

State of Hawaii
Drinking Water Treatment
Revolving Loan Fund
Financial Statements
June 30, 2007

Submitted by
The Auditor
State of Hawaii

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Drinking Water Treatment Revolving Loan Fund
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June 30, 2007**

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CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2007, and the related statements of revenues, expenses and change in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 2007 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters.

The Fund's management has not presented the management's discussion and analysis for the year ended June 30, 2007 that accounting principles generally accepted in the United States of America require to supplement, although not to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The supplementary information presented on pages 15 through 18 is presented for purposes of additional analysis and is not a required part of the Fund's financial statements. Such information has been subjected to the auditing procedures applied in the audit of the Fund's financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the Fund's financial statements taken as a whole.

Accuity LLP

Honolulu, Hawaii
November 28, 2007

Financial Statements

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Net Assets
June 30, 2007

Assets

Current assets	
Cash held in State Treasury	\$ 18,083,787
Loan fees receivable	285,105
Accrued interest on loans	51,263
Other accrued interest	162,092
Due from other funds	392,700
Due from federal government	486,487
Current maturities of loans receivable	<u>2,078,021</u>
Total current assets	21,539,455
Loans receivable, net of current maturities	38,801,458
Capital assets, net of accumulated depreciation of \$684,837	<u>270,103</u>
Total assets	<u>\$ 60,611,016</u>

Liabilities and Net Assets

Current liabilities	
Accounts payable and other accrued liabilities	<u>\$ 128,433</u>
Total current liabilities	128,433
Accrued vacation, net of current portion	19,678
Commitments and contingencies	
Net assets	
Invested in capital assets	270,103
Restricted – expendable	<u>60,192,802</u>
Total net assets	60,462,905
Total liabilities and net assets	<u>\$ 60,611,016</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2007

Operating revenues	
Interest income from loans	\$ 197,018
Administrative loan fees	790,290
Total operating revenues	<u>987,308</u>
Operating expenses	
Administrative	270,214
State program management	324,398
Water protection	65,740
Small systems	227,500
Total operating expenses	<u>887,852</u>
Operating income	99,456
Nonoperating revenues	
State contributions	1,661,000
Federal contributions	21,353,757
Other interest income	777,242
Other income	1,087
Total nonoperating revenues	<u>23,793,086</u>
Change in net assets	23,892,542
Net assets	
Beginning of year	<u>36,570,363</u>
End of year	<u>\$ 60,462,905</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Cash Flows
Year Ended June 30, 2007

Cash flows from operating activities	
Interest income from loans	\$ 187,637
Administrative loan fees	632,869
Principal repayments on loans	1,157,968
Disbursement of loan proceeds	(25,068,775)
Payments to employees	(198,504)
Payments to vendors	(474,117)
Net cash used in operating activities	<u>(23,762,922)</u>
Cash flows from noncapital financing activities	
State contributions	1,661,000
Federal contributions	21,404,046
Net advances to other funds	(27,700)
Net cash provided by noncapital financing activities	<u>23,037,346</u>
Cash flows from capital and related financing activities	
Purchased equipment	(72,670)
Net cash used in capital and related financing activities	<u>(72,670)</u>
Cash flows from investing activities	
Other interest	745,359
Net cash provided by investing activities	<u>745,359</u>
Net decrease in cash	(52,887)
Cash balance	
Beginning of year	<u>18,136,674</u>
End of year	<u>\$ 18,083,787</u>
Reconciliation of operating income to net cash used in operating activities	
Operating income	\$ 99,456
Adjustments to reconcile operating income	
Depreciation expense	88,307
Other nonoperating income	1,087
Change in assets and liabilities	
Loans receivables	(23,910,808)
Accrued interest on loans	(9,381)
Loan fees receivable	(157,422)
Accounts payable and other accrued liabilities	125,839
Net cash used in operating activities	<u>\$ (23,762,922)</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

1. Establishment and Purpose of the Fund

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

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

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the State and Department that is attributable to the transactions of the Fund and are not intended to present the financial position, results of operations or cash flows of the State or Department.

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

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

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

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates, among others, include the allowances for uncollectible accounts and depreciable lives of capital assets.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

Cash in State Treasury

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

At June 30, 2007, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. 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.

Loans Receivable

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

Administrative Loan Fees

In May 2000, the Department implemented an administrative loan fee program to pay for the Fund's administration, including employee salaries and benefits. The program applies an administrative loan fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

Capital Assets

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

Accrued Vacation

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. The current portion of the accrued vacation balance is included in the accounts payable and other accrued liabilities balance.

Net Assets

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

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted expendable: Net assets whose use by the Fund are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

Administration Costs

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

Fund Accounts

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

Expenses

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

New Accounting Pronouncements

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

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. This Statement establishes standards for accounting for termination benefits that affect an employer's obligations. For defined benefit OPEB plans, the provisions of this Statement are effective for the fiscal year beginning after December 15, 2006. Management does not expect this Statement to have a material effect on the Fund's financial statements.

In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The provisions of this Statement are effective for the fiscal year beginning after December 15, 2006. Management does not expect this Statement to have a material effect on the Fund's financial statements.

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The provisions of this Statement are effective for the fiscal year beginning after December 15, 2007. Management does not expect this Statement to have a material effect on the Fund's financial statements.

State of Hawaii
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Notes to Financial Statements
June 30, 2007

In May 2007, The GASB issued Statement No. 50, *Pension Disclosures – An Amendment of GASB Statements No. 25 and 27*. This Statement is to amend note disclosure and required supplementary information (“RSI”) standards of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with applicable changes adopted in Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2007, except for requirements related to the use of the entry age actuarial cost method for the purpose of reporting a surrogate funded status and funding progress of plans that use the aggregate actuarial cost method, which are effective for periods for which the financial statements and RSI contain information resulting from actuarial valuations as of June 15, 2007, or later. Management has not yet determined the effect this Statement will have on the Fund’s financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The provisions of this Statement establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement also results in a more faithful representation of the service capacity of intangible assets — and therefore the financial position of governments — and of the periodic cost associated with the usage of such service capacity in governmental financial statements. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2009. Management does not expect this Statement to have a material effect on the Fund’s financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

3. Loans Receivable

At June 30, 2007, loans receivable from government entities were as follows:

Five loans receivable from the City & County of Honolulu, due in semi-annual payments, including interest ranging from 0.00% to 0.31%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	\$ 13,439,746
Seven loans receivable from the County of Hawaii, due in semi-annual payments, including interest ranging from 0.41% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	5,599,767
Two loans receivable from the County of Maui, due in semi-annual payments, including interest ranging from 0.15% to 1.55%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	8,975,884
Nine loans receivable from the County of Kauai, due in semi-annual payments, including interest ranging from 0.16% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	<u>12,864,082</u>
	40,879,479
Less: Current portion	<u>2,078,021</u>
Noncurrent portion	<u>\$ 38,801,458</u>

Loans are expected to mature at various dates through 2027. The scheduled principal payments on loans maturing in subsequent years are as follows:

2008	\$ 2,078,021
2009	2,339,212
2010	2,353,840
2011	2,368,903
2012	2,383,945
Thereafter	<u>29,355,558</u>
	<u>\$ 40,879,479</u>

Accrued interest on loans amounted to \$51,263 at June 30, 2007. Interest income from loans amounted to \$197,018 for the year ended June 30, 2007.

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

At June 30, 2007, \$6,256,399 was committed to be loaned out to the City & County of Honolulu under existing loan agreements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

4. Contributed Capital

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2007:

Budget Period	Amount	Total Draws at June 30, 2006	Total 2007 Cash Draws	Funds Available
12/05/97 — 06/30/06	\$ 12,558,800	\$ 12,558,800	\$ -	\$ -
09/24/98 — 09/30/08	7,121,300	5,218,501	1,881,663	21,136
02/04/00 — 09/30/07	7,463,800	1,154,968	6,122,688	186,144
02/26/01 — 06/30/08	7,757,000	750,857	4,561,498	2,444,645
09/01/02 — 09/30/08	7,789,100	672,071	5,651,022	1,466,007
10/01/03 — 06/30/11	8,052,500	423,927	2,331,061	5,297,512
04/01/04 — 06/30/11	8,004,100	182,293	548,507	7,273,300
10/01/05 — 06/30/13	8,303,100	-	305,107	7,997,993
09/01/06 — 06/30/16	8,285,500	-	2,500	8,283,000
07/01/07 — 06/30/17	8,229,300	-	-	8,229,300
	<u>\$ 83,564,500</u>	<u>\$ 20,961,417</u>	<u>\$ 21,404,046</u>	<u>\$ 41,199,037</u>

The State is required to match 20% of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2007, the Fund was in compliance with the 20% State matching requirement. The required State match through June 30, 2007 approximated \$16.7 million, of which approximately \$9.2 million has been utilized and \$7.5 million was available to be loaned out at June 30, 2007.

5. Capital Assets

Summary of capital assets at June 30, 2007 is as follows:

	Balance at June 30, 2006	Additions	Retirements/ Transfers	Balance at June 30, 2007
Equipment	\$ 885,085	\$ 72,670	\$ 2,815	\$ 954,940
Less: Accumulated depreciation	<u>599,345</u>	<u>88,307</u>	<u>2,815</u>	<u>684,837</u>
	<u>\$ 285,740</u>	<u>\$ (15,637)</u>	<u>\$ -</u>	<u>\$ 270,103</u>

6. Due from Other Funds

Advances to other government agencies at June 30, 2007 were as follows:

Environmental Management, Public Water System Supervision	\$ 366,000
Environmental Management, Environmental Planning Office	<u>26,700</u>
	<u>\$ 392,700</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

7. Long-Term Obligation

The accrued vacation liability as of June 30, 2007 was as follows:

Balance at June 30, 2007	\$ 20,653
Less: Current portion	975
Noncurrent portion	<u>\$ 19,678</u>

8. Employee Benefit Plan

Employees' Retirement System

Substantially all eligible employees of the Department are members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the contributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, or highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State general fund.

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

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan will be eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

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

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

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

Post-retirement Health Care and Life Insurance Benefits

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

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

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in ERS. At June 30, 2007, accumulated sick leave was approximately \$25,800.

9. Commitments and Contingencies

Insurance Coverage

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

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2007

periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

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

Deferred Compensation Plan

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

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

Supplementary Information

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Cash Receipts, Disbursements and Cash Balance
Year Ended June 30, 2007

Receipts	
Principal repayments on loans	\$ 1,157,968
Interest income from loans	187,637
State contributions	1,661,000
Federal contributions	21,404,046
Administrative loan fees	632,869
Other interest	745,359
Repayments from other funds	425,300
Other	<u>1,087</u>
Total receipts	26,215,266
Disbursements	
Disbursement of loan proceeds	25,068,775
State program management	304,907
Administrative	215,298
Water protection program	63,673
Small systems	162,500
Advances to other funds	<u>453,000</u>
Total disbursements	<u>26,268,153</u>
Excess of disbursements over receipts	(52,887)
Cash balance	
Beginning of year	<u>18,136,674</u>
End of year	<u>\$ 18,083,787</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Net Assets
June 30, 2007

	State Revolving Fund Activity	Non-SRF Activity	Total
Assets			
Current assets			
Cash held in State Treasury	\$ 16,970,304	\$ 1,113,483	\$ 18,083,787
Loan fees receivable	-	285,105	285,105
Accrued interest on loans	51,263	-	51,263
Other accrued interest	162,092	-	162,092
Due from other funds	-	392,700	392,700
Due from federal government	-	486,487	486,487
Current maturity of loans receivable	2,078,021	-	2,078,021
Total current assets	19,261,680	2,277,775	21,539,455
Loans receivable, net of current maturities	38,801,458	-	38,801,458
Capital assets, net of accumulated depreciation	-	270,103	270,103
Total assets	<u>\$ 58,063,138</u>	<u>\$ 2,547,878</u>	<u>\$ 60,611,016</u>
Liabilities and Net Assets			
Current liabilities			
Accounts payable and other accrued liabilities	\$ -	\$ 128,433	\$ 128,433
Total current liabilities	-	128,433	128,433
Accrued vacation, net of current portion		19,678	19,678
Net assets			
Invested in capital assets	-	270,103	270,103
Restricted – expendable	58,063,138	2,129,664	60,192,802
Total net assets	<u>58,063,138</u>	<u>2,399,767</u>	<u>60,462,905</u>
Total liabilities and net assets	<u>\$ 58,063,138</u>	<u>\$ 2,547,878</u>	<u>\$ 60,611,016</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2007

	State Revolving Fund Activity	Non-SRF Activity	Total
Operating revenues			
Interest income from loans	\$ 197,018	\$ -	\$ 197,018
Administration loan fees	-	790,290	790,290
Total operating revenues	197,018	790,290	987,308
Operating expenses			
Administrative	-	270,214	270,214
State program management	-	324,398	324,398
Water protection	-	65,740	65,740
Small systems	-	227,500	227,500
Total operating expenses	-	887,852	887,852
Operating income (loss)	197,018	(97,562)	99,456
Nonoperating revenues			
State contribution	1,661,000	-	1,661,000
Federal contribution	20,639,088	714,669	21,353,757
Other interest income	777,242	-	777,242
Other income	-	1,087	1,087
Total nonoperating revenues	23,077,330	715,756	23,793,086
Interfund transfers	165,326	(165,326)	-
Change in net assets	23,439,674	452,868	23,892,542
Net assets			
Beginning of year	34,623,464	1,946,899	36,570,363
End of year	\$ 58,063,138	\$ 2,399,767	\$ 60,462,905

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Expenses
Year Ended June 30, 2007

	State Revolving Fund Activity	Non-SRF Activity	Total
Professional services	\$ -	\$ 304,903	\$ 304,903
Personnel	-	256,446	256,446
Repairs and maintenance	-	92,920	92,920
Depreciation	-	88,307	88,307
Travel	-	53,712	53,712
Services rendered by other State agencies	-	26,642	26,642
Training	-	25,819	25,819
Equipment – small tools and supplies	-	8,362	8,362
Rental	-	3,952	3,952
Advertising and printing	-	3,474	3,474
Office and other supplies	-	2,508	2,508
Utilities	-	1,543	1,543
Telephone	-	1,503	1,503
Miscellaneous	-	17,761	17,761
Total	<u>\$ -</u>	<u>\$ 887,852</u>	<u>\$ 887,852</u>



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the year ended June 30, 2007, and have issued our report thereon dated November 28, 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 Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

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 a 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.

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

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as Finding No. 07-01.

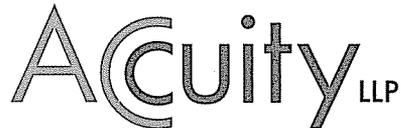
We noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated November 28, 2007.

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

This report is intended solely for the information and use of the Auditor; the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's management; the State of Hawaii, Department of Health's management; and the United States Environmental Protection Agency and is not intended to be and should not be used by anyone other than these specified parties.

Accuity LLP

Honolulu, Hawaii
November 28, 2007



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of and for the year ended June 30, 2007, and have issued our report thereon dated November 28, 2007.

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

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

that are applicable to its major federal program for the year ended June 30, 2007. The management of the Fund is responsible for the Fund's compliance with these requirements. Our responsibility is to express an opinion on those requirements based on our audit.

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

As described in Finding No. 07-01 in the accompanying schedule of findings and questioned costs, the Fund did not comply with requirements for Reporting. Compliance with this requirement is necessary, in our opinion, for the Fund to comply with the requirements applicable to the program.

In our opinion, except for the noncompliance described above regarding Reporting, the Fund complied, in all material respects, with the requirements governing types of activities and types of service and types of costs allowed or unallowed; matching; level of effort or earmarking requirements; special reporting requirements; special tests and provisions; and claims for advances and reimbursements that are applicable to its major Federal financial assistance program for the year ended June 30, 2007. We noted certain matters that we have reported to the Auditor and management of the Fund in a separate letter dated November 28, 2007.

This report is intended solely for the information and use of the Auditor; the State of Hawaii, Drinking Water Treatment Revolving Loan Fund's management; the State of Hawaii, Department of Health's management; and the United States Environmental Protection Agency and is not intended to be and should not be used by anyone other than these specified parties.

Accuity LLP

Honolulu, Hawaii
November 28, 2007

Schedule of Findings and Questioned Costs

**State of Hawaii
 Department of Health
 Capitalization Grants for Drinking Water State Revolving Fund
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2007**

Federal Award Findings and Questioned Costs

		Questioned Cost
Finding No. 07-01:	Filing of SF-272 (Material Weakness)	\$ <u> </u> –
Federal Agency:	Environmental Protection Agency ("EPA")	
CFDA Number and Title:	66.468 – Capitalization Grants for Drinking Water State Revolving Fund	
Award Number and Award Year:	FS-9998659X-1, 9/24/98 – 6/30/17 FS-99986500-1, FS-9998650X-0	

Finding and Cause and Effect

The Department's Administrative Service Office ("ASO") prepares and submits the Standard Form (SF)-272 reports to the U.S. Environmental Protection Agency (the "EPA") on behalf of the Fund. As of September 30, 2007, we noted that due to a staffing shortage and changes in personnel, ASO did not submit the SF-272 report for the period July 1, 2006 to December 31, 2006, which was due on January 15, 2007.

As the program is not in compliance with grant award requirements, there is a risk that the EPA will withhold future funds from the program.

Criteria

In accordance with Office of Management ("OMB") Circular A-110, the SF-272 report is required to be filed 15 days following the end of each quarter. However, due to special arrangements made between the Department and the EPA for the Drinking Water State Revolving Fund, the reports are filed by ASO semi-annually for the periods July 1, 20XX to December 31, 20XX and January 1, 20XX to June 30, 20XX. This arrangement was approved by the EPA and is documented in the grant agreement.

Recommendation

We recommend that ASO designate a competent individual to submit all federal reports in an accurate and timely manner. We also recommend that ASO maintain a document, which includes all federal reporting requirements and submission deadlines, in order to ensure that the designated ASO personnel are aware of all federal guidelines and significant reporting dates. In the case of a staffing shortage, ASO management should ensure that the reports are submitted by another competent individual.

Correction Action Plan

LINDA LINGLE
GOVERNOR OF HAWAII



CHIYOME LEINAALA FUKINO, M.D.
DIRECTOR OF HEALTH

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

In reply, please refer to:
File:

ASO-F-4653

October 29, 2007

Office of the Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Office of the Auditor:

Attached is the Department of Health's Correction Action Plan to the findings on the A-133 audit report for the Drinking Water State Revolving Fund and The Water Pollution Control Revolving Fund.

We appreciate the opportunity to comment on the audit report.

Sincerely,

Valerie K. Ako

VALERIE K. AKO
Acting Chief
Administrative Services Office

Attachment

bc: Acting Chief

Finding 07-01: Filing of SF-272 (Federal Cash Transaction Report)-Significant Deficiency

Corrective Action Plan:

Person Responsible: Accountant V

Date of Completion: December 31, 2007

The Administrative Service Office, Fiscal Section will be compiling a list of all Federal Grants indicating due dates for Financial Status Reports and SF-272 reports. This schedule will ensure that the financial reports are completed and submitted by the appropriate deadlines.