

State of Hawaii
Department of Accounting and General Services
State Motor Pool Revolving Fund
Financial and Compliance Audit
June 30, 2011

Submitted By
The Auditor
State of Hawaii

TABLE OF CONTENTS

| | <u>Page</u> |
|---|-------------|
| PART I - TRANSMITTAL | 1 |
| PART II - MANAGEMENT'S DISCUSSION AND ANALYSIS | 3 |
| PART III - FINANCIAL SECTION: | |
| Independent auditors' report | 7 |
| Financial Statements | |
| Statement of Net Assets | 9 |
| Statement of Revenues, Expenses and Changes in Net Assets | 10 |
| Statement of Cash Flows | 11 |
| Notes to Financial Statements | 13 |
| PART IV - INTERNAL CONTROL AND COMPLIANCE SECTION: | |
| Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i> | 23 |
| PART V - SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS | 25 |
| PART VI - CORRECTIVE ACTION PLAN | 26 |

PART I
TRANSMITTAL

The Auditor
State of Hawaii

We have completed our financial audit of State of Hawaii, Department of Accounting and General Services, State Motor Pool Revolving Fund (the "Fund") as of and for the year ended June 30, 2011. The audit was performed in accordance with our agreement with the Auditor, State of Hawaii dated June 29, 2010.

OBJECTIVES

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Fund's financial statements as of and for the fiscal year ended June 30, 2011. More specifically, the objectives of our audit were as follows:

1. To provide a basis for an opinion on the fairness of the financial statements of the Fund.
2. To ascertain whether or not expenditures have been made and all revenues and other receipts to which the Fund is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the Federal Government.
3. To ascertain the adequacy of the financial and other management information reports in providing officials at the different levels of the State and the Fund the proper information to plan, evaluate, control and correct program activities.
4. To evaluate the adequacy, effectiveness and efficiency of the systems and procedures for financial accounting, operational and internal controls, and to recommend improvements to such systems and procedures.

SCOPE OF THE AUDIT

Our audit was performed 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. The scope of our audit included an examination of the transactions and accounting records of the Fund for the fiscal year ended June 30, 2011.

ORGANIZATION OF THE REPORT

This report is organized into six parts:

PART I - presents the transmittal letter.

PART II - presents management's discussion and analysis.

PART III - presents the financial section which includes the Fund's financial statements and the auditors' report on such statements.

PART IV - contains the report on internal controls over financial reporting and compliance.

PART V - presents the schedule of audit findings and questioned costs.

PART VI - contains the corrective action plan.

At this time, we wish to thank the Fund's personnel for their cooperation and assistance extended to us. We will be happy to respond to any questions that you may have on this report.

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**Original document signed by
Egami & Ichikawa CPAs, Inc.**

Honolulu, Hawaii
February 2, 2012

PART II

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2011

This section of the annual financial report presents an analysis of the Fund's financial performance during the fiscal year ended June 30, 2011. Please read it in conjunction with the financial statements which follow this section.

2011 FINANCIAL HIGHLIGHTS

- The Fund's net assets decreased by \$1,183,000 or 25.68%, as compared to 2010.
- The Fund received \$28,304 and transferred out \$41,354 in capital assets.
- The Fund's investment in capital assets was \$1,514,000, which increased by \$311,000 or 25.85%, as compared to 2010.
- The Fund's operating revenues decreased by \$17,000 or 0.73%, as compared to 2010, due to decreased vehicle rentals.
- The Fund transferred out to the General Fund \$1,500,000.

OVERVIEW OF ANNUAL REPORT

This annual report consists of six parts: Transmittal letter; management's discussion and analysis; financial section; internal control and compliance; schedule of audit findings and questioned costs; and corrective action plan.

REQUIRED FINANCIAL STATEMENTS

The Financial Statements of the Fund present information about the Fund as a whole and its activities and uses the accrual basis of accounting. The accrual basis which is similar to the accounting basis used by private sector companies recognizes revenues and expenses regardless of when cash is paid or received.

The Statement of Net Assets provides both short-term and long-term information about the Fund's financial position, which reflects the Fund's economic condition at the end of the year.

The Statement of Net Assets provides, over time, indicators of the Fund's financial position. The Statement of Net Assets includes all the Fund's assets and liabilities, and provides information about the nature and the amounts of investment in resources (assets) and obligations (liabilities) of the Fund.

The Statement of Revenues, Expenses and Changes in Net Assets reflect the Fund's current year's revenues and expenses regardless of when cash is received or paid.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
June 30, 2011

REQUIRED FINANCIAL STATEMENTS (Continued)

The Statement of Cash Flows reflects the flow of cash of the Fund in four categories or activities: operating, investing, capital, and noncapital.

Tables 1 and 2 present a comparative view of net assets and changes in net assets as of June 30, 2011 and 2010.

TABLE 1
NET ASSETS
(Rounded to nearest \$1,000)

| | 2011 | 2010 |
|---|---------------------|---------------------|
| ASSETS | | |
| Current | \$ 2,534,000 | \$ 3,891,000 |
| Capital assets, net of depreciation | <u>1,514,000</u> | <u>1,203,000</u> |
| TOTAL ASSETS | <u>\$ 4,048,000</u> | <u>\$ 5,094,000</u> |
| LIABILITIES | | |
| Current | \$ 120,000 | \$ 80,000 |
| Long-term | <u>504,000</u> | <u>407,000</u> |
| TOTAL LIABILITIES | <u>624,000</u> | <u>487,000</u> |
| NET ASSETS | | |
| Invested in capital assets, net of related debt | 1,514,000 | 1,203,000 |
| Unreserved | <u>1,910,000</u> | <u>3,404,000</u> |
| TOTAL NET ASSETS | <u>3,424,000</u> | <u>4,607,000</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 4,048,000</u> | <u>\$ 5,094,000</u> |

Net assets of the Fund decreased by 25.68% in 2011. Investment in capital assets (i.e., vehicles, shop equipment, furniture and fixtures), net of the related debt used to purchase the assets represents a large portion of the Fund's net assets; \$1,514,000 or 44.22% in 2011 and \$1,203,000 or 26.11% in 2010. Capital assets are used to provide vehicles for state agencies. The Fund's investment in its capital assets is reported net of debt. The resources needed to repay this debt must be provided by other sources, since the capital assets, mainly the vehicles, cannot be used to liquidate the debt. The remaining unreserved assets may be used to finance day to day operations without any constraints established by debt, or other legal requirements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
June 30, 2011

REQUIRED FINANCIAL STATEMENTS (Continued)

TABLE 2
CHANGES IN NET ASSETS
(Rounded to nearest \$1,000)

| | 2011 | 2010 |
|---|---------------------|---------------------|
| OPERATING REVENUES | | |
| Motor vehicle rentals | \$ 2,186,000 | \$ 2,206,000 |
| Motor vehicle repairs | <u>112,000</u> | <u>109,000</u> |
| TOTAL OPERATING REVENUES | <u>2,298,000</u> | <u>2,315,000</u> |
| OPERATING EXPENSES | | |
| General operating and administrative | 1,627,000 | 1,610,000 |
| Depreciation | <u>433,000</u> | <u>482,000</u> |
| TOTAL OPERATING EXPENSES | <u>2,060,000</u> | <u>2,092,000</u> |
| INCOME FROM OPERATIONS | 238,000 | 223,000 |
| NET NON OPERATING REVENUE | <u>79,000</u> | <u>121,000</u> |
| EXCESS BEFORE TRANSFER | 317,000 | 344,000 |
| TRANSFERS | <u>(1,500,000)</u> | <u>-</u> |
| CHANGE IN NET ASSETS | (1,183,000) | 344,000 |
| NET ASSETS BEGINNING OF THE YEAR | <u>4,607,000</u> | <u>4,263,000</u> |
| NET ASSETS END OF THE YEAR | <u>\$ 3,424,000</u> | <u>\$ 4,607,000</u> |

The Fund's vehicle rental rates are established under the jurisdiction of the Comptroller, as Chief of the Department of Accounting and General Services or the Comptroller's designated representative, the division head of the Automotive Management Division. The decrease in operating revenues of 0.73% or \$17,000 in 2011 was primarily due to the decrease in motor vehicle assignments.

The decrease in general operating expenses of 1.53% or \$32,000 in 2011 was primarily due to decreases in depreciation in the current year.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
June 30, 2011

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Fund's investment in capital assets amounted to \$1,514,000 and \$1,203,000 (net of accumulated depreciation of \$4,485,000 in 2011 and \$4,329,000 in 2010). Capital assets include vehicles, shop equipment, furniture and fixtures.

Net capital assets (Rounded to the nearest \$1,000) are accounted for as follows:

| | <u>2011</u> | <u>2010</u> |
|--|---------------------|---------------------|
| ASSETS | | |
| Capital assets, net of accumulated depreciation: | | |
| Vehicles | \$ 1,470,000 | \$ 1,197,000 |
| Shop equipment, furniture and fixtures | <u>44,000</u> | <u>6,000</u> |
| TOTAL CAPITAL ASSETS, NET | <u>\$ 1,514,000</u> | <u>\$ 1,203,000</u> |

Debt Administration

There was no debt as of June 30, 2011 and 2010.

CURRENTLY KNOWN DECISIONS AND FACTS

None

PART III
FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

The Auditor
State of Hawaii

We have audited the accompanying financial statements of the State of Hawaii, Department of Accounting and General Services, State Motor Pool Revolving Fund (the "Fund") as of and for the year ended June 30, 2011, as listed in the table of contents. 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 the 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 1, the financial statements present only the Fund and do not purport to, and do not, present fairly the financial position of the State of Hawaii, or any other segment thereof, as of June 30, 2011, and the changes in its financial position, or, its cash flows for the year then ended 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, 2011, and the changes in financial position and cash flows thereof 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 February 2, 2012, 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 agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 – 6, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

This report is intended solely for the information and use of the Office of the Auditor, management of the Fund, the Department of Accounting and General Services and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

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**Original document signed by
Egami & Ichikawa CPAs, Inc.**

Honolulu, Hawaii
February 2, 2012

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
STATEMENT OF NET ASSETS
JUNE 30, 2011

| | |
|--|--------------------------------|
| CURRENT ASSETS | |
| Cash and cash equivalents | \$ 2,289,495 |
| Motor vehicle receivable, net | 222,762 |
| Interest receivable | 1,823 |
| Inventories | <u>20,007</u> |
| TOTAL CURRENT ASSETS | <u><u>2,534,087</u></u> |
| NONCURRENT ASSETS | |
| Capital assets, at cost, less accumulated depreciation | <u>1,514,187</u> |
| TOTAL ASSETS | <u><u>\$ 4,048,274</u></u> |
| CURRENT LIABILITIES | |
| Accounts payable | \$ 70,343 |
| Accrued liabilities | <u>49,669</u> |
| TOTAL CURRENT LIABILITIES | <u><u>120,012</u></u> |
| NONCURRENT LIABILITIES | |
| Accrued liabilities | 157,364 |
| Net OPEB obligation | <u>346,930</u> |
| TOTAL NONCURRENT LIABILITIES | <u><u>504,294</u></u> |
| TOTAL LIABILITIES | <u><u>624,306</u></u> |
| NET ASSETS | |
| Invested in capital assets, net of related debt | 1,514,187 |
| Unrestricted | <u>1,909,781</u> |
| TOTAL NET ASSETS | <u><u>3,423,968</u></u> |
| TOTAL LIABILITIES AND NET ASSETS | <u><u>\$ 4,048,274</u></u> |

See accompanying notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2011

| | |
|---|---------------------|
| OPERATING REVENUES | |
| Motor vehicle rentals | \$ 2,185,735 |
| Motor vehicle repairs | 112,540 |
| TOTAL OPERATING REVENUES | <u>2,298,275</u> |
| | |
| OPERATING EXPENSES | |
| Personnel services | 813,334 |
| Depreciation | 432,712 |
| Gas and oil | 459,823 |
| Repairs and maintenance | 236,520 |
| Others | 117,577 |
| TOTAL OPERATING EXPENSES | <u>2,059,966</u> |
| | |
| INCOME FROM OPERATIONS | <u>238,309</u> |
| | |
| NONOPERATING REVENUES | |
| Interest and miscellaneous income | 27,686 |
| Gain on investments in State Treasury | 46,497 |
| Gain on disposition of capital assets | 4,308 |
| TOTAL NONOPERATING REVENUES | <u>78,491</u> |
| | |
| INCOME BEFORE TRANSFERS | 316,800 |
| | |
| OPERATING TRANSFER | <u>1,500,000</u> |
| | |
| CHANGE IN NET ASSETS | (1,183,200) |
| | |
| TOTAL NET ASSETS, BEGINNING OF THE YEAR | <u>4,607,168</u> |
| TOTAL NET ASSETS, END OF THE YEAR | <u>\$ 3,423,968</u> |

See accompanying notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2011

| | |
|---|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | |
| Receipts from motor vehicle rentals | \$ 2,255,300 |
| Receipts from motor vehicle repairs | 112,540 |
| Payments for personnel services | (709,579) |
| Payments for gas and oil | (441,275) |
| Payments for repairs and maintenance | (221,591) |
| Other administrative payments | (122,787) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | <u>872,608</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | |
| Interest from pooled funds | 56,407 |
| Gain on investments held in State Treasury | 46,497 |
| NET CASH PROVIDED BY INVESTING ACTIVITIES | <u>102,904</u> |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | |
| Acquisition of capital assets | (779,537) |
| Proceeds from disposal of capital assets | 39,956 |
| NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES | <u>(739,581)</u> |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | |
| Operating transfer out to general fund | (1,500,000) |
| NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES | <u>(1,500,000)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,264,069) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR | <u>3,553,564</u> |
| CASH AND CASH EQUIVALENTS, END OF THE YEAR | <u>\$ 2,289,495</u> |

See accompanying notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
STATEMENT OF CASH FLOWS (Continued)
YEAR ENDED JUNE 30, 2011

RECONCILIATION OF INCOME FROM OPERATIONS TO NET
CASH PROVIDED BY OPERATING ACTIVITIES:

| | | |
|---|--------|---------------------------|
| Income from operations | \$ | 238,309 |
| Adjustments to reconcile income from operations to net cash provided by operating activities: | | |
| Depreciation | | 432,712 |
| (Increase) decrease in assets: | | |
| Motor vehicle rental receivable | | 69,565 |
| Inventories | | (4,983) |
| Increase (decrease) in liabilities: | | |
| Accounts payable | | 33,249 |
| Accrued wages payable | | 8,291 |
| Accrued vacation payable | | 5,488 |
| Net OPEB obligation | | 89,977 |
| | | 634,299 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | \$ | <u><u>872,608</u></u> |

See accompanying notes to financial statements.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The State Motor Pool Revolving Fund (the "Fund") was established pursuant to Act 77, Session Laws of Hawaii 1963 (Section 26-6 of the Hawaii Revised Statutes). The Fund is responsible for providing safe and economical transportation for the personnel of state departments and agencies requiring the use of passenger vehicles in connection with official state business. All monies collected are used for the acquisition, operation, repair, maintenance, storage, and disposition of all state-owned vehicles assigned to the State Motor Pool.

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for State and Local Governments through its pronouncements (Statements and Interpretations). Governments are required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 (when applicable) that do not conflict with or contradict GASB pronouncement. The more significant accounting policies established by GAAP and used by the Fund are discussed below.

Basis of Accounting - The Fund is an internal service fund (proprietary fund type) as defined by the Governmental Accounting Standards Board (GASB), which uses the flow of economic resources measurement focus and accrual basis of accounting, as generally applied to commercial enterprises. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary Funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering 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.

Reporting Entity - The financial statements reflect only the Fund's financial activities. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State of Hawaii (State) annually, which include the Fund's financial activities.

Net Assets - Net assets are reported into two categories: net assets invested in capital assets, net of related debt and unrestricted net assets.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates - The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the basic financial statements and accompanying notes. Actual results could differ from those estimates.

Special Assessments - HRS Section 36-27 requires that the Fund be assessed its pro rata share of central service expenses of government in relation to other special funds based on a percentage of the Fund's receipts. HRS Section 36-30 requires that the Fund be assessed its pro rata share of administrative expenses incurred by the Department of Accounting and General Services (DAGS), based on the ratio of the general administrative service expenses to DAGS' net departmental expenses. There was no HRS Section 36-27 or HRS Section 36-30 assessment in 2011.

Risk Management - The Fund is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. As part of the State Department of Accounting and General Services, the Fund is insured under the State of Hawaii (the State) as follows: The State generally retains the first \$1 million per occurrence of property losses, the first \$4 million with respect to general liability claims, and the first \$500,000 of losses due to crime. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$100 million, except for flood and earthquake which individually is \$100 million aggregate loss, and terrorism which is \$50 million per occurrence. The annual aggregate for general liability losses and losses due to crime per occurrence is \$10 million each. The State also has an insurance policy to cover medical malpractice risk in the amount of \$25 million per occurrence and \$29 million in the aggregate. The State is generally self-insured for workers' compensation and automobile claims.

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

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Operating Transfers - Operating transfers between funds occur when a fund receiving revenues transfers resources to a fund where the resources are to be expended or when nonrecurring or nonroutine transfers of equity between funds occur. For the fiscal year ended June, 30, 2011, the Fund transferred to the General Fund, \$1,500,000.

Compensated Absences - It is the Fund's policy to permit employees to accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since sick leave is not convertible to pay upon termination of employment. All vacation pay is accrued when incurred. A liability for these amounts is reported only if they have matured, for example, as a result of employee resignations and retirements.

Deferred Compensation Plan - The Fund offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code Section 457. The Plan, available to all Fund employees, permits employees to defer a portion of their compensation 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 Fund has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the Fund's deferred compensation plan are not reported in the accompanying basic financial statements.

Cash and Cash Equivalents - Cash and cash equivalents include all cash, repurchase agreements, and U.S. government securities with original maturities of three months or less, and all time certificates of deposit. For purposes of the statement of cash flows, the Fund has defined cash equivalents to be all highly liquid investments with a maturity of three months or less when purchased.

Investments - Investments in U.S. government securities and time certificates of deposit are carried at fair value based on quoted market prices. Investments in repurchase agreements are carried at cost. Investments in student loan auction rate securities are reported at fair value, which is generally calculated using the present value of projected cash flows methodology.

Inventories - Inventories, principally supplies, are stated at the lower of cost or market, with cost being determined by the first-in, first-out method (FIFO).

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets - Capital assets are defined by the Fund as vehicles, shop equipment, furniture and fixtures. Infrastructures used by the Fund are not included. Capital assets included in the financial statements are assets with estimated useful lives greater than one year and acquisition costs greater than the following amounts:

| | |
|--|---------|
| Vehicles | \$5,000 |
| Shop equipment, furniture and fixtures | 5,000 |

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at their estimated fair market value at the date of donation. Transfers are recorded at cost, net of the depreciation which would have been charged had the asset been directly acquired by the Fund. Maintenance and repairs are charged to operations when incurred. Betterments and major improvements which significantly increase values, change capacities, or extend useful lives are capitalized. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the respective accounts, and any resulting gain or loss is recognized in the statement of revenues, expenses and changes in net assets.

Capital assets are depreciated using the straight-line method over the following estimated useful lives:

| | |
|--|---------------------|
| | <u>Useful Lives</u> |
| Vehicles | 10 years |
| Shop equipment, furniture and fixtures | 5 – 7 years |

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

The Director of Finance is responsible for the safekeeping of all monies deposited into the State Treasury. The Director of Finance pools and invests any monies of the State, which in the Director of Finance’s judgment, are in excess of the amounts necessary for meeting the specific requirements of the State. Investment earnings are allocated to the Fund based on its equity interest in the pooled monies. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, auction rate securities, and repurchase

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

agreements with federally-insured financial institutions. Pooled cash balances invested included auction rate securities, which were determined to be impaired in 2008 and 2009. In 2011, the Fund's allocated share of investment losses decreased by \$46,497. The cumulative net loss on investments was \$691 as of June 30, 2011.

3. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011, was as follows:

| | <u>Beginning Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending Balance</u> |
|--|------------------------------|-------------------|------------------|---------------------------|
| Vehicles | \$ 5,457,440 | \$ 770,141 | \$ 340,999 | \$ 5,886,582 |
| Shop equipment, furniture & fixtures | <u>74,762</u> | <u>37,700</u> | <u>-</u> | <u>112,462</u> |
| Total capital assets | <u>5,532,202</u> | <u>807,841</u> | <u>340,999</u> | <u>5,999,044</u> |
| Less accumulated depreciation for: | | | | |
| Vehicles | (4,260,823) | (432,711) | (277,047) | (4,416,487) |
| Shop equipment, furniture & fixtures | <u>(68,370)</u> | <u>-</u> | <u>-</u> | <u>(68,370)</u> |
| Total accumulated depreciation | <u>(4,329,193)</u> | <u>(432,711)</u> | <u>(277,047)</u> | <u>(4,484,857)</u> |
| Total capital assets, net of depreciation | <u>\$ 1,203,009</u> | <u>\$ 375,130</u> | <u>\$ 63,952</u> | <u>\$ 1,514,187</u> |

4. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

| | |
|---|-------------------|
| Accrued vacation payable | \$ 164,709 |
| Accrued wages payable | 33,624 |
| Accrued workers' compensation | <u>8,700</u> |
| | 207,033 |
| Less current portion | <u>(49,669)</u> |
| Total accrued liabilities, net of current portion | <u>\$ 157,364</u> |

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

5. WORKERS' COMPENSATION RESERVE

The Fund is fully self-insured for workers' compensation and disability claims which are expensed when incurred. The Fund pays a portion of wages, medical bills, and judgments as stipulated by the Department of Labor and Industrial Relations, and other costs for injured workers. During the year ended June 30, 2011, there were no payments for workers' compensation claims and disability expenses. The Fund has recorded a reserve of \$8,700 for the expected cost of open reported claims based on historical cost information for closed and open claims as of June 30, 2011.

6. CHANGES IN NON-CURRENT LIABILITIES

Changes in non-current liabilities were as follows:

| | <u>Beginning</u> <u>Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending</u> <u>Balance</u> | <u>Due within</u> <u>one year</u> |
|-------------------------------|------------------------------------|------------------|------------------|---------------------------------|--------------------------------------|
| Accrued liabilities | \$ 193,254 | \$ 75,039 | \$ 61,260 | \$ 207,033 | \$ 49,669 |
| Net OPEB obligation | <u>256,953</u> | <u>123,948</u> | <u>33,971</u> | <u>346,930</u> | <u>-</u> |
| Total non-current liabilities | <u>\$ 450,207</u> | <u>\$198,987</u> | <u>\$ 95,231</u> | <u>\$ 553,963</u> | <u>\$ 49,669</u> |

7. RETIREMENT BENEFITS

Employees' Retirement System

All eligible employees of the Fund are required by HRS Chapter 88 to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits, as well as death and disability benefits and is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. The report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

7. RETIREMENT BENEFITS (Continued)

Employees' Retirement System (Continued)

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new non-contributory plan 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 non-contributory plan. The non-contributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new non-contributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and non-contributory plans, respectively.

Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 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. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

Most covered employees of the contributory plan 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. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The State's contribution requirement as of June 30, 2010, 2009 and 2008, based on the most recent information available, was approximately \$398,724,000, \$387,748,000, and \$377,475,000 respectively. The State contributed 100% of its required contributions for those years. The Fund's covered payroll was approximately \$553,153 in 2011. The retirement plan contributions charged to the Fund's operation was \$77,910 in 2011.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

7. RETIREMENT BENEFITS (Continued)

Post-Retirement Health Care and Life Insurance Benefits

The State provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH of 2001, the State contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The EUTF currently provides medical, prescription drug, dental, vision, chiropractic, and group life insurance benefits. The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

For employees hired before July 1, 1996, the State pays the entire monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

7. RETIREMENT BENEFITS (Continued)

Funding Policy and Annual OPEB Cost

Effective July 1, 2006, the EUTF implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires defined benefit OPEB plans that are administered as trust or equivalent arrangements to prepare a statement of plan assets and a statement of changes in plan assets.

The reporting of active and retiree (including their respective beneficiaries) healthcare benefits provided through the same plan should separate those benefits for accounting purposes between active and retiree healthcare benefits. Accordingly, the EUTF reports the retiree healthcare benefits as OPEB in conformity with GASB 43 and the active employee healthcare benefits as risk financing in conformity with GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10), as amended.

Effective July 1, 2007, the State of Hawaii adopted GASB Statement 45, *Accounting and Financial Reporting by Employer for Postemployment Benefits Other Than Pensions* (GASB 45), which requires reporting the OPEB liability on an accrual basis. Because the Statement was implemented on a prospective basis, the OPEB liability at transition was zero.

The State is required by GASB 45 to obtain an actuarial valuation every other year, therefore, an actuarial valuation was performed for July 1, 2009.

The State's base contribution levels to EUTF are established by statutes. The retiree is responsible to pay the difference if the base contribution is less than the cost of the monthly premium.

The State's base contribution levels are currently tied to the pay-as-you-go amount necessary to provide current benefits to retirees. The State's annual OPEB cost for each plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters in GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The actuarial methods and assumptions used to compute the ARC is disclosed in the notes to the financial statements of the State of Hawaii's comprehensive annual financial report. The Fund's

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
NOTES TO THE FINANCIAL STATEMENTS (Continued)
JUNE 30, 2011

7. RETIREMENT BENEFITS (Continued)

Funding Policy and Annual OPEB Cost (Continued)

contribution for the years ended June 30, 2011, 2010, and 2009 were \$33,970, \$35,453 and \$51,459, respectively.

For the year ended June 30, 2011, total annual required contribution of \$846,916,000 was recognized for post-retirement health care and life insurance benefits by the State of which \$248,200,000 was paid in 2011 and a net OPEB obligation of \$598,716,000 remained as of June 30, 2011. The Fund's share of the total annual required contribution was \$123,948, of which \$33,970 was paid in 2011. A net OPEB obligation of \$346,930 is presented in the statement of net assets at June 30, 2011.

8. COMMITMENTS AND CONTINGENCIES

Accumulated Sick Leave Pay

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, an 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 the ERS. As of June 30, 2011, accumulated sick leave was approximately \$499,522.

PART IV

INTERNAL CONTROL AND COMPLIANCE SECTION

REPORT 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, Department of Accounting and General Services, State Motor Pool Revolving Fund (the “Fund”) as of and for the year ended June 30, 2011, and have issued our report thereon dated February 2, 2012. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the 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 deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Fund’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting 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 agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to governance of the Fund, in a separate letter dated February 2, 2012.

This report is intended solely for the information and use of the management of the Fund, the Department of Accounting and General Services and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

COPY

**Original document signed by
Egami & Ichikawa CPAs, Inc.**

Honolulu, Hawaii
February 2, 2012

PART V

SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2011

SECTION I - SUMMARY OF AUDITORS' RESULTS

FINANCIAL STATEMENTS:

| | |
|--|----------------------|
| Type of auditors' report issued: | <u>Unqualified</u> |
| Internal control over financial reporting: | |
| Material weaknesses identified? | <u>No</u> |
| Reportable condition identified that is not considered to be material weakness | <u>None reported</u> |
| Noncompliance material to financial statements noted? | <u>No</u> |

SECTION II - FINANCIAL STATEMENT FINDINGS

Status of Prior Year's Comments

No matters were reported.

Current Year's Comments

No matters were reported.

PART VI
CORRECTIVE ACTION PLAN

STATE OF HAWAII
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE MOTOR POOL REVOLVING FUND
CORRECTIVE ACTION PLAN
YEAR ENDED JUNE 30, 2011

A corrective action plan is not required since there were no audit findings and questioned costs reported for the year ended June 30, 2011.