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-07 – Internal Controls – Matching, Level of Effort, and Earmarking

U.S. Department of Education
Even Start (84.213)
Adult Education (84.002)
Special Education (84.027)
Award Year: 2005-2006

Criteria: 2007 Office of Management and Budget Circular A-133 Part 6 *Internal Controls* and for Even Start – 34 CFR 80.24(b)(6) "Costs and third party in-kind contributions counting towards satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantee or cost-type contractors. These records must show how the value placed on third party in-kind contributions was derived…"

Condition/Context: For Even Start, the DOE's documentation to support in-kind cost requirements was inadequate. We noted that the DOE used "best guess" estimates using brief narratives to support its in-kind costs.

For Adult Education and Special Education, the DOE does not monitor its level of effort and earmarking requirements throughout the year. Furthermore, the Special Education Program lacked documentation to support earmarking requirements (see Finding 2007-10).

Cause: In response to a similar finding for Even Start in the previous audit, management noted that they believed their existing documentation to support in-kind costs were adequate.

Effect: Failure to monitor its matching, level of effort, and earmarking requirements may cause the DOE to be in noncompliance at year end which may further lead to a reduction or discontinuation of future federal funding.

Questioned costs: None.

Recommendation: We recommend the DOE implement procedures to ensure matching, level of effort, and earmarking calculations are monitored throughout the year. This may include the use of a standard worksheet that is maintained throughout the year by one or two individuals, and reviewed by management at the end of an award year.

For Even Start, the DOE should develop and maintain more robust documentation to support their in-kind costs. For example, in-kind payroll charges may be supported by time distribution reports.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-08 – Internal Controls – Allowable Costs and Cost Principles

U.S. Department of Education
Adult Education (84.002); Migrant Education (84.011)
Even Start (84.213); Native Hawaiian Education (84.362); Special Education (84.027)
Award Year: 2006-2007

Criteria: Attachment B, Paragraph 8h(3) of the Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments states "Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee."

Condition/Context: We noted several instances where payroll certifications were not completed in a timely manner. In some cases, these payroll certifications were signed and dated after our audit request date.

Cause: This is a repeat finding from the 2006 audit. In the prior year, the individual schools were unaware of this requirement. For the current year, the individual schools were unaware that the payroll certifications were to be completed within a certain time period. Furthermore, the DOE was in the process of implementing action plans as a result of the 2006 finding.

Effect: Without periodic and timely certifications, no documentation exists about the ongoing status of employees charged solely to a federal program. Officials may question the propriety of the transaction, and may ultimately demand reimbursement for the transactions in question.

Questioned costs: None.

Recommendation: We recommend management be more diligent in completing the required certifications in a timely manner.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-09 – Period of Availability

U.S. Department of Education
Vocational Education
CFDA No. 84.048
Award Year: 2005 – 2006

Criteria: 20 USC 2353(b)(1) In general in any academic year that an eligible recipient does not expend all of the amounts the eligible recipient is allocated for such year, the eligible recipient shall return any unexpended amounts to the eligible agency to be reallocated, as appropriate.

Condition/Context: We noted that the DOE failed to report unexpended and unencumbered funds to the Office of the State Director of Career and Technical Education (OSDCTE) for the 2006 grant award before the August 15, 2006 deadline. Total expenditures related to the 2006 grant year were approximately $699,000 as of June 30, 2006.

Cause: The above condition was primarily due to management oversight.

Effect: Failure to maintain period of availability requirements may prevent the proper reallocation of funds for the next fiscal year. The Vocational Education program has been in non-compliance prior to fiscal year 2007 with reporting and returning of unexpended and unencumbered amounts to

OSDCTE. However, after federal review in 2006, program administrators are aware of the aforementioned issue and have enacted corrective measures for subsequent fiscal years.

Questioned costs: None.

Recommendation: We recommend that the DOE improve its internal controls to ensure that all unexpended and unencumbered funds be reported and returned to OSDCTE at the end of each grant award year for reallocation as appropriate.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-10 – Earmarking

U.S. Department of Education
Special Education Program
CFDA No: 84.027
Award Year: 2006-2007

Criteria: 34 CFR 300.74 States may reserve a portion of their allocations for other State-level activities. For fiscal year 2007, an amount equal to not more than 9 percent of the State's total grant allocation for fiscal year 2007 may be used for State-level activities. State Educational Agencies must use State-level activity funds for monitoring, enforcement, and complaint investigation, and to establish and implement the mediation process, including providing for the costs of mediators and support personnel.

Condition/Context: The DOE was unable to provide documentation of calculations in support of the above requirement. Total authorized funding for grant year 2007 was approximately $36,801,000.

Cause: The above condition was primarily due to management oversight and lack of internal controls over federal earmarking requirements.

Effect: Without proper documentation, the DOE cannot support its compliance with federal earmarking requirements and may lead to a reduction or discontinuation of future federal funding.

Questioned costs: None.

Recommendation: We recommend that the DOE maintain adequate documentation to support calculations of "Other State Level Activity" funds. Final calculations should be reviewed by appropriate management.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-11 – Allowable Costs and Cost Principles

U.S. Department of Education
Special Education Program
CFDA No: 84.027
Award Year: 2006-2007

Criteria: Office of Management and Budget (OMB) Circular A-87, 2 CFR 225: Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

Paragraph 8.h(3): Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification.

Condition/Context: We noted that payroll charges were being made to the federal program for an employee who did not perform services under the program. Total payroll expenditures charged to this program during the 2007 fiscal year amounted to approximately $21,636,000.

Cause: Management noted that the above condition was a result of a classification error when the employee transferred to a different school.

Effect: Improper charges made to a federal program prevent the funds in question from being utilized for program related expenditures. Officials may question the propriety of the transaction, and may ultimately demand reimbursement for the transactions in question.

Questioned costs: We estimated questioned costs to be approximately $23,200, calculated as the $1,033 per pay period salary (based on the identified error) multiplied by 16 pay periods between November 1, 2006 (the date when the employee should no longer have been charged to the federal program) and June 30, 2007 plus $6,700 in fringe benefits calculated using a 40.66% rate.

Recommendation: We recommend the DOE be more diligent in charging the correct Federal program.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-12 – Special Tests and Provisions – Highly Qualified Teachers and Paraprofessionals

U.S. Department of Education
Title I Grants to Local Educational Agencies
CFDA No. 84.010
Award Year: 2006-2007

Criteria: 34 CFR 200.55 requires that each State that receives funds under subpart A of this part, and each LEA in that State, must ensure that all public elementary and secondary school teachers in the State who teach core academic subjects, including teachers employed by an LEA to provide services to eligible private school students under Sec. 200.62, are highly qualified as defined in Sec. 200.56.

Condition/Context: Per review of the 2006 – 2007 school year "Annual Financial Plans," school "Progress Reports," and school "Trend Reports" we noted that none of the 10 schools selected for testing met the requirement that 100% of its teachers teaching core classes be "highly qualified."

Cause: The above conditions were primarily due to a shortage of qualified teachers available to fill positions.

Effect: Noncompliance with this requirement will prevent the schools from reaching their full potential in delivering quality education to the children of the State of Hawaii.

Questioned costs: None.

Recommendation: The DOE has noted that they have been working with the U.S. DOE in implementing a plan to alleviate this condition. In a letter dated June 26, 2007 to the Hawaii Superintendent of Education, the U.S. DOE accepted the DOE's comprehensive plan to meet the highly qualified teacher requirement.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-13 – Procurement, Suspension, and Debarment

U.S. Department of Education
Adult Education (84.002); Vocational Education (84.048)
Special Education Program (84.027); Native Hawaiian Education (84.362)
Even Start (84.213); Title I Grants to Local Educational Agencies (84.010)
Award Year: 2006-2007

Criteria: March 2007 Office of Management and Budget Circular A-133 Part 3 I. *Procurement and Suspension and Debarment*; Hawaii Revised Statutes (HRS) 103D; Hawaii Administrative Rules (HAR) 3-120-4 and 3-122-75.

The DOE is required to "use the same State policies and procedures used for procurements from non-Federal funds." Pursuant to HRS and HAR, the DOE is required to "cite on the purchase order or on the contract, the authority waiver as "Exempt from Chapter 103D, HRS, pursuant to section 3-120-4(b) (cite exemption number from exhibit)." In addition, the DOE is required to obtain no less than three quotes for purchases between $5,000 – $15,000; for purchases between $15,000 and $25,000 the three quotes must be written.

Condition/Context: We selected a sample of 30 procurement items for each of the 10 major programs for a total of 300 items tested. We noted noncompliance consisting of the DOE's failure to cite the reason for exemption from HRS 103D on the purchase order (Type A) and failure to obtain the required three quotations for purchases exceeding $5,000 from vendors not on the State's approved vendor list (Type B). The following is a summary of our findings:

	Rate of occurrence – Type A	Rate of occurrence – Type B	Total
Adult Education	1	-	1
Vocational Education	1	1	2
Special Education	5	2	7
Native Hawaiian Education	1	1	2
Even Start	-	2	2
Title 1	2	2	4
Totals	10	8	18

In addition, the DOE was unable to provide us with documents for three of the items selected for testing. Management noted that these documents were destroyed in a fire.

Cause: Unless noted, the above conditions were primarily due to staff and management oversight.

Effect: The Hawaii Procurement Code at HRS 103D was developed in part to ensure that public money is expended using the best interests of the public and that funds are expended in an equitable manner. The conditions noted above resulted in noncompliance with HRS 103D.

Questioned costs: None.

Recommendation: We recommend the DOE be more diligent in complying with applicable procurement requirements.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2007-14 – Indirect Cost Rate

Criteria: Attachment E, Paragraph B.6 of OMG Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, codified in 2 CFR Part 225 states in part, "'Fixed rate' means an indirect cost rate which…the difference between the estimated costs and the actual, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period."

Condition/Context: The U.S. Department of Education approved DOE's proposed fixed indirect cost rates used to assess indirect cost charges for the fiscal year ended June 30, 2007. The rates were based on fiscal year 2005 costs as allowed. However, the indirect cost rate proposal for the fiscal year 2007 did not include adjustment for (under) over-recovery of indirect costs related to the use of fixed indirect costs rates for the fiscal year ended June 30, 2005. The amount of (under) over-recovery was $1,039,585, $(1,485,921), and $(4,741,642) for the food service unrestricted rate, instruction restricted rate and instruction unrestricted rate, respectively. In the transmittal letter for the proposed indirect cost rates, the U.S. Department of Education informed the DOE that the carryover adjustment was not received and thus not deducted. No further discussion of the omission was made.

Cause: Management noted that due to the timing of a similar prior-year finding and the implementation of their corrective action plan, the DOE was unable to incorporate the indirect cost adjustments into the proposal for the fiscal year ended June 30, 2007. However, management noted that all adjustments were included in the proposal for fiscal year ending June 30, 2008.

Effect: As a result of excluding the over-recovery carryforward adjustment, the unrestricted rate for food service of 5.80%, restricted rate for instruction of 2.1%, and unrestricted rate for instruction of 10.3% were (understated) overstated by (0.90)%, 0.40% and 0.70%, respectively.

Recommendation: We recommend that the DOE take steps to ensure that future indirect cost rate proposals include any necessary carryforward adjustments.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

PART V

CORRECTIVE ACTION PLAN

(Provided by the Department of Education, State of Hawaii)

LINDA LINGLE
GOVERNOR

PATRICIA HAMAMOTO
SUPERINTENDENT

STATE OF HAWAI`I
DEPARTMENT OF EDUCATION
P.O. BOX 2360
HONOLULU, HAWAI`I 96804

OFFICE OF THE SUPERINTENDENT

July 30, 2008

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

Ladies and Gentlemen:

The State of Hawaii Department of Education (DOE) has, for decades, faithfully complied with the Single Audit deadline of submission within the nine-month timeline in accordance with OMB Circular A-133. Unfortunately, due to several unforeseen circumstances, an extension of the Single Audit deadline was requested for the first time in the history of the DOE for the year ended June 30, 2007. This is a transition year from our prior year auditors to your firm; however, I am confident that the issues have been resolved and that working together, we will be able to meet the Single Audit deadline for the next audit year ending June 30, 2008.

We have reviewed your audit findings and recommendations and each office with findings has prepared a corrective action plan response. The DOE will follow this response plan to continue to make further improvements. In accordance with OMB Circular A-133, on the following pages are the **Corrective Action Plan** for the year ended June 30, 2007 and **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2006.

Very truly yours,

Patricia Hamamoto
Superintendent

PH:JMB:DY

Attachments

AN AFFIRMATIVE ACTION AND EQUAL OPPORTUNITY EMPLOYER

STATE OF HAWAII DEPARTMENT OF EDUCATION
SINGLE AUDIT -- CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2007

FINANCIAL STATEMENT FINDINGS

2007-01 Error Corrections **(**Pages 65 to 67)

Corrective Action Plan

The financial and compliance audit of the Department of Education was significantly delayed for fiscal year ended June 30, 2007. The original deadline was March 31, 2008. The Department obtained three extensions of time, to May 31, 2008; July 31, 2008; and August 3, 2008. This was the first time in the Department's history that this audit deadline was missed.

Several factors and circumstances contributed to the challenges in the Department of Education's Accounting Section:

- Retirement of six (6) key seasoned veterans in Accounting, (representing over one-third of the positions) with a combined total of over 175 years of Department of Education Accounting experience.
- Hiring of new replacement staff that had to focus on day-to-day work processing.
- Delays in hiring additional replacement staff.
- Termination of employment of one account clerk, and the resulting vacancy not filled for over one year. This position was primarily responsible for reconciling the Department's four major central bank accounts.
- Absence of another accountant position for over one year.
- Other conditions resulting in the absences of two other accountants.
- Complexity of Capital Improvement Program (CIP) accounting and coordination due to responsibilities transferred from the Department of Accounting & General Services (DAGS).
- Strains placed on the new staff due to the vacancies without staffing relief.
- Resignations of two accounting supervisors, in April 2008.
- Resignations of four accountants: three in April and one in June 2008.

The Department is evaluating the audit findings to determine next steps in identifying supervisory deficiencies.

Currently, the Department has taken action by hiring temporary personnel into the vacant supervisory and accountant positions, and has begun replacing personnel vacancies with new hires. In addition, several retiree accountants have been brought back to assist the Accounting Section by providing training and support.

The following paragraphs highlight the actions being taken to address the specific areas mentioned in the auditor's recommendations:

Reconciliation of accounts: The Department has brought the reconciliation of bank accounts fully current, by hiring an external certified public accountant firm, on a short-term project basis. Through proper and adequate staffing, all monthly accounting functions, including bank reconciliations, will be kept current.

Property and equipment: The Accounting Section will work with the Facilities Office to ensure that the financial statement workpapers for the next fiscal year ended June 30, 2008 will be complete and accurate.

Accruals of payables, wages and benefits payable: The Accounting Section will work with the Operations Section Payroll Unit; the Office of Human Resources; and the Office of Information Technology Services, to ensure that information compiled for year-end accruals of payables, wages and benefits payable are complete and accurate.

Workers' compensation claims: The Accounting Section will work with the Office of Human Resources Workers' Compensation Unit, to ensure that information compiled for year-end determinations of estimated reserves for workers' compensation claims will be in accordance with U.S. generally accepted accounting standards.

Assessment of control processes and procedures: The Office of Fiscal Services Administrative Services Branch has initiated a contract with an external CPA firm to conduct an assessment of internal control processes and procedures in its Accounting and Operations Sections. Consideration will be given to restructuring of functions in the accounting and financial management area, as recommended by the auditors.

Restatement of prior year financial statements: The Department concurs with the current auditor's restatements of financial statements as of the fiscal year ended June 30, 2006. The audited financial statements have now been significantly adjusted.

Accounting Director monitoring: As recommended, the Accounting Director has already begun directing the efforts in implementing improvements in the financial reporting process. A work plan and implementation schedule is being prepared, detailing the requirements, persons responsible, and timetable. The Accounting Director is making significant improvements in the staffing and completion of tasks necessary for the Department's financial statements, with the goal that the audit for fiscal year ended June 30, 2008 will be on time, and financial statement findings will be minimized.

Improved communication with auditor: This year involved a change in auditor. The Department will ensure that communication will be improved with the auditor, to monitor the progress of the audit closely, and to resolve audit issues at early stages, so that the audit can be completed by the required Federal deadline.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: March 31, 2009
(Consistent with A-133 Federal Audit Deadline)

2007-02 Accounting for Compensated Absences (Pages 67 to 68)

Corrective Action Plan

The Department's corrective action plan for employee sick and vacation leave consists of three major initiatives:

1. Clearing of employee leave processing backlog

The Department has contracted the services of a certified public accounting and consulting firm to assist with clearing the backlog of processing employee leave accounting reports. The existing employee leave accounting system was developed in the 1980s and has not been modified since its inception.

Updating employee leave records in the Department is a difficult time-consuming process because of the large number of employees in the Department and the assorted variety of different leave accrual rules which must be followed for different types of employees to comply with different union contract provisions. In most other state agencies, employees simply earn 14 hours of sick and vacation leave each month, which may be prorated based on the actual number of days the employee is on paid status during the month. In the Department of Education, there are basically 4 categories of employees with different leave accrual rules:

a) 10-month certificated employees, or teachers, who are credited with 18 days of sick leave at the beginning of each school year.

b) 10-month classified employees, like Educational Assistants, who are credited with 144 hours of sick leave at the beginning of each school year.

c) 12-month certificated/classified employees, who earn the normal 14 hours of sick leave and vacation leave each month.

d) 12-month teachers and registrars, who earn 21 days of sick leave and 14 days of vacation leave each year.

With the assistance of the CPA consulting firm, we will make substantial progress towards clearing of the backlog of processing employee leave accounting reports.

2. Conversion to a new KRONOS time and attendance and payroll system

The Department is in the process of converting to a new KRONOS time and attendance and payroll system. The new system is expected to streamline the procedures for employee leave balances, and will be able to provide updated information in a timely manner. The time and attendance portion is being implemented in a phased approach, with full implementation anticipated by June 30, 2009. The payroll portion is in the process of being tested. The overall project has

been challenging due to the complexity of payroll for the various classifications of our employees, due to collective bargaining negotiated pay characteristics that vary significantly by employee classification.

3. Fiscal year-end accrual of vacation and sick leave balances

The audit finding pertains to concerns regarding the accrual of vacation and sick leave balances in the prior fiscal year ended June 30, 2006. The auditors have determined that the current fiscal year calculations for the year ended June 30, 2007 were adequate. The Department's 2006 calculations were based on estimates based on general classifications of employees. The 2007 accruals, initiated by the Operations Section, were based on employee-by-employee specific calculations.

In order to ensure the continued accuracy of the year-end calculations, the Department's Accounting Section will take a more active role in determining the calculation methodology; coordinating the payroll data retrieval; and verifying the accuracy of the accrual calculations. The previous procedure of heavy involvement of the Operations Section was not appropriate, since the Operations Section is primarily responsible for processing payroll, vendor payment and inventory; and should not normally be responsible for determining fiscal year-end accounting accruals of sick and vacation leave balances for financial statement reporting purposes.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: Clearing of backlog: (est.) June 30, 2009
Year-end accrual: March 31, 2009

2007-03 Improve Compensating Controls for Inadequate Segregation of Duties over Agency Funds (Pages 68 to 69)

Corrective Action Plan

Beginning with school year 2007-08, the Department is implementing an Annual Checklist for Compliance of Local School Fund Procedures for all schools. Each school will be required to certify that specific steps have been completed, such as:

- Bank reconciliations completed;
- Annual Principal Financial Report completed and signed;
- Administrator's Checklist completed and signed;
- Money Raising and Donations are summarized and accounted for;
- Training sessions attended;
- Cash receipts and disbursements are accounted for;
- Petty cash accounted for; and
- Fixed assets inventory updated.

This checklist will be required to be submitted to the Department's Internal Audit Office by August 15 of every year. Schools that do not submit copies of the completed checklists will be placed on a site visit list. The Department's Internal Audit Office will visit those schools to investigate the reasons for the non-response, and will also perform random site visits of other schools to assess compliance (post audit), as well as to review corrective action plans from prior audits.

These procedures will result in strengthened internal controls, and are expected to result in substantial reductions in the occurrences of these local school fund audit findings.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date:	Implementation of Procedures:	June, 2008, done
	Improved Audit Results:	June 30, 2009

2007-04 Agency Fund Bank Reconciliations (Pages 69 to 70)

Corrective Action Plan

As stated in the corrective action plan for Finding Number 2007-03 above, beginning with school year 2007-08, the Department is implementing an Annual Checklist for Compliance of Local School Fund Procedures for all schools. Each school will be required to certify that specific steps have been completed, which will include the requirement for bank reconciliations.

This Checklist will be required to be submitted to the Department's Internal Audit Office by August 15 of every year. Schools that do not submit copies of the completed Checklists will be placed on a site visit list. The Department's Internal Audit Office will visit those schools to investigate the reasons for the non-response, and will also perform random site visits of other schools to assess compliance (post audit), as well as to review corrective action plans from prior audits.

These procedures will result in strengthened internal controls, and are expected to result in substantial reductions in the occurrences of these local school fund audit findings, specifically for bank reconciliations in this case.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date:	Implementation of Procedures:	June, 2008 - done
	Improved Audit Results:	June 30, 2009

2007-05 Workers' Compensation – Risk Financing (Page 70)

Corrective Action Plan

The Workers' Compensation (WC) Unit will take the following action:

1. Work with the Office of Fiscal Services, Accounting Section to identify and procure the services of an outside loss reserve specialist to review the reasonableness of the Department of Education's (DOE) loss reserve estimate.

2. Gather and maintain historical data and other evidence to support estimates of WC claims for an outside loss reserve specialist to make recommendations regarding proper estimating and reporting of WC claims liabilities.

3. Revise its reserve procedures, based on recommendations by an outside loss reserve specialist to ensure that the reserve methodology uses past experience adjusted for current trends and other factors that would modify past experience and include specific, incremental claim adjustment expenditures/expenses.

Contact Person: Keith Nakanishi, Personnel Specialist II
Workers' Compensation Unit
Personnel Assistance Branch
Office of Human Resources

Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: January 30, 2009

2007-06 Internal Controls -- Cash Management (Pages 71 to 73)

Corrective Action Plan

The Accounting Section has in place specific cash withdrawal procedures and worksheets. Through continuous training, review, and monitoring, we will be assured of accurate compliance regarding the cash management requirements.

Beginning July 1, 2008, the Accounting Section will implement withdrawing federal funds based on actual expenditures only. Our previous cash withdrawal methodology involved estimated projections of our semi-monthly payroll requirements based on a payroll data received from the Department of Accounting and General Services (DAGS), which the Department posts in its Financial Management System (FMS) only on a once-a-month basis.

We will develop and establish a new reporting process to incorporate the use of the semi-monthly DAGS payroll data to provide the accountants with actual payroll expense information. With this updated information, our cash drawdowns will improve the calculations and will reduce the differences between actual expenditures versus estimates, and "reconciliations" (as recommended by the auditors) will not be necessary.

We do not agree or support some of the auditor's recommendations:

- *Develop and implement a written policy related to cash draw downs to maintain consistency among programs.*

The federal cash withdrawal process is an operational function that does not require a policy statement. The Accounting Section already has written procedures that are in place. Due to the newness of staff, these procedures were followed in varying degrees. The Accounting Section has undergone significant turnover of staff within the last two years. The current staff is now being trained, and the Section will develop better techniques or reporting tools to minimize excess cash balances to meet federal compliance issues.

We will review the six items that exceeded the 3-day cash balance rule. We question the auditor's methodology and accuracy of the conclusion, since the audit review focused on individual grant document cash balances. Our position in evaluating our cash requirements is that the grants cash balance may include two active grant awards and should be evaluated as a whole.

- *Maintain a schedule when cash draws are to be made. For example, one program could draw every other Monday, another program every other Wednesday, and so forth.*

This is not a suitable solution for the Accounting Section and will present an operational problem. The Accounting Section is responsible for the accounting for over 50 federal grants. If cash draws are staggered, the Accounting Section staff will be working on cash draws virtually all day, every day of the week, and will not be able to attend to other duties. The Accounting Section has, and will continue to, draw for all federal fund programs based on the operational needs of each federal grant. Currently, we do comply with a separate cash withdrawal schedule in the case of two specific federal grants based on meeting Federal Cash Management Improvement Act (CMIA) reporting requirements.

- *Implement a policy where estimated payroll amounts greater than $50,000 (or other amount as appropriate) are reconciled to actual as soon as information is available.*

Beginning July 1, 2008, the Accounting Section will implement withdrawing federal funds based on actual expenditures only. Our previous cash withdrawal methodology involved estimated projections of our semi-monthly payroll requirements based on a payroll data received from the Department of Accounting and General Services (DAGS), which the Department records in its Financial Management System (FMS) only on a once-a-month basis.

We will develop and establish a new reporting process to incorporate the use of the semi-monthly DAGS payroll data to provide the accountants with actual payroll expense information. With this updated information, our cash draw-downs will improve the calculations and will minimize the differences between actual expenditures versus estimates, and "reconciliations" (as recommended by the auditors) will not be necessary. Such reconciliations would present a tremendous operational burden. The Accounting Section manages over 50 active federal grants that may require weekly cash withdrawals. The cash status of the federal grant is evaluated and reviewed at the time the Accounting Section will draw funds.

As stated earlier, the federal cash withdrawal process is an operation function that does not require a policy statement. The compliance objective is to maintain minimal cash balances.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date:	Revised Procedures:	July 1, 2008 - done
	Improved Audit Results:	June 30, 2009

2007-07 Internal Controls -- Matching, Level of Effort, and Earmarking (Pages 73 to 74)

Corrective Action Plan

Adult Education has been in compliance with level of effort and earmarking requirements at the end of the year and recognizes the need to monitor these requirements throughout the year.

The Community Education Section (CES) oversees adult education programs and will work with the Accounting Section to develop a system to track the requirements for compliance that can be maintained throughout the year

Earmarking requirements are met when grant funds from the Adult Education and Family Literacy Act are allocated to providers on October 1 of each year. The tracking system to ensure maintenance of effort will be reviewed twice during the year, in advance of the completion of the Financial Status Reports that are due to the U.S. Department of Education on December 31 of each year.

In addition, CES will continue to collect and review quarterly reports from adult education providers that show how funds are being used and what outcomes attained. These reports provide periodic checks on financial and program status.

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Contact Person: Kara Mark, Educational Specialist II
Community Education Section
School and Community Leadership Branch
Office of Curriculum, Instruction and Student Support

Anticipated Completion Date: September, 2008

2007-08 Internal Controls -- Allowable Costs and Cost Principles (Pages 74 to 75)

Corrective Action Plan

The Department of Education's Federal Compliance and Project Management Office has developed a Standard of Practice (SoPO404), department-wide, that requires all federally paid employees to complete a payroll certification as per the requirement outlined in attachment B, paragraph 8h(3) of the Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments.

The Department will monitor to ensure program managers of federally funded programs:

1. Include as part of their regular program monitoring and evaluation activities verification of fund recipient adherence to the payroll certification requirement SoP0404, and

2. Assurance that fund recipient training includes information regarding this requirement.

Contact Person: Robert Campbell, Ph.D., Director
Federal Compliance and Project Management Office
Office of the Superintendent

Anticipated Completion Date: December, 2008

2007-09 Period of Availability (Vocational Education) (Pages 75 to 76)

Corrective Action Plan

Corrective measures have already been enacted. At the time of Federal review, which was held during May, 2006, procedures were not well defined. As a result of Federal recommendations, formal policies and procedures were developed and on September 5, 2006 the State Director for Career and Technical Education sent a formal response to the US Department of Education Office of Vocational and Adult Education's request for corrective action which included the following:

- The HIDOE's Perkins Program Administrator will collaborate with the Accounting Section of the Office of Fiscal Services to ensure that the policies and procedures address the concerns of the Office of Vocational and Adult Education.

- The corrective action ensured that all unexpended and unencumbered funds will be reported and returned to OSDCTE at the end of each grant award year for reallocation as appropriate in accordance with the requirements of section 133 of Perkins III.

Contact Person: Sherilyn Lau, Educational Specialist II, Carl D. Perkins Act
Arts, Sciences and Technology Section
Instructional Services Branch
Office of Curriculum, Instruction and Student Support

Anticipated Completion Date: COMPLETED, September 5, 2006

2007-10 Earmarking (Special Education Program) (Page 76)

Corrective Action Plan

The Special Education Section will establish a tracking system to ensure that State-level activity expenditures are easily identified and monitored to be in compliance with the earmarking requirement of an amount equal to nine (9) percent or less of the State's total grant allocation.

1. Establish additional accounting codes to track state –level activities.
2. Ensure that all program employees understand the components of "State-level activities."
3. Monitor and review the "State-level activities" accounts to ensure proper expenditures are recorded.

Contact Person: Debra Farmer
Educational Specialist III
Special Education Section
Student Support Services Branch
Office of Curriculum, Instruction and Student Support

Anticipated Completion Date: October 31, 2008

2007-11 Allowable Costs and Cost Principles (Special Education Program) (Page 77)

Corrective Action Plan

Schools and offices are responsible to monitor their monthly FMS report – DAFMZ032 "Payroll Detail Transaction Report" to ensure that the proper payroll expenditures for the correct employees are deducted from their accounts. If an error is found, it is the responsibility of the school/office to make the proper corrections.

The Accounting Section investigated this finding and determined that the questioned costs were actually $3,126.19 for salary and $1,251.15 for fringe benefits. The employee was correctly paid with federal funds at the original school and after the transfer to another school, should have been paid by general funds. There was a lag in the transfer documents and at the receiving school, the employee was incorrectly paid by federal funds. A correction was made to reimburse the federal funds with general fund money.

For the fiscal year ended June 30, 2008, a total of $3,101.55 in salary costs and $1,268.34 in fringe benefit costs were also incorrectly charged. This was also corrected.

The School Support Section of the Administrative Services Branch in the Office of Fiscal Services will ensure that this procedure is included in the training to all schools and offices. Schools will be instructed to be more diligent in monitoring the payroll expenditures to ensure that the proper funds are used.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: Accounting corrections completed: June, 2008
Training workshops: July & August, 2008

2007-12 Special Tests and Provisions – Highly Qualified Teachers and Paraprofessionals (Title I Grants to Local Educational Agencies) (Page 78)

Corrective Action Plan

The Department has an USDE approved Highly Qualified Teacher State Plan, which outlines the Hawaii Department of Education commitment to ensure all public elementary and secondary school teachers in the State who teach core academic subjects, including teachers employed to provide services to eligible private school students are highly qualified.

Since the approval of the HQT State Plan, the Department has completed the following:

- HIDOE has USDE-approved criteria in determining the HQT status of teachers
- Determined the HQ status of teachers of the core academic subjects based on the approved criteria
- Identified Priority Schools based on the percentage of non-HQTs
- Provided training for Title I NCLB status school on how professional development funds may be utilized to assist teachers to gain their HQT status, and required that all Priority Schools place a minimum of 5% of their Title I funds to assist teachers to become HQT
- Peer review of school's Academic and Financial Plans on the use of the professional development funds.
- In-serviced Title I Linkers, liaison of between the state and the complex areas/schools, on HQT and the State Plan

The Office of Human Resources (OHR) along with School Synergy, a professional services provider, has made many efforts to assist teachers in meeting HQT requirements. In SY 2007-2008 OHR has accomplished the following:

- Created a database to capture data relevant to HQ status and reporting
- Created a web-based system to view HQ status and reporting
- Integrated multiple data sources into the above created database to create an HQ individual status report for each teacher
- Compiled records and created HQ folders for each teacher identified as Non-Highly Qualified Teachers (NHQT) by: downloaded transcripts, Praxis scores, license information, etc for approximately 10,000 teachers (for SY2006-2007 and SY2007-2008 combined) who were initially identified as NHQT.
- Input above information into the HQ database
- Conducted outreach meetings to all complexes for a total of 90 meetings to individually meet with all teachers identified as NHQ. The purpose of the meeting was to (1) provide information on what NCLB requires for HQ (2) show them their current status along with license(s) and qualifications, (3) provide a suggested plan of action to become HQ for their individual situation
- Trained Complex Area Superintendents (CAS) and Principals in the HQ guidelines, requirements, policies and procedures for approximately 35 meetings

- School Synergy has conducted numerous meetings, trainings, audits, etc. with each complex
- Provided monthly updates to CASs and principals of the progress of their teachers HQ status
- Worked with Hawaii Teachers Standards Board to collect license information on teachers
- Developed and offered PRAXIS preparation workshops
- Developed and offered Professional Development Credit courses in the core content areas that count towards HQ points for HOUSSE

As a result, approximately **7500** teachers of **core subject areas** have become highly qualified during the 2007-2008 SY.

The limited number of teachers graduating locally from post secondary institutions, compounded by the high cost of living, has been the root causes of the shortage of highly qualified, core subject teachers. However, in just a year the Department has made significant progress in increasing HQT. The Department will continue the initiatives outlined in the State HQT Plan.

Contact Persons: For Title I Schools:
Ms. Sharon T. Nakagawa, Educational Specialist III
Special Programs Management Section
School and Community Leadership Branch
Office of Curriculum and Instructional Services

For HQT State Plan:
Robert Campbell, Ph.D., Director
Federal Compliance and Project Management Office
Office of the Superintendent

Sheri Lee, Assistant Superintendent
Office of Human Resources

Anticipated Completion Date: June, 2009

The Department aims to achieve its goal of HQ Teachers by June 2009. However, achieving its goal will be dependent upon the availability of HQ teachers, and the increase in cost of living and the ability of the state to offer competitive salaries to off-set the high cost of living. The Department is committed to sustain its effort to have a highly qualified teacher in all our core subject areas.

Please note: The indicators reviewed by the USDE Title I Monitoring of Title A Funds do not include whether **all teachers** are highly qualified who teach core subject areas. This indicator is monitored through the Title IIA funds for HQT. USDE Title I Monitoring of Title I A funds deals with (1) paraprofessionals providing instructional support meet the NCLB requirements and (2) personnel funded with Title I funds meet the NCLB requirements.

2007-13 Procurement, Suspension, and Debarment (Pages 78 to 80)

Corrective Action Plan

The Department of Education, Office of Fiscal Services, Procurement and Contracts Branch provides workshops and training on procurement and contracts issues throughout the year. The workshops and training are provided to a target audience of school/program administrators, school administrative services assistants (SASAs), account clerks, and administrative services assistants (ASAs). The training is provided as stand-alone workshops, part of the summer School Support Services workshops, and as requested by program managers and offices.

The training covers the various procurement methods, including price lists, vendor lists, small purchase and exempt procurement for goods and services ($0 - $24,999), exempt, sole source, IFB, RFP, professional services, emergency procurement, and MOA/MOU procurements ($25,000 and above). A procurement and contracting database is maintained with flowcharts, checklists, forms, and instructions/guidelines and is available to all DOE employees as necessary for review and reference. DOE employees are also able to contact the Procurement and Contracts Branch if there are further questions that may arise.

The Office of Fiscal Services, Procurement and Contracts Branch will continue to provide training via workshops and through an "opening of school/office" memo to remind all administrators and support staff of procurement and contracts requirements. The Office of Fiscal Services will work with the complex area business managers to perform reviews of school level procurement transactions to ensure on-going compliance. The federal program managers will also notify their program participants of compliance to the procurement code, whether for federal or general fund procurement transactions. Finally, school level administrators and support staff must be more diligent in complying with applicable procurement requirements, as outlined in training and notifications to the federal program participants.

Contact Person: Andrell Beppu-Aoki, Director of Procurement
Procurement and Contracts Branch
Office of Fiscal Services

Anticipated Completion Date: March 31, 2009

2007-14 Indirect Cost Rate (Page 80)

Corrective Action Plan

The Indirect Cost Rate Proposal for fiscal year 2006-07 did not include the over (under) recovery adjustment. However, the Proposal for the fiscal year 2007-08 (filed on August 27, 2007) was in full compliance.

Contact Person: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: COMPLETED, August 27, 2007

PART VI

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Prior Fiscal Year Ended June 30, 2006

SECTION II - FINANCIAL STATEMENT FINDINGS

2006-01 Improve Reporting System for Vacation and Sick Leave
(Pages 55 to 56 of the Prior Year June 30, 2006 Report)
(Page 58 of the June 30, 2005 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Findings No. 2007-02.

2006-02 Improving Compensating Controls For Inadequate Segregation of Duties over Local School Funds
(Pages 57 to 58 of the Prior Year June 30, 2006 Report)
(Pages 54 to 55 of the June 30, 2005 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-03.

2006-03 Strengthen Controls Over Workers' Compensation Data
(Pages 59 to 60 of the Prior Year June 30, 2006 Report)
(Pages 56 to 57 of the June 30, 2005 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-05.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2006-04 Document Time Spent on Federal Programs
(Pages 61 to 62 of the Prior Year June 30, 2006 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-08.

2006-05 Use Actual Costs To Document Compliance With Cost Sharing Requirement
(Pages 63 to 65 of the Prior Year June 30, 2006 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-07.

2006-06 Perform and Document Eligibility Verification Procedures
(Pages 66 to 67 of the Prior Year June 30, 2006 Report)

Status -- Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.

2006-07 Compute Indirect Cost Rate In Accordance With OMB Circular A-87
(Page 68 of the Prior Year June 30, 2006 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-14.

2006-08 Improve Cash Management Procedures
(Page 69 of the Prior Year June 30, 2006 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2007-06.

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