

State of Hawaii Drinking Water Treatment Revolving Loan Fund

Financial Statements

June 30, 2009

**Submitted by
The Auditor
State of Hawaii**

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
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June 30, 2009

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Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2009, 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, or 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, 2009, 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 March 23, 2010 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, 2009 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. The Fund's management discussion and analysis for the year ended June 30, 2009 is incorporated in the financial statements for the State of Hawaii, Department of Health.

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The supplementary information presented on pages 14 through 17 is presented for purposes of additional analysis and 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
March 23, 2010

Financial Statements

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Net Assets
June 30, 2009

Assets

Current assets

Equity in cash and cash equivalents and investments in State Treasury	\$ 24,862,525
Loan fees receivable	530,655
Accrued interest on loans	56,366
Other accrued interest	219,902
Due from federal government	20,677
Current maturities of loans receivable	<u>3,482,402</u>
Total current assets	29,172,527

Loans receivable, net of current maturities 53,036,981

Capital assets, net of accumulated depreciation of \$846,340 272,366

 Total assets \$ 82,481,874

Liabilities and Net Assets

Current liabilities

Accounts payable and other accrued liabilities	<u>\$ 161,354</u>
Total current liabilities	161,354

Accrued vacation, net of current portion 35,896

Other postemployment benefits 84,261

 Total liabilities 281,511

Commitments and contingencies

Net assets

Invested in capital assets	272,366
Restricted – expendable	<u>81,927,997</u>
Total net assets	<u>82,200,363</u>

 Total liabilities and net assets \$ 82,481,874

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, 2009

Operating revenues	
Interest income from loans	\$ 229,316
Administrative loan fees	<u>1,774,766</u>
Total operating revenues	2,004,082
Operating expenses	
Administrative	468,216
State program management	639,626
Water protection	62,205
Small systems	<u>336,891</u>
Total operating expenses	<u>1,506,938</u>
Operating income	497,144
Nonoperating revenues and expenses	
State contributions	1,671,000
Federal contributions	8,704,715
Other interest loss	<u>(598,776)</u>
Total nonoperating revenues and expenses	<u>9,776,939</u>
Change in net assets	10,274,083
Net assets	
Beginning of year	<u>71,926,280</u>
End of year	<u>\$ 82,200,363</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, 2009

Cash flows from operating activities	
Interest income from loans	\$ 228,453
Administrative loan fees	1,710,973
Principal repayments on loans	3,128,123
Disbursement of loan proceeds	(9,984,387)
Payments to employees	(420,188)
Payments to other state agencies for services rendered	(40,952)
Payments to vendors	<u>(1,035,822)</u>
Net cash used in operating activities	<u>(6,413,800)</u>
Cash flows from noncapital financing activities	
State contributions	1,671,000
Federal contributions	<u>9,092,888</u>
Net cash provided by noncapital financing activities	<u>10,763,888</u>
Cash flows from capital and related financing activities	
Purchased equipment	<u>(5,268)</u>
Net cash used in capital and related financing activities	<u>(5,268)</u>
Cash flows from investing activities	
Other interest loss	<u>(709,640)</u>
Net cash used in investing activities	<u>(709,640)</u>
Net increase in cash	3,635,180
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	<u>21,227,345</u>
End of year	<u>\$ 24,862,525</u>
Reconciliation of operating income to net cash used in operating activities	
Operating income	\$ 497,144
Adjustments to reconcile operating income to net cash used in operating activities	
Depreciation expense	90,397
Change in assets and liabilities	
Loans receivables	(6,856,263)
Accrued interest on loans	(863)
Loan fees receivable	(63,793)
Accounts payable and other accrued liabilities	(129,791)
Other postemployment benefits	<u>49,369</u>
Net cash used in operating activities	<u>\$ (6,413,800)</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, 2009

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. The Fund has elected not to apply all FASB pronouncements issued after November 30, 1989.

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, 2009

Equity in Cash and Cash Equivalents and Investments 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, 2009, 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.

In February 2010, DAGS issued guidance informing State agencies participating in the State Treasury Investment Pool that the State's investments in auction rate securities were impaired as of and for the year ended June 30, 2009 and that each participating State agency would be allocated a portion of the impairment. The Fund's allocated impairment loss for 2009 amounted to \$1,131,379.

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.

State of Hawaii

Drinking Water Treatment Revolving Loan Fund

Notes to Financial Statements

June 30, 2009

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, 2009, accumulated sick leave was approximately \$78,900.

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.

Administrative Costs

The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the 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 March 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP. The requirements of this Statement became effective upon its issuance and did not materially impact the Fund's financial statements.

In March 2009, the GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The objective of this Statement is to incorporate certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statement on Auditing Standards into GASB's authoritative literature. This statement was intended to improve financial reporting by bringing the authoritative accounting and financial reporting literature together in one place. The requirements of this Statement became effective upon its issuance and did not materially impact the Fund's financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2009

In January 2010, the GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The objective of this Statement is to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, as an option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates. The requirements of this Statement are effective for periods beginning after June 15, 2011. Management does not expect that this Statement will have a material effect on the Fund's financial statements as the Fund participates in the State's plan, which has more than 100 members.

In January 2010, the GASB also issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms a new payment plan. The requirements of this Statement are effective for reporting periods beginning after June 15, 2009. Currently, management does not expect that this Statement will apply to the Fund.

3. Loans Receivable

At June 30, 2009, loans receivable from government entities were as follows:

Nine loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 0.36%, 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.	\$ 23,314,881
Eight loans receivable from the County of Hawaii, Water Board, 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.	8,154,507
Three loans receivable from the County of Maui, Board of Water Supply, 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.	12,918,029
Ten loans receivable from the County of Kauai, Board of Water Supply, 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>12,131,966</u>
	56,519,383
Less: Current portion	<u>3,482,402</u>
Noncurrent portion	<u>\$ 53,036,981</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2009

Loans are expected to mature at various dates through 2028. The scheduled principal payments on loans maturing in subsequent years are as follows:

2010	\$ 3,482,402
2011	3,507,681
2012	3,525,014
2013	3,543,228
2014	3,560,969
Thereafter	<u>38,900,089</u>
	<u>\$ 56,519,383</u>

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, 2009, \$4,733,954 was committed to be loaned out to the County of Kauai, Board of Water Supply under existing loan agreements.

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, 2009:

Budget Period	Amount	Total Draws at June 30, 2008	Total 2009 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	7,121,300	-	-
02/04/00 – 09/30/07	7,463,800	7,463,800	-	-
02/26/01 – 06/30/08	7,757,000	7,636,709	120,291	-
09/01/02 – 09/30/08	7,789,100	7,105,711	683,389	-
10/01/03 – 06/30/11	8,052,500	5,491,761	1,564,478	996,261
04/01/04 – 06/30/11	8,004,100	1,118,492	3,815,442	3,070,166
10/01/05 – 06/30/13	8,303,100	3,862,804	803,862	3,636,434
09/01/06 – 06/30/16	8,285,500	2,500	2,105,426	6,177,574
07/01/07 – 06/30/17	8,229,300	-	-	8,229,300
03/01/08 – 06/30/17	8,229,000	-	-	8,229,000
03/01/09 – 06/30/18	8,146,000	-	-	8,146,000
	<u>\$ 99,939,500</u>	<u>\$ 52,361,877</u>	<u>\$ 9,092,888</u>	<u>\$ 38,484,735</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, 2009, the Fund was in compliance with the 20% State matching requirement. The required State match through June 30, 2009 approximated \$20.0 million, of which approximately \$13.9 million has been utilized and \$6.1 million was available to be loaned out at June 30, 2009.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2009

5. Capital Assets

Summary of capital assets at June 30, 2009 is as follows:

	Balance at June 30, 2008	Additions	Retirements/ Transfers	Balance at June 30, 2009
Equipment	\$ 1,126,154	\$ 5,268	\$ (12,716)	\$ 1,118,706
Accumulated depreciation	<u>(768,659)</u>	<u>(90,397)</u>	<u>12,716</u>	<u>(846,340)</u>
	<u>\$ 357,495</u>	<u>\$ (85,129)</u>	<u>\$ -</u>	<u>\$ 272,366</u>

6. Accrued Vacation

The accrued vacation liability as of June 30, 2009 was as follows:

Balance at July 1, 2008	\$ 48,571
Increase	14,749
Decrease	<u>(13,951)</u>
Balance at June 30, 2009	49,369
Less: Current portion	<u>13,473</u>
Noncurrent portion	<u>\$ 35,896</u>

7. Employee Benefit Plans

Substantially all employees of the Fund participate in the State's various employee benefit plans, including the Employees' Retirement System ("ERS") of the State of Hawaii, post-employment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans, refer to the State of Hawaii and ERS' Comprehensive Annual Financial Reports ("CAFR"). The State's CAFR can be found at the Department of Accounting and General Services' ("DAGS") website: <http://hawaii.gov/dags/rpts>. The ERS CAFR can be found at the ERS website: <http://www4.hawaii.gov/ers/default.htm>.

Employees' Retirement System

The ERS is 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.

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 an 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.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2009

Post-Employment Healthcare and Life Insurance Benefits

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund (“EUTF”), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

State Policy

The actuarial valuation of the EUTF does not provide other postemployment benefits (“OPEB”) information by department or agency. Accordingly, the State’s policy on the accounting and reporting for OPEB is to allocate a portion of the State’s Annual Required Contribution (“ARC”), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State’s CAFR. The basis for the allocation is the proportionate share of contributions made by each component unit or proprietary fund for retiree health benefits.

Allocated OPEB Cost

The following table shows the components of the annual OPEB cost that have been allocated to the Fund for the year ended June 30, 2009:

Annual required contribution	\$ 76,879
Interest on net OPEB obligation	2,361
Adjustment to annual required contribution	<u>(2,007)</u>
Annual OPEB cost (expense)	77,233
Contributions made	<u>(27,864)</u>
Increase in net OPEB obligation	49,369
Net OPEB obligation	
Beginning of year	<u>34,892</u>
End of year	<u><u>\$ 84,261</u></u>

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Fund’s contributions for the years ended June 30, 2009, 2008 and 2007 approximated \$27,900, \$20,800 and \$9,600, respectively.

Required Supplementary Information and Disclosures

The State’s CAFR includes the required footnote disclosures and supplementary information on the State’s OPEB plan.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2009

8. Insurance Coverage

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

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

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

Supplementary Information

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Cash Receipts, Disbursements and Cash Balance
Year Ended June 30, 2009

Receipts

Principal repayments on loans	\$ 3,128,123
Interest income from loans	228,453
State contributions	1,671,000
Federal contributions	9,092,888
Administrative loan fees	<u>1,710,973</u>
Total receipts	15,831,437

Disbursements

Disbursement of loan proceeds	9,984,387
Administrative	434,075
State program management	684,676
Water protection program	47,671
Small systems	335,808
Other interest	<u>709,640</u>
Total disbursements	<u>12,196,257</u>
Excess of receipts over disbursements	3,635,180

**Equity in cash and cash equivalents and investments
in State Treasury**

Beginning of year	<u>21,227,345</u>
End of year	<u>\$ 24,862,525</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Net Assets
June 30, 2009

	State Revolving Fund Activity	Non-SRF Activity	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 22,147,089	\$ 2,715,436	\$ 24,862,525
Loan fees receivable	-	530,655	530,655
Accrued interest on loans	56,366	-	56,366
Other accrued interest	219,902	-	219,902
Due from federal government	-	20,677	20,677
Current maturities of loans receivable	<u>3,482,402</u>	<u>-</u>	<u>3,482,402</u>
Total current assets	25,905,759	3,266,768	29,172,527
Loans receivable, net of current maturities	53,036,981	-	53,036,981
Capital assets, net of accumulated depreciation	<u>-</u>	<u>272,366</u>	<u>272,366</u>
Total assets	<u>\$ 78,942,740</u>	<u>\$ 3,539,134</u>	<u>\$ 82,481,874</u>
Liabilities and Net Assets			
Current liabilities			
Accounts payable and other accrued liabilities	<u>\$ -</u>	<u>\$ 161,354</u>	<u>\$ 161,354</u>
Total current liabilities	-	161,354	161,354
Accrued vacation, net of current portion	-	35,896	35,896
Other postemployment benefits	<u>-</u>	<u>84,261</u>	<u>84,261</u>
Total liabilities	-	281,511	281,511
Net assets			
Invested in capital assets	-	272,366	272,366
Restricted – expendable	<u>78,942,740</u>	<u>2,985,257</u>	<u>81,927,997</u>
Total net assets	<u>78,942,740</u>	<u>3,257,623</u>	<u>82,200,363</u>
Total liabilities and net assets	<u>\$ 78,942,740</u>	<u>\$ 3,539,134</u>	<u>\$ 82,481,874</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2009

	State Revolving Fund Activity	Non-SRF Activity	Total
Operating revenues			
Interest income from loans	\$ 229,316	\$ -	\$ 229,316
Administration loan fees	-	1,774,766	1,774,766
Total operating revenues	<u>229,316</u>	<u>1,774,766</u>	<u>2,004,082</u>
Operating expenses			
Administrative	-	468,216	468,216
State program management	-	639,626	639,626
Water protection	-	62,205	62,205
Small systems	-	336,891	336,891
Total operating expenses	<u>-</u>	<u>1,506,938</u>	<u>1,506,938</u>
Operating income	229,316	267,828	497,144
Nonoperating revenues and expenses			
State contributions	1,671,000	-	1,671,000
Federal contributions	7,202,483	1,502,232	8,704,715
Other interest loss	(598,776)	-	(598,776)
Total nonoperating revenues and expenses	<u>8,274,707</u>	<u>1,502,232</u>	<u>9,776,939</u>
Interfund transfers	<u>1,290,028</u>	<u>(1,290,028)</u>	<u>-</u>
Change in net assets	9,794,051	480,032	10,274,083
Net assets			
Beginning of year	<u>69,148,689</u>	<u>2,777,591</u>	<u>71,926,280</u>
End of year	<u>\$ 78,942,740</u>	<u>\$ 3,257,623</u>	<u>\$ 82,200,363</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Expenses
Year Ended June 30, 2009

	State Revolving Fund Activity	Non-SRF Activity	Total
Professional services	\$ -	\$ 662,467	\$ 662,467
Personnel	-	454,674	454,674
Repairs and maintenance	-	102,653	102,653
Depreciation	-	90,397	90,397
Travel	-	58,288	58,288
Services rendered by other state agencies	-	47,243	47,243
Training	-	31,417	31,417
Office and other supplies	-	18,622	18,622
Rental	-	9,262	9,262
Utilities	-	3,425	3,425
Equipment – small tool and supplies	-	2,239	2,239
Telephone	-	1,937	1,937
Advertising and printing	-	1,393	1,393
Miscellaneous	-	22,921	22,921
Total	<u>\$ -</u>	<u>\$ 1,506,938</u>	<u>\$ 1,506,938</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, 2009, and have issued our report thereon dated March 23, 2010. 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 Standard*.

We noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated March 23, 2010.

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
March 23, 2010



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, 2009, and have issued our report thereon dated March 23, 2010.

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, 2009. 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.

In our opinion, the Fund complied, in all material respects, with requirements governing types of services 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, 2009. The results of our procedures disclosed an instance 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 Finding No. 09-01. We also noted certain matters that we have reported to the Auditor and management of the Fund in a separate letter dated March 23, 2010.

The Fund's responses to the finding identified in our audit are described in the Fund's Corrective Action Plan. 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
March 23, 2010

Schedule of Findings and Questioned Costs

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

Federal Award Findings and Questioned Costs

		Questioned Cost
Finding No. 09-01:	Allowability (Set-Asides used for Grants)	\$ <u>75,000</u>
Federal Agency:	<u>Environmental Protection Agency</u>	
CFDA Number and Title:	<u>66.468 – Capitalization Grants for Drinking Water State Revolving Funds</u>	
Award Number and Award Year:	<u>FS-99986502-1</u>	<u>9/01/2002 – 9/30/2008</u>
	<u>FS-99986505-1</u>	<u>10/01/2005 – 6/30/2013</u>

Finding and Cause and Effect

During our testing of the federal reporting compliance requirement for the Capitalization Grants for Drinking Water State Revolving Funds (“DWSRF”) program (CFDA 66.468) administered by the Drinking Water Treatment Revolving Loan Fund (“DWTRLF”), we noted three grants aggregating \$75,000 that were disbursed from the program’s set-aside funds (2% set-aside for Small Systems Technical Assistance and 15% for Technical or Financial Assistance to PWS’s).

In accordance with program guidelines, the State must comply with State statutes. In accordance with State statutes, there is contradictory language in the intent of the law which led us to question whether or not grants are allowed to be made from the DWTRLF program. Therefore, there is risk that the program is not in compliance with Federal and State guidelines.

Criteria

In accordance with the Drinking Water State Revolving Fund Program Guidelines, “The State must comply with all State statutes and regulations that are applicable to DWSRF funds, including Federal capitalization funds, State match, interest earnings, bond proceeds and repayments, and funds used for set-aside account activities”.

§340E-34 of the Hawaii Revised Statutes (“HRS”) states:

- (a) The director may make grants to public water systems from state funds as authorized and appropriated by the legislature for the construction of necessary water treatment works or other related drinking water projects. Grants shall not be made from the drinking water fund.
- (b) The director shall coordinate the granting of state funds with available federal funds for the same purpose. Grants involving federal funds shall be consistent with federal law.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

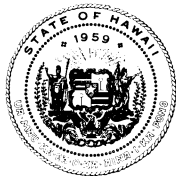
- (c) The director may allocate grants to drinking water projects on the basis of existing health concerns. No grant shall be made for any project unless:
- (1) The project conforms with the state grant plan to provide safe drinking water;
 - (2) The project is certified by the director as being entitled to priority over other eligible projects on the basis of financial as well as drinking water quality needs; and
 - (3) In the case of water treatment works, the applicant for the grant commits to maintain the water treatment plant efficiently and properly after its construction.

Recommendation

We recommend that the program seek an opinion from the Attorney General on whether grants from the program's set-aside funds are an allowable activity to ensure that the program is in compliance with State as well as Federal guidelines.

Corrective 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

In reply, please refer to:
EMD / WB

March 23, 2010

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

Dear State Auditor:

Attached is the Department of Health's Corrective Action Plan to the finding on the audit report for fiscal year 2009 for the Drinking Water Treatment Revolving Loan Fund.

We appreciate the opportunity to comment on the audit report.

Sincerely,

STUART YAMADA, P.E., CHIEF
Safe Drinking Water Branch

Attachment

Federal Award Findings and Questioned Costs

Finding No. 09-01: Allowability (Set-Asides Used for Grants)

Finding and Cause and Effect

During our testing of the federal reporting compliance requirements for the Capitalization Grants for Drinking Water State Revolving Funds ("DWTRLF") program (CFDA 66.468) administered by the Drinking Water Treatment Revolving Loan Fund ("DWTRLF"), we noted three grants aggregating \$75,000 that were disbursed from the program's set-aside funds (2% set-aside for Small Systems Technical Assistance and 15% for Technical or Financial Assistance to PWS's).

In accordance with program guidelines, the State must comply with State statutes. In accordance with State statutes, there is contradictory language in the intent of the law which led us to question whether or not grants are allowed to be made from the DWTRLF program. Therefore, there is risk that the program is not in compliance with Federal and State guidelines.

Corrective Action Plan

The Safe Drinking Water Branch will be seeking advice from the Department of the Attorney General to clarify this issue.

Person Responsible for Corrective Action

Safe Drinking Water Branch Chief

Anticipated Completion Date

December 1, 2010