

**State of Hawaii**  
**Department of Health**  
**Financial and Compliance Audit**  
**June 30, 2011**

**Submitted by**  
**The Auditor**  
**State of Hawaii**

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**Department of Health**  
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## Report of Independent Auditors

The Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department"), as of and for the year ended June 30, 2011, which collectively comprises the Department's basic financial statements as listed in the index. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions 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 opinions.

As discussed in Note 1, the basic financial statements of the Department are intended to present the financial position and the changes in the financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2011, or the changes in its financial position and cash flows, where applicable, thereof 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 respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2011, and the respective changes in financial position and, where applicable, 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 March 22, 2012 on our consideration of the Department'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 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 and budgetary comparison information on pages 3 through 11 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements as a whole. The accompanying schedule of expenditures of federal awards (the "Schedule") is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is not a required part of the financial statements. As described in Note 1 to the Schedule, the accompanying Schedule was prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects on the basis of accounting described in Note 1 to the Schedule, in relation to the basic financial statements as a whole.

*Accuity LLP*

Honolulu, Hawaii  
March 22, 2012

**State of Hawaii**  
**Department of Health**  
**Management's Discussion and Analysis (Unaudited)**  
**June 30, 2011**

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This Management Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities and performance of the State of Hawaii, Department of Health (the "Department") during the fiscal year that ended on June 30, 2011. Please read it in conjunction with the Department's Financial Statements including its related notes (which follow this section) as well as the subsequent Schedule of Expenditures of Federal Awards ("SEFA"). The following is a brief description of the contents of those three sections:

**Overview of the Financial Statements**

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements; (2) fund financial statements; and (3) notes to the basic financial statements.

***Department-wide Financial Statements***

The department-wide financial statements provide information about the Department's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consist of the Statement of Net Assets and the Statement of Activities.

The department-wide statements report information about the Department as a whole using accounting methods similar to those used by private sector companies. The statement of net assets provides both short-term and long-term information about the Department's financial position, which assists in assessing the Department's economic condition at the end of the fiscal year. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The department-wide financial statements include two statements:

- The *Statement of Net Assets* presents all of the Department's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases and decreases in the Department's net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.
- The *Statement of Activities* presents information showing how the Department's net assets changed during the most recent fiscal year.

The department-wide financial statements of the Department are further divided into two categories:

- *Governmental activities* –The activities in this section are primarily supported by State of Hawaii appropriations, funds from the tobacco settlement, beverage container deposit administrative fees, federal grants, and fees.
- *Business-type activities* –These functions normally are intended to recover all or a significant portion of their costs through user's fees and charges to external users. These activities include the Department's two revolving loan funds.

***Fund Financial Statements***

The fund financial statements include the Department's: (1) governmental funds, for which activities are funded primarily from appropriations from the State of Hawaii, by revenues from the tobacco settlement agreement, beverage container deposit program and federal grants; (2) proprietary funds, which consist of revolving loan funds and are reported similar to business activities; and (3) fiduciary funds. The governmental funds are presented on the modified accrual basis of accounting. The proprietary and the fiduciary funds are presented on the accrual basis of accounting.

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The fund financial statements provide more detailed information about the Department's most significant funds and not the Department as a whole. In these statements, the financial activities of the Department are recorded in individual funds. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Funds are reported as a major fund or a non-major (other) fund. The Governmental Accounting Standards Board ("GASB") issued Statement 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments*, which sets forth the minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

The fund financial statements also include the budgetary comparison statements, which include reconciliations for the general fund, tobacco settlement fund, and deposit beverage container fund, comparing the excess of revenues over expenditures presented on a budgetary basis to the excess (deficiency) of revenues over expenditures presented in conformity with generally accepted accounting principles ("GAAP") as presented in the governmental fund financial statements.

To reiterate, the Department has three types of funds:

- *Governmental funds* – Governmental funds are used to account for essentially the same functions reported in the governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, governmental financial statements focus on near-term inflows and outflows of expendable resources as well as on the balances of expendable resources available at the end of the fiscal year.

Because the focus of governmental funds is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. Both the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate comparison between governmental funds and governmental activities in the department-wide financial statements.

- *Proprietary funds* – Proprietary funds are used to report activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the department-wide financial statements. The Department uses enterprise funds to account for the operations of its two revolving loan funds each of which are considered to be major funds of the Department.
- *Fiduciary funds* – The fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

**Notes to Financial Statements**

The *Notes to Financial Statements* section provides additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements follow the basic financial statements.

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**Schedule of Expenditures of Federal Awards**

Other information consists of the Schedule of Expenditures of Federal Awards and the Notes to the Schedule of Expenditures of Federal Awards. The SEFA reports federal awards to the Department expended on the cash basis of accounting for the year ended June 30, 2011.

**Financial Highlights**

- The Department's total net assets increased from \$707.0 million as of June 30, 2010 to \$746.0 million as of June 30, 2011, or by approximately \$39.0 million. The total increase in net assets was attributed to an increase in the Department's business type activities' net assets of \$41.1 million, offset by a decrease in governmental activities' net assets of \$2.1 million during the year.
- The Department's governmental funds reported an aggregate decrease in fund balance of approximately \$2.6 million during the year totaling \$144.3 million at June 30, 2011. Note that this is based on the fund balance at June 30, 2010 of \$146.9 million.
- The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net assets of \$41.1 million for FY 2011. Total net assets were \$560.6 million at June 30, 2011 compared to the FY 2010 year end total of \$519.5 million.

**Department-Wide Financial Analysis**

This section includes condensed Department-wide financial information and analysis.

**Statement of Net Assets**  
**June 30, 2011**  
**(\$000)**

	<b>Governmental Activities</b>		<b>Business-Type Activities</b>		<b>Total</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Current assets	\$ 257,202	\$ 262,645	\$ 174,618	\$ 157,351	\$ 431,820	\$ 419,996
Capital assets	61,255	60,452	333	203	61,588	60,655
ARRA advances	-	-	37,984	23,693	37,984	23,693
Loans receivable, noncurrent	-	-	349,450	339,295	349,450	339,295
<b>Total assets</b>	<b>\$ 318,457</b>	<b>\$ 323,097</b>	<b>\$ 562,385</b>	<b>\$ 520,542</b>	<b>\$ 880,842</b>	<b>\$ 843,639</b>
Current liabilities	\$ 114,363	\$ 118,368	\$ 565	\$ 262	\$ 114,928	\$ 118,630
Long term liabilities	18,722	17,271	1,170	760	19,892	18,031
<b>Total liabilities</b>	<b>133,085</b>	<b>135,639</b>	<b>1,735</b>	<b>1,022</b>	<b>134,820</b>	<b>136,661</b>
<b>Net assets</b>						
Invested in capital assets	61,255	60,452	333	204	61,588	60,656
Restricted	115,877	124,714	560,317	519,316	676,194	644,030
Unrestricted	8,240	2,292	-	-	8,240	2,292
<b>Total net assets</b>	<b>185,372</b>	<b>187,458</b>	<b>560,650</b>	<b>519,520</b>	<b>746,022</b>	<b>706,978</b>
<b>Total liabilities and net assets</b>	<b>\$ 318,457</b>	<b>\$ 323,097</b>	<b>\$ 562,385</b>	<b>\$ 520,542</b>	<b>\$ 880,842</b>	<b>\$ 843,639</b>

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As noted earlier, changes in net assets may serve over time as a useful indicator of the Department's financial position. As of June 30, 2011, the Department's total net assets were approximately \$746.0 million.

At June 30, 2011, in addition to cash in the state treasury approximating \$291.4 million, the Department had total loans receivable from county governments in the amount of \$381.5 million arising from its two revolving loan funds. The Department had total liabilities of \$134.8 million at June 30, 2011 of which \$9.5 million relates to accrued wages and employee benefits payable. Approximately \$45.6 million in liabilities relate to vouchers and contracts payable. At June 30, 2011, restricted net assets were \$676.2 million. The restrictions arise from legal and contractual agreements.

**Statement of Activities**  
**June 30, 2011**  
**(\$000)**

	<b>Governmental Activities</b>		<b>Business-Type Activities</b>		<b>Total</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<b>Revenue</b>						
Program revenues						
Charges for services	\$ 32,627	\$ 43,670	\$ 7,488	\$ 7,323	\$ 40,115	\$ 50,993
Operating grants and contributions	114,989	107,682	31,415	54,964	146,404	162,646
General revenues						
State appropriated funds	367,144	382,031	-	-	367,144	382,031
Non imposed fringe benefits	39,851	45,689	-	-	39,851	45,689
Tobacco settlement funds	46,986	50,925	-	-	46,986	50,925
Environmental fees and taxes	37,930	38,331	-	-	37,930	38,331
Total revenues	<u>639,527</u>	<u>668,328</u>	<u>38,903</u>	<u>62,287</u>	<u>678,430</u>	<u>730,615</u>
<b>Expenses</b>						
General administration	34,937	34,594	-	-	34,937	34,594
Environmental health	71,422	66,007	3,644	2,572	75,066	68,579
Behavior health	205,541	213,745	-	-	205,541	213,745
Health resources	280,180	280,521	-	-	280,180	280,521
Total expenses	<u>592,080</u>	<u>594,867</u>	<u>3,644</u>	<u>2,572</u>	<u>595,724</u>	<u>597,439</u>
Excess before transfers	47,447	73,461	35,259	59,715	82,706	133,176
Transfers	(49,533)	(54,516)	5,872	2,675	(43,661)	(51,841)
Change in net assets	(2,086)	18,945	41,131	62,390	39,045	81,335
<b>Net assets</b>						
Beginning of year	<u>187,458</u>	<u>168,513</u>	<u>519,519</u>	<u>457,129</u>	<u>706,977</u>	<u>625,642</u>
End of year	<u>\$ 185,372</u>	<u>\$ 187,458</u>	<u>\$ 560,650</u>	<u>\$ 519,519</u>	<u>\$ 746,022</u>	<u>\$ 706,977</u>

Governmental activities decreased the Department's net assets by \$2.1 million in FY 2011. There was a decrease in the State appropriated funds of \$14.9 million from FY 2010 to FY 2011. The decrease was due mainly to the incorporation of the 2009 Reduction-In-Force cuts and furlough savings into the Department's budget appropriation.

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Revenues of the Department's business-type activities, which decreased by \$23.4 million from 2010, consist of the Department's environmental loan programs — one for water pollution control and the other for drinking water treatment — were generated from charges for services, program investment income, and federal assistance program funds as well as state matching funds. Charges for services consist primarily of administration loan fees and interest income on loans related to the Department's two revolving loan programs. The majority of the programs investment income is from the Department's participation in the State Treasury Investment Pool System.

For the fiscal year ended June 30, 2011, business-type activities increased the Department's net assets by \$41.1 million to \$560.6 million as compared to the fiscal year ending June 30, 2010.

Total Department-wide expenses for FY 2011 were \$595.7 million of which \$592.1 million was for governmental activities. As compared to FY 2010, total Department-wide expenses were \$597.4 million of which \$594.9 million was for governmental activities. Overall, the Department is organized into four major administrations.

The Behavioral Health Services Administration expended a significant 34.5% or \$205.5 million of departmental funds with a decrease of \$8.2 million over FY 2010. This administration is responsible for providing available and coordinated mental health and substance abuse treatment and prevention programs. Programs within this administration are:

- Adult Mental Health Division ("AMHD") that includes the Hawaii State Hospital and Community Mental Health Center Branches;
- Child and Adolescent Mental Health Division ("CAMHD") which includes seven Family Guidance Centers and the Family Court Liaison Branches; and
- Alcohol and Drug Abuse Division ("ADAD") which plans for and purchases substance abuse prevention and treatment services for adolescents and adults.

A portion of the decrease in expenditures is attributed to a decrease in the AMHD's client count which resulted from the change in eligibility criteria and the movement of consumers back to their commercial insurance plans. In FY 2011, AMHD serviced 11,194 clients as compared to the 14,633 clients serviced in FY 2010. AMHD's Access Line continues to provide the community with a resource site for information as well as a referral point for possible clients. CAMHD continues to respond to the ongoing requirements of the settled Felix case, while ADAD is still responsible for implementing the "Ice" (nickname for methamphetamine) initiative. The programs were also assessed \$1.83 million in restrictions for FY 2011 which contributed to the decrease in expenditures.

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The Health Resources Administration expended approximately 47.0% of all expenses. FY 2011 expenditures for this Administration decreased \$0.3 million over FY 2010. Major programs included in this administration include:

- Developmental Disabilities Division (“DDD”) that services disabled clients in Hawaii while addressing the conditions of the Makin Settlement;
- Family Health Services Division (“FHSD”) that administers the State’s Early Intervention program for children zero to three in compliance with the Federal Individual with Disabilities Education Act, Part C as well as serving children, youth and families through its three branches, namely, Children with Special Health Needs, Maternal and Child Health, and Women Infants and Children;
- Emergency Medical Services and Injury Prevention System Branch that includes the State’s mandated Emergency Medical Services, which operates the State’s emergency ambulance service in the four major counties, and the injury prevention program;
- Communicable Disease Division which provides tuberculosis control, Hansen’s disease control programs in the community and at Kalaupapa, and STD/AIDS prevention services;
- Disease Outbreak Control Division which provides immunization and disease investigation services as well as provides emergency response to disease outbreaks and potential acts of bioterrorism;
- General Medical and Preventative Services Division (formerly Dental Health Division) which is the smallest division in this administration and implements a dental hygiene program in the public schools and provides public health dental services to the State’s disabled clientele.

This administration provides a wide array of public health services in addition to meeting the court settlement conditions, which results in the expenditure of a high percentage of departmental funds.

The Environmental Health Administration is responsible for the management of the clean air, clean water, solid and hazardous waste, public health sanitation, vector control, and purity of food and drugs. It expended approximately 12.6% of the departmental funds with an increase of \$6.5 million expended over FY 2010. The increase in expenditures is due mainly to increased costs incurred by the Deposit Beverage Container Program. Other programs in this administration are heavily federally funded through the Environmental Protection Agency. This administration also manages both the Water Pollution Control Revolving and the Drinking Water Treatment Revolving Loan Funds.

Finally, General Administration provides the overall leadership and oversight for the Department. It includes administrative support staff, three district health offices, and five administratively attached agencies. This administration expends approximately 5.9% of the departmental funds.

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The following table presents revenues and expenditures of the governmental funds for FY 2011 and FY 2010 (\$000):

	<b>2011</b>	<b>2010</b>
<b>Revenues</b>		
State general fund allotments	\$ 367,143	\$ 382,030
Nonimposed fringe benefits	39,851	45,689
Tobacco settlement funds	46,986	50,925
Deposit beverage container program	18,387	18,027
Intergovernmental	124,260	130,034
Taxes, fees, fines and other	42,188	33,782
Investment income	3,913	9,219
Total revenues	642,728	669,706
<b>Expenditures</b>		
General administration	34,524	32,910
Environmental health	70,874	66,236
Behavioral health	206,248	211,548
Health resources	278,262	282,151
Total expenditures	589,908	592,845
Excess of revenues over expenditures before transfers	\$ 52,820	\$ 76,861

The governmental funds revenue consist of the Department's general fund, tobacco settlement funds, deposit beverage container funds, intergovernmental (federal) funds, taxes, fees, fines and investment income.

During the fiscal year ended June 30, 2011, general fund revenues were \$400.5 million, including \$39.7 million for fringe benefits paid directly from the State general fund. General fund expenditures were \$382.6 million, including the \$39.7 million for fringe benefits discussed above.

For FY 2011, the tobacco settlement fund earned revenues of \$48.0 million, including investment income of \$1.0 million. \$46.4 million was transferred to other State departments and agencies of which \$6.7 million was for the State's Emergency and Budget Reserve Fund (a.k.a. Rainy Day Fund), \$12.4 million was for the University of Hawaii to pay debt service on revenue bonds to support construction of a new health and wellness center, to include a new medical school and bio-research center in Kakaako, and \$12.1 million was required to be transferred to the State's General Fund in accordance with Act 79/90.

In FY 2011, the deposit beverage container fund earned revenues of \$19.2 million from beverage container deposit administrative fees and unredeemed containers and investment income. Of this amount received, \$30.3 million was paid to recycling centers, or utilized to fund the program. The bottle bill fund collected \$45.9 million in deposits from distributors and repaid \$35.0 million in deposits to consumers during FY 2011.

The proprietary funds consist of two funds: Water Pollution Control Revolving Fund and Drinking Water Treatment Revolving Loan Fund and are reported in the statement of net assets and statement of activities as business-type activities.

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The Water Pollution Control Revolving Fund accounts for federal and state funds used to provide loans to county governments for the construction of wastewater treatment facilities and the repayment of principal, interest and fees from such loans and investment of such monies. During FY 2011, this fund received \$12.1 million and \$3.2 million of federal and state funds, respectively. The fund also disbursed \$33.6 million in loan proceeds and collected \$25.6 million in principal repayments in 2011. As compared to 2010, the fund collected \$17.5 million and \$1.0 million in federal and state contributions, and disbursed \$66.6 million in loan proceeds and collected \$22.0 million in principal payments.

The Drinking Water Treatment Revolving Loan Fund accounts for federal and state match funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment of principal interest and fees from such loans and the investment of such monies. During FY 2011, this fund received \$14.2 million and \$2.7 million of federal and state funds, respectively. The fund also disbursed \$9.2 million in loan proceeds and collected \$4.5 million in principal repayments in 2011. As compared to 2010, the fund collected \$26.2 million and \$1.6 million in federal and state contributions, and disbursed \$18.3 million in loan proceeds and collected \$3.7 million in principal payments.

The Department accounts for funds held as an agent and/or trustee for certain individuals in the fiduciary funds.

**Budgetary Analysis**

The following budget information relates to the general fund, tobacco settlement fund, and deposit beverage container fund for 2011:

	<b>Budgeted Amounts (\$000)</b>		<b>Actual on a Budgetary Basis (\$000)</b>
	<b>Original</b>	<b>Final</b>	
<b>General fund</b>			
Revenues	\$ 382,751	\$ 382,751	\$ 367,789
Expenditures			
General administration	16,911	16,911	15,469
Environmental health	15,741	15,741	14,329
Behavioral health	184,861	184,861	179,895
Health resources	165,238	165,238	158,096
<b>Tobacco settlement fund</b>			
Revenues	50,135	50,135	47,005
Expenditures	50,135	50,135	40,512
<b>Deposit beverage container fund</b>			
Revenues	71,056	71,056	55,069
Expenditures	71,056	71,056	65,291

The differences between the original budgeted appropriation and actual expenditures for the general fund were due in part to the \$7.1 million in restrictions that were assessed against the Department for FY 2011.

For the tobacco settlement fund, the actual expenditures of \$40.5 million in FY 2011 were \$6.5 million less than the actual revenues received.

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The deposit beverage container program recognized revenues from the program's beverage container deposit administrative fees and unredeemed deposits of \$18.4 million, which is based on the actual number of containers sold. In fiscal year 2010, there were 901,861,628 containers sold. The amount of containers sold increased to 907,119,634 in fiscal year 2011.

**Capital Assets**

As of June 30, 2011, the Department's governmental activities had invested approximately \$61.3 million (net of accumulated depreciation) in a broad range of capital assets. See Note 4 to the Department's financial statements for a description of capital assets activities for the fiscal year ended June 30, 2011.

**Capital Assets**  
**Governmental Activities**  
**June 30, 2011**  
**(\$000)**

	<b>2011</b>	<b>2010</b>
Land	\$ 1,018	\$ 1,018
Land and building improvements	144,579	138,828
Furniture and equipment	22,691	22,646
Total	168,288	162,492
Accumulated depreciation	107,033	102,040
Total capital assets, net	\$ 61,255	\$ 60,452

**Currently Known Facts, Decisions, or Conditions**

The effects of the ongoing slowdown in the State's economy compounded the Department's challenge to continue to provide needed services to ensure the overall health and safety of the people of our state, especially in the areas of mental health and developmental disabilities.

The Department has continued to evaluate and monitor the statewide service delivery system of the adult mental health program in order to improve service delivery and to contain operational costs.

In the developmental disabilities program, the number of clients increased by 132 clients in FY 2011. In FY 2011, the program served 2,617 clients in the home and community-based waiver program as compared to 2,485 clients served in FY 2010. Further, the Federal Medical Assistance Percentage ("FMAP") increased from 66.13% to 67.35% for the period April 2009 through December 2010. The FMAP decreased to 64.52% for the period January 2011 to March 2011 and decreased again to 62.63% for the period April 2011 through June 2011. The FY 2011 year-end Average Cost per Client ("APC") decreased to \$38,619 as compared to the FY 2010 year-end APC of \$43,267. With the increase in the number of clients, program management continues to reevaluate the program and its services to achieve operational efficiencies.

And lastly, the Drinking Water Treatment Revolving Loan Fund ("DWTRLF") executed a total of three loan agreements for \$5.2 million during FY 2011. Further, the Water Pollution Control Revolving Fund ("WPCRF") expects to execute a total of four loan agreements in the amount of \$36.8 million while the DWTRLF expects to execute a total of four loan agreements for \$5.0 million in FY 2012.

**State of Hawaii**  
**Department of Health**  
**Department-wide – Statement of Net Assets**  
**June 30, 2011**

	<b>Governmental Activities</b>	<b>Business-Type Activities</b>	<b>Total</b>
<b>Assets</b>			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 151,040,352	\$ 140,401,290	\$ 291,441,642
Receivables			
Due from State Treasury	61,522,765	-	61,522,765
Due from other State agencies	7,561,000	-	7,561,000
Accrued interest and loan fees	52,080	2,058,499	2,110,579
Accounts receivable	4,970,473	-	4,970,473
Due from Federal government	5,155,404	142,807	5,298,211
Tobacco settlement receivable	26,900,000	-	26,900,000
Current maturities of loans receivable	-	32,015,408	32,015,408
	<u>106,161,722</u>	<u>34,216,714</u>	<u>140,378,436</u>
Total current assets	257,202,074	174,618,004	431,820,078
ARRA advances	-	37,983,922	37,983,922
Loans receivable, net of current maturities	-	349,449,555	349,449,555
Capital assets, net of accumulated depreciation	61,254,542	333,282	61,587,824
Total assets	<u>\$ 318,456,616</u>	<u>\$ 562,384,763</u>	<u>\$ 880,841,379</u>
<b>Liabilities and Net Assets</b>			
Current liabilities			
Vouchers and contracts payable	\$ 45,279,261	\$ 343,701	\$ 45,622,962
Accrued wages and employee benefits payable	9,346,674	117,495	9,464,169
Accrued vacation, current portion	8,369,778	103,803	8,473,581
Workers' compensation liability	325,697	-	325,697
Deferred income	417,391	-	417,391
Due to other State agencies	26,215,204	-	26,215,204
Beverage container deposits	24,409,272	-	24,409,272
Total current liabilities	<u>114,363,277</u>	<u>564,999</u>	<u>114,928,276</u>
Accrued vacation, net of current portion	18,721,815	348,185	19,070,000
Other postemployment benefits	-	821,187	821,187
Total liabilities	<u>133,085,092</u>	<u>1,734,371</u>	<u>134,819,463</u>
Commitments and contingencies			
Net assets			
Investment in capital assets	61,254,542	333,282	61,587,824
Restricted for			
Loans	-	560,317,110	560,317,110
Tobacco prevention and control	24,255,299	-	24,255,299
Capital projects	7,206,824	-	7,206,824
Other purposes	84,414,578	-	84,414,578
Unrestricted	8,240,281	-	8,240,281
Total net assets	<u>185,371,524</u>	<u>560,650,392</u>	<u>746,021,916</u>
Total liabilities and net assets	<u>\$ 318,456,616</u>	<u>\$ 562,384,763</u>	<u>\$ 880,841,379</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii  
Department of Health  
Department-wide – Statement of Activities  
Year Ended June 30, 2011**

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets Primary Government		
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Primary government						
Governmental activities						
General administration	\$ 34,936,799	\$ 706,923	\$ 17,294,470	\$ (16,935,406)	\$ -	\$ (16,935,406)
Environmental health administration	71,422,172	7,121,630	13,598,520	(50,702,022)	-	(50,702,022)
Behavioral health services administration	205,541,081	15,626,327	5,152,708	(184,762,046)	-	(184,762,046)
Health resources administration	280,180,571	9,171,663	78,942,904	(192,066,004)	-	(192,066,004)
Total governmental activities	<u>592,080,623</u>	<u>32,626,543</u>	<u>114,988,602</u>	<u>(444,465,478)</u>	<u>-</u>	<u>(444,465,478)</u>
Business-type activities						
Environmental health loan programs	3,644,180	7,488,089	31,415,091	-	35,259,000	35,259,000
Total business-type activities	<u>3,644,180</u>	<u>7,488,089</u>	<u>31,415,091</u>	<u>-</u>	<u>35,259,000</u>	<u>35,259,000</u>
Total primary government	<u>\$ 595,724,803</u>	<u>\$ 40,114,632</u>	<u>\$ 146,403,693</u>	<u>(444,465,478)</u>	<u>35,259,000</u>	<u>(409,206,478)</u>
General revenues						
State general fund allotments, net				367,143,408	-	367,143,408
Nonimposed employee fringe benefits				39,851,284	-	39,851,284
Environmental response tax				1,402,836	-	1,402,836
Deposit beverage container fee				18,386,834	-	18,386,834
Advance glass disposal fee				710,986	-	710,986
Tobacco tax				17,429,640	-	17,429,640
Tobacco settlement funds				46,986,259	-	46,986,259
Transfers				(49,532,535)	5,872,000	(43,660,535)
Total general revenues and transfers				<u>442,378,712</u>	<u>5,872,000</u>	<u>448,250,712</u>
Change in net assets				(2,086,766)	41,131,000	39,044,234
Net assets at July 1, 2010				<u>187,458,290</u>	<u>519,519,392</u>	<u>706,977,682</u>
Net assets at June 30, 2011				<u>\$ 185,371,524</u>	<u>\$ 560,650,392</u>	<u>\$ 746,021,916</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii  
Department of Health  
Governmental Funds – Balance Sheet  
June 30, 2011**

	General	Tobacco Settlement	Deposit Beverage Container	Other Funds	Total Governmental
<b>Assets</b>					
Equity in cash and cash equivalents and investments in State Treasury	\$ -	\$ 27,397,311	\$ 25,024,491	\$ 98,618,550	\$ 151,040,352
Due from State Treasury	53,934,098	-	-	7,588,667	61,522,765
Due from other State agencies	-	-	-	4,356,000	4,356,000
Accrued interest receivable	-	-	-	52,080	52,080
Accounts receivable	-	-	4,970,473	-	4,970,473
Due from Federal government	-	-	-	5,155,404	5,155,404
Total assets	<u>\$ 53,934,098</u>	<u>\$ 27,397,311</u>	<u>\$ 29,994,964</u>	<u>\$ 115,770,701</u>	<u>\$ 227,097,074</u>
<b>Liabilities and Fund Balances</b>					
<b>Liabilities</b>					
Vouchers and contracts payable	\$ 14,945,854	\$ 691,812	\$ 11,869,690	\$ 16,023,405	\$ 43,530,761
Accrued wages and employee benefits	7,134,298	115,082	30,252	2,067,042	9,346,674
Deferred income	-	-	-	417,391	417,391
Due to other State agencies	2,763,586	2,335,118	-	-	5,098,704
Beverage container deposits	-	-	24,409,272	-	24,409,272
Total liabilities	<u>24,843,738</u>	<u>3,142,012</u>	<u>36,309,214</u>	<u>18,507,838</u>	<u>82,802,802</u>
<b>Fund balance (deficit)</b>					
<b>Restricted for</b>					
Federal grant programs	-	-	-	567,888	567,888
Trust fund programs	-	-	-	2,769,444	2,769,444
Medicaid programs	-	-	-	23,355,336	23,355,336
<b>Committed to</b>					
Health resources administration	-	-	-	39,717,460	39,717,460
Behavioral health administration	-	-	-	1,598,357	1,598,357
Environmental health administration	-	-	-	17,021,896	17,021,896
General administration	-	-	-	5,025,658	5,025,658
Tobacco settlement program	-	24,255,299	-	-	24,255,299
Deposit beverage container program	-	-	3,105,513	-	3,105,513
Capital projects activities	-	-	-	7,206,824	7,206,824
<b>Assigned to</b>					
Behavioral health administration	32,184,958	-	-	-	32,184,958
Health resources administration	7,435,082	-	-	-	7,435,082
General administration	1,254,819	-	-	-	1,254,819
Environmental health administration	248,828	-	-	-	248,828
<b>Unassigned</b>					
	<u>(12,033,327)</u>	<u>-</u>	<u>(9,419,763)</u>	<u>-</u>	<u>(21,453,090)</u>
Total fund balance	<u>29,090,360</u>	<u>24,255,299</u>	<u>(6,314,250)</u>	<u>97,262,863</u>	<u>144,294,272</u>
Total liabilities and fund balance	<u>\$ 53,934,098</u>	<u>\$ 27,397,311</u>	<u>\$ 29,994,964</u>	<u>\$ 115,770,701</u>	<u>\$ 227,097,074</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Reconciliation of the Governmental Funds' Fund Balance to the**  
**Governmental Activities' Net Assets**  
**June 30, 2011**

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Total fund balance – governmental funds	\$ 144,294,272
Amounts reported for governmental activities in the statement of net assets are different because	
Tobacco settlement receivable (net of vouchers payable and Due to State of Hawaii amounts) is not available for current financial resources and therefore is not reported as an asset in the governmental funds.	4,035,000
Capital assets used in governmental activities are not financial resources and therefore not reported as an asset in the governmental funds.	61,254,542
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds.	(27,091,593)
Workers' compensation liability reported in the statement of net assets does not require the use of current financial resources and therefore is not reported as a liability in the governmental funds.	(325,697)
Receivables from other State agencies are not available to pay for current-period expenditures and therefore are not reported as an asset in the governmental funds.	<u>3,205,000</u>
Net assets of governmental activities	<u>\$ 185,371,524</u>

**State of Hawaii**  
**Department of Health**  
**Governmental Funds – Statement of Revenues, Expenditures and Changes in Fund Balance**  
**Year Ended June 30, 2011**

	<b>General</b>	<b>Tobacco Settlement</b>	<b>Deposit Beverage Container</b>	<b>Other Funds</b>	<b>Total</b>
<b>Revenues</b>					
State allotment, net	\$ 360,721,408	\$ -	\$ -	\$ 6,422,000	\$ 367,143,408
Intergovernmental	-	-	-	124,259,869	124,259,869
Tobacco settlement	-	46,986,259	-	-	46,986,259
Deposit beverage container program	-	-	18,386,834	-	18,386,834
Nonimposed employee fringe benefits	39,749,136	-	-	102,148	39,851,284
Taxes, fees, fines and other	-	-	-	42,187,704	42,187,704
Investment income	-	979,984	830,418	2,102,393	3,912,795
Total revenues	<u>400,470,544</u>	<u>47,966,243</u>	<u>19,217,252</u>	<u>175,074,114</u>	<u>642,728,153</u>
<b>Expenditures</b>					
General administration	18,099,157	-	-	16,424,931	34,524,088
Environmental health	18,443,996	-	30,330,818	22,099,332	70,874,146
Behavioral health services	182,154,937	-	-	24,092,699	206,247,636
Health resources	163,915,801	8,490,661	-	105,855,475	278,261,937
Total expenditures	<u>382,613,891</u>	<u>8,490,661</u>	<u>30,330,818</u>	<u>168,472,437</u>	<u>589,907,807</u>
Excess (deficiency) of revenues over expenditures	17,856,653	39,475,582	(11,113,566)	6,601,677	52,820,346
<b>Other financing sources (uses)</b>					
Transfers in	-	1,078,773	-	24,955,450	26,034,223
Transfers out	<u>(12,100,561)</u>	<u>(46,367,652)</u>	<u>(1,300,000)</u>	<u>(21,655,401)</u>	<u>(81,423,614)</u>
Total other financing sources (uses)	<u>(12,100,561)</u>	<u>(45,288,879)</u>	<u>(1,300,000)</u>	<u>3,300,049</u>	<u>(55,389,391)</u>
Net change in fund balance	5,756,092	(5,813,297)	(12,413,566)	9,901,726	(2,569,045)
Fund balance at July 1, 2010	<u>23,334,268</u>	<u>30,068,596</u>	<u>6,099,316</u>	<u>87,361,137</u>	<u>146,863,317</u>
Fund balance at June 30, 2011	<u>\$ 29,090,360</u>	<u>\$ 24,255,299</u>	<u>\$ (6,314,250)</u>	<u>\$ 97,262,863</u>	<u>\$ 144,294,272</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Reconciliation of the Governmental Funds' Changes in Fund Balance to the**  
**Governmental Activities' Change in Net Assets**  
**Year Ended June 30, 2011**

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Net change in fund balance – total governmental funds	\$ (2,569,045)
Amounts reported for governmental activities in the statement of activities are different because	
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays for the year.	802,205
Increase in compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.	(40,848)
Decrease in the noncurrent portion of workers' compensation liability reported in the statement of activities do not require the use of current financials resources and therefore is not reported as an expenditure in the governmental funds.	64,208
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds.	<u>(343,286)</u>
Change in net assets of governmental activities	<u>\$ (2,086,766)</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**General Fund – Budgetary Comparison Statement**  
**Year Ended June 30, 2011**

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	<b>Budgeted Amounts</b>		<b>Actual Amounts (Budgetary Basis)</b>
	<b>Original</b>	<b>Final</b>	
<b>Revenues</b>			
Current-year appropriations	\$ 382,751,143	\$ 382,751,143	\$ 367,788,928
Total revenues	382,751,143	382,751,143	367,788,928
<b>Expenditures</b>			
General administration	16,911,441	16,911,441	15,468,685
Environmental health administration	15,740,778	15,740,778	14,328,958
Behavioral health services administration	184,861,085	184,861,085	179,895,617
Health resources administration	165,237,839	165,237,839	158,095,668
Total expenditures	382,751,143	382,751,143	367,788,928
Excess of revenues over expenditures	\$ -	\$ -	\$ -

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Tobacco Settlement Fund – Budgetary Comparison Statement**  
**Year Ended June 30, 2011**

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	<b>Budgeted Amounts</b>		<b>Actual Amounts</b>
	<b>Original</b>	<b>Final</b>	<b>(Budgetary Basis)</b>
<b>Revenues</b>			
Current-year funds	\$ 50,134,886	\$ 50,134,886	\$ 47,005,381
Total revenues	50,134,886	50,134,886	47,005,381
<b>Expenditures</b>			
Health resources	50,134,886	50,134,886	40,511,644
Total expenditures	50,134,886	50,134,886	40,511,644
Excess of revenues over expenditures	\$ -	\$ -	\$ 6,493,737

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Deposit Beverage Container Fund – Budgetary Comparison Statement**  
**Year Ended June 30, 2011**

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	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>
	<u>Original</u>	<u>Final</u>	
<b>Revenues</b>			
Current-year funds	<u>\$ 71,056,309</u>	<u>\$ 71,056,309</u>	<u>\$ 55,068,685</u>
Total revenues	71,056,309	71,056,309	55,068,685
<b>Expenditures</b>			
Environmental health administration	<u>71,056,309</u>	<u>71,056,309</u>	<u>65,290,790</u>
Total expenditures	<u>71,056,309</u>	<u>71,056,309</u>	<u>65,290,790</u>
Excess of expenditures over revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (10,222,105)</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Proprietary Funds – Statement of Net Assets**  
**June 30, 2011**

	<b>Water Pollution Control Revolving Fund</b>	<b>Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
<b>Assets</b>			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 103,938,603	\$ 36,462,687	\$ 140,401,290
Loan fees receivable	385,235	753,855	1,139,090
Accrued interest receivable	679,039	74,537	753,576
Other accrued interest	127,238	38,595	165,833
Due from federal government	-	142,807	142,807
Current portion of loans receivable	27,058,354	4,957,054	32,015,408
Total current assets	132,188,469	42,429,535	174,618,004
ARRA advances	19,640,992	18,342,930	37,983,922
Loans receivable, net of current portion	278,528,687	70,920,868	349,449,555
Capital assets, net of accumulated depreciation, at cost	-	333,282	333,282
Total assets	<u>\$ 430,358,148</u>	<u>\$ 132,026,615</u>	<u>\$ 562,384,763</u>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and other accrued liabilities	\$ 158,793	\$ 406,206	\$ 564,999
Total current liabilities	158,793	406,206	564,999
Accrued vacation, net of current portion	239,857	108,328	348,185
Other postemployment benefits	620,311	200,876	821,187
Total liabilities	1,018,961	715,410	1,734,371
<b>Net Assets</b>			
Invested in capital assets	-	333,282	333,282
Restricted – expendable	429,339,187	130,977,923	560,317,110
Total net assets	429,339,187	131,311,205	560,650,392
Total liabilities and net assets	<u>\$ 430,358,148</u>	<u>\$ 132,026,615</u>	<u>\$ 562,384,763</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Proprietary Funds – Statement of Revenues, Expenses and**  
**Changes in Fund Net Assets**  
**Year Ended June 30, 2011**

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	<b>Water Pollution Control Revolving Fund</b>	<b>Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
<b>Operating revenues</b>			
Interest income from loans	\$ 3,073,462	\$ 280,818	\$ 3,354,280
Administrative loan fee	1,773,519	2,360,290	4,133,809
Total revenues	4,846,981	2,641,108	7,488,089
<b>Expenses</b>			
Administrative	1,720,288	491,480	2,211,768
State program management	-	987,938	987,938
Water protection	-	444,474	444,474
Total expenses	1,720,288	1,923,892	3,644,180
Operating income	3,126,693	717,216	3,843,909
<b>Nonoperating revenues and expenses</b>			
State contributions	3,157,000	2,715,000	5,872,000
Federal contributions	4,873,058	6,788,861	11,661,919
Federal ARRA contributions	7,242,460	7,426,770	14,669,230
Other interest income	4,337,381	746,561	5,083,942
Total nonoperating revenues and expenses	19,609,899	17,677,192	37,287,091
Change in net assets	22,736,592	18,394,408	41,131,000
<b>Net assets</b>			
Beginning of year	406,602,595	112,916,797	519,519,392
End of year	\$ 429,339,187	\$ 131,311,205	\$ 560,650,392

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Proprietary Funds – Statement of Cash Flows**  
**Year Ended June 30, 2011**

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	<b>Water Pollution Control Revolving Fund</b>	<b>Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
<b>Cash flows from operating activities</b>			
Interest income from loans	\$ 3,133,343	\$ 276,267	\$ 3,409,610
Administrative loan fees	1,808,592	2,266,356	4,074,948
Principal repayments on loans	25,580,064	4,450,701	30,030,765
Disbursement of loan proceeds	(33,639,411)	(9,217,944)	(42,857,355)
Payments to employees	(1,329,312)	(694,111)	(2,023,423)
Payments to vendors	(102,036)	(936,545)	(1,038,581)
	<hr/>	<hr/>	<hr/>
Net cash used in operating activities	(4,548,760)	(3,855,276)	(8,404,036)
<b>Cash flows from noncapital financing activities</b>			
State contributions	3,157,000	2,715,000	5,872,000
Federal contributions	4,873,058	6,726,906	11,599,964
Federal ARRA contributions	7,242,460	7,426,770	14,669,230
Disbursement of ARRA advances	(6,864,564)	(7,426,770)	(14,291,334)
	<hr/>	<hr/>	<hr/>
Net cash provided by noncapital financing activities	8,407,954	9,441,906	17,849,860
<b>Cash flows from investing activities</b>			
Other interest income	5,437,402	985,004	6,422,406
	<hr/>	<hr/>	<hr/>
Net cash provided by investing activities	5,437,402	985,004	6,422,406
	<hr/>	<hr/>	<hr/>
Net increase in cash	9,296,596	6,571,634	15,868,230
<b>Equity in cash and cash equivalents and investments in State Treasury</b>			
Beginning of year	94,642,007	29,891,053	124,533,060
	<hr/>	<hr/>	<hr/>
End of year	\$ 103,938,603	\$ 36,462,687	\$ 140,401,290
	<hr/>	<hr/>	<hr/>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Proprietary Funds – Statement of Cash Flows**  
**Year Ended June 30, 2011**

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	<b>Water Pollution Control Revolving Fund</b>	<b>Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
<b>Reconciliation of operating income to net cash used in operating activities</b>			
Operating income	\$ 3,126,693	\$ 717,216	\$ 3,843,909
Adjustments to reconcile operating income to net cash used in operating activities			
Depreciation expense	-	71,518	71,518
Change in assets and liabilities			
Loan fees receivable	35,074	(93,934)	(58,860)
Accrued interest on loans receivables	59,880	(4,552)	55,328
Loans receivable	(8,059,347)	(4,767,243)	(12,826,590)
Accounts payable and other accrued liabilities	60,511	134,059	194,570
Other postemployment benefits	228,429	87,660	316,089
	<hr/>	<hr/>	<hr/>
Net cash used in operating activities	<u>\$ (4,548,760)</u>	<u>\$ (3,855,276)</u>	<u>\$ (8,404,036)</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii**  
**Department of Health**  
**Fiduciary Funds – Statement of Fiduciary Net Assets**  
**June 30, 2011**

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	<b>Agency Funds</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 482,296
Total assets	<u>\$ 482,296</u>
<b>Liabilities</b>	
Due to others	\$ 482,296
Total liabilities	<u>\$ 482,296</u>

The accompanying notes are an integral part of this statement.

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**1. Organization and Summary of Significant Accounting Policies**

**Financial Reporting Entity**

The State of Hawaii, Department of Health (the "Department"), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment, and the enforcement of environmental health laws. Federal grants received to support the State's health services and programs are administered by the Department.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") prescribed by the Governmental Accounting Standards Board ("GASB").

The Department is part of the executive branch of the State of Hawaii (the "State"). The financial statements of the Department are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2011, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America. The State Comptroller maintains the central accounts for all State funds and publishes a comprehensive annual financial report for the State annually, which includes the Department's financial activities.

Act 262, Session Laws of Hawaii of 1996, established the Hawaii Health Systems Corporation ("HHSC") as a public body corporate and politic and an instrumentality and agency of the State. HHSC consists of the state hospitals and was created to provide quality health care for all of the people in the state. HHSC commenced operations on July 1, 1996 and is administratively attached to the Department. However, HHSC is a component unit of the State and not the Department. HHSC's stand-alone financial statements are included in the State's comprehensive annual financial report but are not included in the Department's basic financial statements.

**Department-wide Financial Statements**

The Department-wide statements of net assets and activities are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Certain eliminations have been made as prescribed by GASB Statement No. 34 related to interfund activities, receivables, and payables. All internal balances have been eliminated except those representing balances between governmental and business-type activities, which are presented as internal balances and eliminated in the total department column when applicable. In the statement of activities, those transactions between governmental and business-type activities have not been eliminated. In addition, the fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

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**Fund Financial Statements**

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments are recorded only when payment is due.

The proprietary and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the department-wide financial statements described above.

The Department has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, to elect to apply all Financial Accounting Standards Board ("FASB") pronouncements issued after November 30, 1989, unless the FASB statements conflict with GASB pronouncements. The Department's enterprise funds have elected not to apply FASB statements after the applicable date.

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.

A description of the funds administered by the Department is as follows:

**Governmental Funds (Governmental Activities):**

- *General Fund* – The General Fund is the general operating fund of the Department. It is used to account for all financial resources except those required to be accounted for in another fund. The General Fund presented is a part of the State's General Fund and is limited to only those appropriations and obligations of the Department.
- *Special Revenue Funds* – Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) that are legally restricted to expenditures for specified purposes.
- *Capital Projects Funds* – Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary fund type) and are included in Other Funds in the fund financial statements.

Effective July 1, 2010, the Department implemented GASB Statement No. 54 ("GASB 54"), *Fund Balance Reporting and Governmental Fund Type Definitions*. GASB 54 provides clearer fund balance classifications and clarifies the existing governmental fund type definitions. The new hierarchical fund balance classification structure is based primarily on the extent to which a government is bound to follow constraints on how resources can be spent. Classifications include:

- *Restricted* – Balances that are restricted for specific purposes by external parties such as creditors, grantors or other governments.

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- *Committed* – Balances that can only be used for specific purposes pursuant to constraints imposed by formal action of the state legislature.
- *Assigned* – Balances that are constrained by management to be used for specific purposes, but are neither restricted nor committed.
- *Unassigned* – Residual balances that are not contained in the other classifications.

When both restricted and unrestricted balances are available for use, it is the Department's policy to use restricted fund balance first, then unrestricted fund balance. Furthermore, committed fund balances are reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of those unrestricted classifications can be used.

**Proprietary Funds (Business-Type Activities):**

- *Enterprise Funds* – Enterprise funds are used to account for the activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers, or where sound financial management dictates that periodic determination of results of operations are appropriate.

**Fiduciary Funds:**

- *Agency Funds* – Agency funds are used to account for cash collected and disbursed by the Department in a custodial capacity.

**Equity in Cash and Cash Equivalents and Investments in State Treasury**

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

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

GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("Statement No. 40"), requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit and custodial risks are not determinable at the department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") which may be obtained from the Department of Accounting and General Services' ("DAGS") website:  
<http://hawaii.gov/dags/rpts>.

In January 2012, DAGS issued guidance informing State agencies participating in the State Treasury Investment Pool that the change in the fair value of the auction rate securities resulted in

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a gain for the year ended June 30, 2011 and that each participating State agency would be allocated a portion of the gain. The Department's total allocated gain for fiscal 2011 amounted to \$7,079,510.

**Due from State Treasury**

The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as Due from State Treasury in the accompanying fund and department-wide financial statements.

**Due from Other State Agencies**

Receivables due from other State agencies consist of reimbursements from the Department of Human Services ("DHS") for Medicaid payments that the Department makes to providers of health services. The Department is responsible to pay the State portion of the Medicaid claims, and DHS reimburses the Department for the Federal portion of the claims. The receivable of \$7.6 million is comprised of various Medicaid rehabilitation option claims.

Payments made to providers and received from DHS for the Federal portion of the Medicaid claims are classified as transfers out and transfers in, respectively, for financial statement purposes.

**Tobacco Settlement**

In November 1998, the State settled its tobacco lawsuit as part of a nationwide settlement involving 46 other states and various tobacco industry defendants. Under the settlement, those tobacco companies that have joined in the Master Settlement Agreement will pay the State approximately \$1.3 billion over a 25-year period. The Department is responsible for administering the Hawaii Tobacco Settlement Special Fund. The Department receives all tobacco settlement monies and then allocates and appropriates 85% of the funds to other State agencies and other entities in accordance with Hawaii Revised Statutes ("HRS") 328L-2. The Department receives annual payments on April 15 of each year for tobacco settlements earned for the preceding calendar year.

Effective July 1, 2010, the Legislature approved Act 192 to address the fiscal year 2011 budget shortfall by transferring excess balances from various non-general funds into the State's general fund. The Legislature determined that \$7,200,000 was in excess of the requirements of the Hawaii Tobacco Settlement Special Fund and authorized the transfer to the State general fund.

The Department received approximately \$47,000,000 in tobacco settlement proceeds during the year ended June 30, 2011 for the calendar year ended December 31, 2011. In accordance with GASB Technical Bulletin No. 04-01, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the Department has recorded a tobacco settlement receivable for \$26,900,000 in the statement of net assets representing tobacco settlements earned for the period January 1, 2011 through June 30, 2011.

**ARRA Advances**

The proprietary funds received American Recovery and Reinvestment Act ("ARRA") stimulus money that was used to provide construction grants with no interest or loan fees and 100% principal forgiveness upon completion of approved projects. The proprietary funds are allowed to use a portion of the ARRA funds for specified purposes as set forth in the grant. ARRA funds provided to counties have been classified as "ARRA Advances" on the Statement of Net Assets

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upon disbursement. The ARRA advances will be completely forgiven and expensed once all the conditions and compliance requirements have been satisfied by the counties. If conditions and compliance requirements are not met, the grants will convert to loans, requiring repayment of principal, interest and loan fees.

**Loans Receivable**

Loans made to 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 proprietary funds. Interest is calculated from the date that funds are advanced. 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**

The Department has implemented an administrative loan fee program to pay for the proprietary fund's administration, including employee salaries and benefits. The proprietary funds apply an administrative fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

**Capital Assets**

Capital assets, which include buildings, furniture, and equipment, are reported in the applicable governmental or business-type activities in the department-wide financial statements and in the proprietary funds' financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

Land	All capitalized
Land improvements	\$100,000
Building and building improvements	\$100,000
Furniture and equipment	\$5,000

Such assets are recorded at historical cost if purchased or constructed. Donated assets are recorded at estimated fair value at the time received. Depreciation expense is recorded in the department-wide financial statements using the straight-line method over the estimated useful lives of the assets. Generally, the useful lives are as follows:

	<b>Governmental- Type Activities</b>	<b>Business- Type Activities</b>
Land improvements	15	Not applicable
Building and building improvements	30	Not applicable
Furniture and equipment	5-7	5-7

**Deferred Income**

Deferred income at the fund level and department-wide level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for deferred income is removed from the statement of net assets and balance sheet, and revenue is recognized. Deferred income at June 30, 2011 consisted primarily of Federal grant funds for which all eligibility requirements had not yet been met.

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**Due to Other State Agencies**

Payables to other State agencies consist of reimbursements to DHS for the State portion of the Medicaid claims for the Developmental Disabilities program and 85% of funds allocated to other State agencies in accordance with the Hawaii Tobacco Settlement Special Fund. The State portion of the Medicaid claims for the Development Disabilities program is \$2.3 million, the repayment due to DHS for overpayment of Medicaid claims is \$500,000, and the amount allocated to other funds in accordance with the Hawaii Tobacco Settlement Special Fund is \$23.4 million.

**Beverage Container Deposits**

Deposits of \$0.05 are made by distributors to the deposit beverage container fund for each qualifying container. The deposit beverage container fund maintains all deposits until the recycling centers claim reimbursement for the deposits that they pay out to the consumers. The deposit beverage container fund maintains the deposits that are expected to be redeemed.

Amounts paid out to the consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e., aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management estimates, based on past collections and success of recycling in other states, that 80% of the containers will be recycled every year. The remaining 20% of the containers are expected to be unredeemed; therefore, 20% of the deposits collected are recognized into revenue each year.

According to HRS 342G-104, any funds that accumulate in the Deposit Beverage Container Fund shall be retained by the fund unless determined to be in excess by the Legislature. The Legislature passed Act 192 during the 2010 session, authorizing a transfer of up to \$1,000,000 from the Deposit Beverage Container Fund to the State's general fund to address the fiscal year 2011 budget shortfall. The Legislature later passed Act 124 during the 2011 session authorizing an additional \$300,000 to be transferred to the State's general fund. Acts 192 and 124 were applied to fiscal year 2011 resulting in a total of \$1,300,000 transferred from the Deposit Beverage Container Fund to the State's general fund.

**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. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet.

**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 the State's Employees' Retirement System ("ERS"). At June 30, 2011, accumulated sick leave was approximately \$68,100,000.

**Intrafund and Interfund Transactions**

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them are recorded as operating transfers in the basic financial statements.

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**Use of Estimates**

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, 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.

**Encumbrances**

Encumbrance accounting, under which purchase orders and contractual commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Although appropriations generally lapse at year end, open encumbrances are reported as reservations of fund balances because the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities. Encumbrances at June 30, 2011 for the Department's governmental funds were as follows:

	<b>Contracts and Claims</b>
General	\$ 41,100,000
Tobacco settlement	7,200,000
Deposit beverage container	3,100,000
Other funds	55,800,000
Total	<u>\$ 107,200,000</u>

**Fund Balance Deficit**

The Deposit Beverage Container Fund had a deficit fund balance at June 30, 2011 of \$6,314,250. This deficit will be financed through future revenues of the fund.

**Use of Restricted and Unrestricted Net Assets**

When an expense is incurred for which both restricted and unrestricted net assets are available, the Department's policy is to apply restricted net assets first.

**New Accounting Pronouncements**

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management does not expect that this Statement will have a material effect on the Department's financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Statement is intended to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The provisions of this Statement are effective for periods beginning after December 15, 2011. The Department has not yet determined the effect this Statement will have on the Department's financial statements.

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In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*. The Statement is intended to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. The Statement sets forth the criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for years beginning after June 15, 2011 with earlier application encouraged. Management does not expect that this Statement will have a material effect on the Department's financial statements.

**2. Budgeting and Budgetary Control**

The Department follows these procedures in establishing the budgetary data reflected in the basic financial statements:

- *The Budget* – Not less than 20 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.
- *Legislative Review* – The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs, and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.
- *Program Execution* – Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

Budgets are adopted for the General Fund of the Department and are prepared on the basis of cash receipts and amounts disbursed, which is a basis of accounting other than GAAP.

The major differences between the budgetary and GAAP basis are that: (1) the budget is prepared on the basis of cash receipts and amounts disbursed; and (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis.

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Since budgetary basis differs from GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures on a budgetary basis at June 30, 2011, to revenues in excess of (less than) expenditures presented in conformity with GAAP follows:

	<b>General Fund</b>	<b>Tobacco Settlement Fund</b>	<b>Deposit Beverage Container Fund</b>
Excess of revenues over expenditures (expenditures over revenues) – actual on a budgetary basis	\$ -	\$ 6,493,737	\$ (10,222,105)
Reserve for encumbrances at year end	41,123,687	7,222,591	3,105,513
Expenditures for liquidation of prior year's encumbrances	(41,415,819)	(16,101,999)	(11,871,057)
Accruals and other adjustments	<u>18,148,785</u>	<u>41,861,253</u>	<u>7,874,083</u>
Excess of revenues over expenditures (expenditures over revenues) – GAAP basis	<u>\$ 17,856,653</u>	<u>\$ 39,475,582</u>	<u>\$ (11,113,566)</u>

**3. Loans Receivable**

At June 30, 2011, the proprietary funds loans receivable consisted of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans require annual, semi-annual or quarterly payments, including interest at 0.00% to 3.02%, 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. Accrued interest receivable on the loans amounted to approximately \$754,000 at June 30, 2011.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2011:

<b>Year ending June 30,</b>	
2012	\$ 32,015,408
2013	32,631,872
2014	30,164,026
2015	26,486,471
2016	26,136,220
Thereafter	<u>234,030,966</u>
	<u>\$ 381,464,963</u>

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**4. Capital Assets**

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

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Dispositions</b>	<b>Ending Balance</b>
<b>Governmental activities</b>				
Capital assets, not being depreciated				
Land	\$ 1,018,080	\$ -	\$ -	\$ 1,018,080
Total capital assets not being depreciated	1,018,080	-	-	1,018,080
Capital assets, being depreciated				
Land improvements	1,862,927	-	-	1,862,927
Building and building improvements	136,965,232	5,749,856	-	142,715,088
Furniture and equipment	22,646,153	486,039	(441,219)	22,690,973
Total capital assets being depreciated	161,474,312	6,235,895	(441,219)	167,268,988
Less: Accumulated depreciation				
Land improvements	1,862,927	-	-	1,862,927
Building and building improvements	84,657,792	4,179,134	-	88,836,926
Furniture and equipment	15,519,336	1,207,292	(393,955)	16,332,673
Total accumulated depreciation	102,040,055	5,386,426	(393,955)	107,032,526
Governmental activities capital assets, net	<u>\$ 60,452,337</u>	<u>\$ 849,469</u>	<u>\$ (47,264)</u>	<u>\$ 61,254,542</u>
<b>Business-type activities</b>				
Capital assets being depreciated				
Furniture and equipment	\$ 1,133,750	\$ 201,553	\$ (88,508)	\$ 1,246,795
Total capital assets being depreciated	1,133,750	201,553	(88,508)	1,246,795
Less: Accumulated depreciation for equipment	930,503	71,518	(88,508)	913,513
Total accumulated depreciation	930,503	71,518	(88,508)	913,513
Business-type activities capital assets, net	<u>\$ 203,247</u>	<u>\$ 130,035</u>	<u>\$ -</u>	<u>\$ 333,282</u>

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Current period depreciation expense was charged to functions as follows:

<b>Governmental activities</b>	
General administration	\$ 579,687
Environmental health	507,388
Behavioral health	1,740,445
Health resources	2,558,906
Total depreciation expense – governmental activities	<u>\$ 5,386,426</u>
 <b>Business-type activities</b>	
Environmental health	<u>\$ 71,518</u>
Total depreciation expense – business-type activities	<u>\$ 71,518</u>

**5. Accrued Vacation**

The changes to the accrued vacation liability during 2011 were as follows:

	<b>Governmental Activities</b>	<b>Business-Type Activities</b>
<b>Balance at July 1, 2011</b>	\$ 27,050,744	\$ 333,581
Increase	11,216,621	255,666
Decrease	<u>(11,175,772)</u>	<u>(137,259)</u>
<b>Balance at June 30, 2011</b>	27,091,593	451,988
Less: Current portion	<u>8,369,778</u>	<u>103,803</u>
Noncurrent portion	<u>\$ 18,721,815</u>	<u>\$ 348,185</u>

**6. Beverage Container Deposits**

The changes to the beverage container deposit liability during 2011 were as follows:

<b>Balance at July 1, 2010</b>	\$ 22,680,452
Increase: Deposits received from distributor	45,887,659
Decrease: Payments made to recycling centers, net of refunds	(34,981,307)
Decrease: Unredeemed deposits recognized as revenues	<u>(9,177,532)</u>
<b>Balance at June 30, 2011</b>	<u>\$ 24,409,272</u>

**7. Non-Imposed Employee Fringe Benefits**

Non-imposed employee fringe benefits related to general and State special fund salaries are funded by the State. These costs, totaling approximately \$39,900,000 for the fiscal year ended June 30, 2011, have been reported as revenues and expenditures of the Department's general and State special revenue fund.

Payroll fringe benefit costs related to Federally-funded salaries are not funded by the State and are recorded as expenditures in the Federal special revenue fund.

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**8. Employee Benefit Plans**

Substantially all employees of the Fund participate in the State's various employee benefit plans, including the ERS, 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 ERS' CAFR. The State's CAFR can be found on the DAGS website. The ERS CAFR can be found at the ERS website: <http://ers.ehawaii.gov/>.

**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.

**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 and proprietary fund for retiree health benefits.

*Annual OPEB Cost*

The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the Department's two proprietary funds. The following table shows the allocated annual OPEB cost that has been allocated to the two proprietary funds of the Department for the year ended June 30, 2011:

	<b>Water Pollution Control Revolving Fund</b>	<b>Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
Annual OPEB cost	\$ 297,595	\$ 116,954	\$ 414,549
Less: Contributions made	<u>(69,166)</u>	<u>(29,293)</u>	<u>(98,459)</u>
Increase in net OPEB obligation	228,429	87,661	316,090
Net OPEB obligation, beginning of year	<u>391,882</u>	<u>113,215</u>	<u>505,097</u>
Net OPEB obligation, end of year	<u>\$ 620,311</u>	<u>\$ 200,876</u>	<u>\$ 821,187</u>

*Amount of Contributions Made*

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years June 30, 2011, 2010, and 2009 were approximately \$2,161,000, \$2,330,000, and \$2,751,000.

**State of Hawaii**  
**Department of Health**  
**Notes to Financial Statements**  
**June 30, 2011**

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*Required Supplementary Information and Disclosures*

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

**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.

**9. Commitments and Contingencies**

**Operating Leases**

The Department leases various office facilities and equipment through fiscal year 2016 on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rent payments on noncancelable operating leases at June 30, 2011:

<b>Year ending June 30,</b>	
2012	\$ 564,000
2013	234,500
2014	189,700
2015	122,400
2016	59,000
	<hr/>
	\$ 1,169,600

Rent expenditures for the fiscal year ended June 30, 2011 approximated \$2,400,000.

**Insurance Coverage**

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2011, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation expense for the year ended June 30, 2011 was approximately \$303,000.

**Litigation**

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

**State of Hawaii**  
**Department of Health**  
**Notes to Financial Statements**  
**June 30, 2011**

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**Ceded Lands**

The Office of Hawaiian Affairs (“OHA”) and the State are involved in litigation regarding the State’s alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. The ultimate outcome of this matter is still unknown. Full discussion of this matter and other legal matters between OHA and the State are disclosed in the State’s CAFR.

**Schedule of  
Expenditures of Federal Awards**

**State of Hawaii**  
**Department of Health**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2011**

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
<b>U.S. Department of Health and Human Services ("DHHS")</b>				
Direct Programs				
Special Programs for Aging – Title VII Chapter 3	468	93.041	\$ 14,774	\$ -
Special Programs for Aging – Title VII Chapter 2	401, 468	93.042	425,949	-
Special Programs for Aging – Title III Part D	401	93.043	102,277	102,277
Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers	401	93.044	2,102,299	2,102,299
Special Programs for Aging – Title III Part C – Nutrition Services	401	93.045	2,447,373	2,225,800
Nutrition Services Incentive Program	406	93.053	536,439	536,439
ARRA – Aging Home-Delivered Nutrition Services for States	586	93.705	67,603	67,603
ARRA – Aging Congregate Nutrition Services for States	489	93.707	138,323	138,323
Subtotal Aging Cluster			5,292,037	5,070,464 *
Special Programs for Aging – Title IV and Title II – Discretionary Projects	various	93.048	478,163	22,495
National Family Caregiver Support, Title III, Part E	401	93.052	688,314	688,314
Public Health Emergency Preparedness	various	93.069	4,966,563	22,545 *
Environmental Public Health and Emergency Response	various	93.070	712,891	235,470
Medicare Enrollment Assistance Program	various	93.071	73,026	-
Emergency System for Advance Registration of Volunteer Health Professionals	588	93.089	109,487	-
Food and Drug Administration Research	580	93.103	233,081	-
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances ("SED")	229, 589	93.104	1,982,515	-
Maternal and Child Health Federal Consolidated Programs	various	93.110	838,658	604,436
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	247	93.116	839,737	-
Emergency Medical Services for Children	388	93.127	78,722	-
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	298	93.130	147,027	5,603
Injury Prevention and Control Research and State and Community Based Programs	343, 278	93.136	147,865	9,900
Projects for Assistance in Transition from Homelessness ("PATH")	various	93.150	459,246	299,384
Hansen's Disease National Ambulatory Care Program	264	93.215	691,644	-
Family Planning – Services	239	93.217	2,661,081	2,204,028
State Rural Hospital Flexibility Program	410, 415	93.241	271,081	-
Substance Abuse and Mental Health Services – Projects of Regional and National Significance	various	93.243	4,913,540	2,797,889 *
Universal Newborn Hearing Screening	416	93.251	169,054	10,574
State Health Access Program	437	93.256	77,193	-
Immunization Grants	457	93.268	15,812,952	13,273,555
ARRA – Immunization	579	93.712	272,373	-
Subtotal Immunization Cluster			16,085,325	13,273,555 *
Adult Viral Hepatitis Prevention and Control	397	93.270	89,176	-
Substance Abuse and Mental Health Services – Access to Recovery Centers for Disease Control and Prevention – Investigations and Technical Assistance	various	93.283	3,091,975	301,430 *
State Partnership Grant Program to Improve Minority Health	611	93.296	5,288	-
Small Rural Hospital Improvement Grant Program	454	93.301	96,980	-
Affordable Care Act ("ACA") Maternal, Infant, and Early Childhood Home Visiting Program	602	93.505	42,579	14,243
Strengthening Public Health Infrastructure for Improved Health Outcomes	615	93.507	3,894	-
ELC PPACA – Building & Strengthening Capacity	607	93.521	50,549	-
Community-Based Child Abuse Prevention Grants	270	93.590	506,694	420,391
Development Disabilities Basic Support and Advocacy Grants	240	93.630	368,490	-
Child Abuse and Neglect Discretionary Activities	274	93.670	279,748	89,041
ARRA – Preventing Healthcare – Associated Infections	582	93.717	88,561	-
ARRA – Prevention and Wellness – State, Territories and Pacific Islands	594	93.723	103,099	-
ARRA – Prevention and Wellness – Communities Putting Prevention to Work Funding Opportunities Announcement ("FOA")	595	93.724	1,109,302	-
ARRA – Communities Putting Prevention to Work: Chronic Disease Self-Management Program	596	93.725	24,481	23,721
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	various	93.777	1,636,336	39,144

\* Denotes Major Federal Program

**State of Hawaii**  
**Department of Health**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2011**

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
Centers for Medicare and Medicaid Services Research, Demonstrations and Evaluations	403, 590	93.779	366,662	148,175
National Bioterrorism Hospital Preparedness Program	435, 564	93.889	2,139,338	1,580,640
Grants to States for Operation of Offices of Rural Health	299	93.913	88,484	-
HIV Care Formula Grants	293	93.917	4,005,526	- *
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Early Detection Programs	448	93.919	1,063,325	894,945
Healthy Start Initiative	286	93.926	843,861	650,429
HIV Prevention Activities – Health Department Based	266	93.940	1,955,379	-
HIV / AIDS Surveillance	272	93.944	221,573	-
Cooperative Agreements to Support State-Based Safe Motherhood and Infant Health Initiative Programs	319	93.946	157,041	5,302
Block Grants for Community Mental Health Services	various	93.958	1,881,826	920,556
Substance Abuse Prevention and Treatment Block Grants	various	93.959	6,809,445	6,420,586 *
Preventive Health Services – Sexually Transmitted Diseases Control Grants	268	93.977	388,594	-
Preventive Health and Health Services Block Grant	various	93.991	638,545	6,250
Maternal and Child Health Services Block Grant	various	93.994	2,085,306	22,701
Vital Statistics Cooperative Program	285	93.200-2000-07211	212,392	-
Subtotal Direct Programs			<u>74,297,930</u>	<u>37,951,286</u>
Pass-through from the State Department of Human Services				
Temporary Assistance for Needy Families	various	93.558	515,870	515,870
Child Care and Development Block Grant	various	93.575	468	1,020
Child Abuse and Neglect State Grants	various	93.669	60,900	-
Subtotal Pass-through Programs			<u>577,238</u>	<u>516,890</u>
Total Department of Health and Human Services			<u>74,875,168</u>	<u>38,468,176</u>
<b>U.S. Department of Agriculture</b>				
Direct Program				
Wildlife Services	392	10.028	14,957	-
Food Safety Cooperative Agreements	203, 580	10.479	166,911	-
Special Supplemental Nutrition Program for Women, Infants, and Children	275, 295	10.557	32,165,159	2,819,732 *
WIC Grants to States (“WGS”)	587	10.578	49,755	39,755
Subtotal Direct Programs			<u>32,396,782</u>	<u>2,859,487</u>
Pass-through from the State Department of Human Services				
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	various	10.561	517,975	-
Subtotal Pass-through Programs			<u>517,975</u>	<u>-</u>
Total Department of Agriculture			<u>32,914,757</u>	<u>2,859,487</u>
<b>Environmental Protection Agency (“EPA”)</b>				
Direct Program				
Air Pollution Control Program Support	233	66.001	621,416	-
Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	294	66.034	77,623	-
State Clean Diesel Grant Program	328	66.040	17,176	17,176
ARRA – State Clean Diesel Grant Program	484	66.040	1,034,733	1,034,733
Total State Clean Diesel Grant Program			<u>1,051,909</u>	<u>1,051,909</u>
Water Pollution Control State, Interstate, and Tribal Program Support	various	66.419	2,352,144	18,666
State Public Water System Supervision	232	66.432	425,586	-
Water Quality Management Program	14284-16284	66.454	40,258	-
ARRA – Water Quality Management Program	485	66.454	158,543	-
Total Water Quality Management Program			<u>198,801</u>	<u>-</u>
Capitalization Grants for Clean Water State Revolving Funds	19206-20206	66.458	4,873,058	4,873,058
ARRA – Capitalization Grants for Clean Water State Revolving Funds	483	66.458	7,242,460	6,864,564
Total Capitalization Grants for Clean Water State Revolving Funds			<u>12,115,518</u>	<u>11,737,622 *</u>
Nonpoint Source Implementation Grants	various	66.460	1,172,688	660,841
Capitalization Grants for Drinking Water State Revolving Funds	3207-11207	66.468	6,726,906	5,452,188
ARRA – Capitalization Grants for Drinking Water State Revolving Funds	482	66.468	7,426,770	7,426,770
Total Capitalization Grants for Drinking Water State Revolving Funds			<u>14,153,676</u>	<u>12,878,958 *</u>

\* Denotes Major Federal Program

**State of Hawaii  
Department of Health  
Schedule of Expenditures of Federal Awards  
Year Ended June 30, 2011**

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
Beach Monitoring and Notification Program	8291	66.472	395,773	-
Water Protection Coordination	449	66.474	130,409	-
Environmental Information Exchange Grant Program	various	66.608	350,748	-
Toxic Substances Compliance Monitoring Cooperative Agreements	243	66.701	125,318	-
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	330	66.707	167,622	-
Multi-Media Capacity Building Grants for States and Tribes	373	66.709	15,423	-
Hazardous Waste Management State Program Support	230	66.801	486,065	-
Superfund State Site Specific Cooperative Agreements	394	66.802	290,051	-
State Underground Storage Tanks Program ("UST" Program)	339	66.804	183,643	-
Leaking Underground Storage Tank Trust Fund Corrective Action Program	258	66.805	540,372	-
ARRA – Leaking Underground Storage Tank Trust Fund Corrective Action Program	487	66.805	400,704	-
Total Leaking Underground Storage Tank Trust Fund Corrective Action Program			941,076	-
State and Tribal Response Program Grants	360	66.817	1,013,731	-
Total Environmental Protection Agency			36,269,220	26,347,996
<b>U.S. Department of Education</b>				
Direct Program				
Special Education – Grants for Infants and Families	213	84.181	2,323,231	785,121
ARRA – Early Intervention Services	488	84.393	1,027,461	930,882
Early Intervention Services Cluster			3,350,692	1,716,003 *
Subtotal Direct Programs			3,350,692	1,716,003
Pass-through from the State Department of Education				
Special Parent Information Network	322	84.000	177,759	-
Subtotal Pass-through Programs			177,759	-
Total Department of Education			3,528,451	1,716,003
<b>U.S. Department of Defense</b>				
Direct Program				
State Memorandum of Agreement Program for the Reimbursement of Technical Services	245	12.113	232,988	-
Total Department of Defense			232,988	-
<b>U.S. Department of Justice</b>				
Direct Program				
Enforcing Underage Drinking Laws Program	458, 480	16.727	462,036	426,519
Pass-through from the State Department of the Attorney General				
Evidence-Based Forensic Student Internship	609	16.803	24,452	-
Total Department of Justice			486,488	426,519
<b>U.S. Department of Labor</b>				
Pass-through from the State Department of Labor and Industrial Relations				
WIA Pilots, Demonstrations, and Research Projects	various	17.261	307,371	-
Total Department of Labor			307,371	-
<b>U.S. Department of Transportation</b>				
Pass through from the State Department of Transportation				
State and Community Highway Safety	various	20.600	70,606	-
Total Department of Homeland Security			70,606	-
<b>Total Expenditures of Federal Awards</b>			<b>\$ 148,685,049</b>	<b>\$ 69,818,181</b>

\* Denotes Major Federal Program

**State of Hawaii**  
**Department of Health**  
**Notes to the Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2011**

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**1. Basis of Presentation**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the State of Hawaii, Department of Health (the "Department"), and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**2. Loans Outstanding**

The Department had the following loan balances outstanding at June 30, 2011. Loans made during the year are included in the federal expenditures presented in the schedule of expenditures of federal awards.

Program Title	Federal CFDA Number	Amount Outstanding
Capitalization Grants for Clean Water State Revolving Funds	66.458	\$ 39,005,507
Capitalization Grants for Drinking Water State Revolving Funds	66.468	35,493,397

**3. Noncash Awards**

The Department also receives noncash awards for the Immunization Grants and Public Health Emergency Preparedness program. The Department expended approximately \$13,273,555 and \$22,545 for the Immunization Grants and Public Health Emergency Preparedness program respectively, in vaccines for the fiscal year ended June 30, 2011.

**PART II**  
**Government Auditing Standards**

**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 governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department") as of and for the year ended June 30, 2011, which collectively comprise the Department's basic financial statements and have issued our report thereon dated March 22, 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**

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Department'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 Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as Finding No. 11-01 to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as Finding Nos. 11-02 and 11-03 to be significant deficiencies.

### **Compliance and Other Matters**

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

We noted certain matters that we will report to the State Auditor and management of the Department in a separate letter.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor, the Department's management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Accuity LLP*

Honolulu, Hawaii  
March 22, 2012

**PART III**  
**OMB Circular A-133**



CERTIFIED PUBLIC ACCOUNTANTS

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**Report of Independent Auditors on Compliance with Requirements  
That Could Have a Direct and Material Effect on Each Major Program  
and on Internal Control Over Compliance in Accordance with OMB Circular A-133**

The Auditor  
State of Hawaii

**Compliance**

We have audited the State of Hawaii, Department of Health's (the "Department") compliance with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the year ended June 30, 2011. The Department's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding Nos. 11-04 through 11-09.

## Internal Control Over Compliance

Management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as Finding No. 11-04. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor, the Department's management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Accuity LLP*

Honolulu, Hawaii  
March 22, 2012

## **PART IV**

### **Schedule Of Findings and Questioned Costs**

**State of Hawaii  
 Department of Health  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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**Section I – Summary of Auditors’ Results**

**Financial Statements**

Type of auditors’ report issued	Unqualified
Internal control over financial reporting	
Material weakness identified?	Yes
Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

**Federal Awards**

Internal control over major programs	
Material weakness identified?	No
Significant deficiency identified that are not considered to be material weaknesses?	Yes
Type of auditors’ report issued on compliance for major programs	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	Yes

**Identification of major programs**

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster</b>
	<b>U.S. Department of Health &amp; Human Services</b>
	Aging Cluster
93.044	Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers
93.045	Special Programs for Aging – Title III Part C – Nutrition Services
93.053	Nutrition Services Incentive Program
93.705	ARRA – Aging Home-Delivered Nutrition Services for States
93.707	ARRA – Aging Congregate Nutrition Services for States
93.069	Public Health Emergency Preparedness
93.243	Substance Abuse and Mental Health Services – Projects of Regional and National Significance
	Immunization Cluster
93.268	Immunization Grants
93.712	ARRA – Immunization Grants
93.283	Centers for Disease Control and Prevention – Investigations and Technical Assistance
93.917	HIV Care Formula Grants
93.959	Substance Abuse Prevention and Treatment Block Grants

**State of Hawaii  
 Department of Health  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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**Identification of major programs (continued)**

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster</b>
	<b>U.S. Department of Agriculture</b>
10.557	Special Supplemental Nutrition Program for Women, Infants & Children
	<b>U.S. Environmental Protection Agency</b>
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.458	ARRA – Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds
66.468	ARRA – Capitalization Grants for Drinking Water State Revolving Funds
	<b>U.S. Department of Education</b>
	Early Intervention Services Cluster
84.181	Special Education – Grants for Infants and Families
84.393	ARRA – Early Intervention Services

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

Auditee qualified as low-risk auditee? No

**State of Hawaii  
 Department of Health  
 Financial Statement Findings  
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**II. Financial Statement Findings**

		<b>Questioned Cost</b>
<b>Finding No. 11-01:</b>	<b>Department of Human Services Transactions (Material Weakness)</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable	Not applicable

**Finding and Cause and Effect**

The Department has difficulty determining the amounts due to or from the State of Hawaii, Department of Human Services (“DHS”) related to services provided by the Department’s Adult Mental Health Division program to Medicaid eligible patients under contracts between the Department and DHS.

Due to the decentralized manner in which DHS contracts are structured and managed, and the fact that DHS does not regularly reconcile payments to the Department, the Department continually struggles with DHS to accurately determine the settlement of Medicaid related transactions for financial reporting purposes, which could lead to material misstatements in the Department’s financial statements.

**Criteria**

In accordance with GASB 34, paragraph 12e, the Department is required to:

*“Measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains, and losses using the economic resources measurement focus and accrual basis of accounting.”*

In order to report on the accrual basis of accounting, the Department needs to assess all amounts due to and from other State Agencies for services that were provided throughout the year.

In addition, the Department’s management makes the following representation to us before we issue the financial statements:

*“We understand that as part of your audit, you prepared the adjusting journal entries necessary to convert our cash basis records to the accrual basis of accounting and acknowledge that we have reviewed and approved those entries and accepted responsibility for them.”*

**State of Hawaii  
Department of Health  
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**Recommendation**

We recommend that the Department work toward developing Medicaid services contracts with DHS that contain consistent terms and conditions. The Department should develop policies to ensure that appropriate documentation is maintained to support billings to DHS and hold DHS accountable for reconciliation of Medicaid payments and timely communication of over or underpayments. Finally, the Department should ensure that adequate funds are available in the event that overpayments need to be returned to DHS.

**State of Hawaii  
 Department of Health  
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		Questioned Cost
<b>Finding No. 11-02:</b>	<b>Compensated Absences (Significant Deficiency)</b>	\$ <u>          </u> -
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable	Not applicable

**Finding and Cause and Effect**

The Department’s process for tracking compensated absences is decentralized. Each program is responsible for maintaining and tracking its own vacation, sick and compensatory time records. On an annual basis, the programs report their compensated absence information to the Department’s Administrative Service Office (“ASO”) for purposes of preparation of the year-end financial statements and submission to the Department of Accounting and General Services (“DAGS”). We noted the following matters during our prior year audits:

- Although employees are entitled to payment for their residual balances of accrued vacation and compensatory time upon termination of their employment, we noted that, until June 2011, there were no Department-wide policies or procedures for programs to follow to ensure that terminated employees are paid out for their vested compensated absence balances in a timely manner.
- We noted issues with the G-1 tracking system. We continued to note discrepancies in the amount of vacation/sick/comp hours between the “Annual Vacation and Sick Leave Accrual Report” and the DPS-7, Employee Leave Record forms.

**Criteria**

In accordance with GASB 34, paragraph 12e, the Department is required to:

*“Measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains, and losses using the economic resources measurement focus and accrual basis of accounting.”*

In order to report on the accrual basis of accounting, the Department needs to accurately calculate its accrued vacation balance.

In addition, the Department’s management makes the following representation to us before we issue the financial statements:

*“We understand that as part of your audit, you prepared the adjusting journal entries necessary to convert our cash basis records to the accrual basis of accounting and acknowledge that we have reviewed and approved those entries and accepted responsibility for them.”*

**State of Hawaii  
Department of Health  
Financial Statement Findings  
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**Recommendation**

We recommend that Department personnel responsible for maintenance, tracking and reporting of compensated absence information receive formal training on how to properly use the G-1 tracking system and understand the purpose for tracking such information. The Department should and has established in June 2011 a standardized format for reporting vacation, sick and compensatory time balances to ensure consistency across programs, as well as timely payments to terminated employees.

**State of Hawaii  
 Department of Health  
 Financial Statement Findings  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-03:</b>	<b>Equipment Management (Significant Deficiency)</b>	<b>\$ _____ –</b>
<b>Federal Agency:</b>	Department of Health and Human Services (“DHHS”) Department of Education	
<b>CFDA Number and Title:</b>	93.069 – Public Health Emergency Preparedness	
	93.243 – Substance Abuse and Mental Health Services – Projects of Regional and National Significance	
	84.393 – ARRA – Early Intervention Services	
<b>Award Number and Award Year:</b>	1H75TP000330-01	07/31/09 – 07/30/11
	5U90TP916969-10	08/10/09 – 08/09/11
	3U90TP916969-10W1	08/10/09 – 08/09/11
	5U79SM057457-04	09/30/09 – 09/29/10
	5U79SM057457-05	09/30/10 – 09/29/11
	H393A090091A	07/31/09 – 07/30/10 07/01/10 – 06/30/11 07/01/10 – 06/30/11
		02/17/09 – 09/30/11

**Finding and Cause and Effect**

The Department adheres to the State’s policies and procedures contained in the DAGS – State Procurement Office (“SPO”) – Inventory Management Branch Training Manual (“State Inventory Manual”) for capital asset accounting, financial reporting, and compliance with equipment management in accordance with OMB Circular A-133. In addition, the Department requires property custodians to reconcile quarterly equipment acquisitions in the Financial Accounting and Management Information System (“FAMIS”) to the DAGS computerized inventory reports (“MDB reports”) from the State’s Fixed Asset Inventory System (“FAIS”).

During our audit, we noted the following matters that resulted in either audit adjustments or noncompliance with federal requirements:

- Quarterly reconciliations were not performed consistently and discrepancies identified went unresolved.
- The programs reported capital asset purchases to SPO for inclusion in FAIS in an untimely manner and failed to use decals on capital asset additions for physical tracking purposes.

The matters identified were primarily caused by competing priorities of program personnel, the lack of a compliance monitoring function to ensure that all programs adhere to policies and procedures, and the lack of enforcement by senior Department administration.

**State of Hawaii**  
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**Criteria**

40 CFR 31.32 states that a state will use, manage, and dispose of equipment acquired in accordance with the state's laws and procedures. Per the SPO State Inventory Manual:

- Chapter 3 – “Record keeping of property which includes accounting for all acquired state property by reconciling financial expenditures for property with property recorded in the FAIS; conducting of physical inventory; updating the master inventory listing; maintaining an accurate audit trail; and conducting internal audits.”
- Chapter 3 – “Safekeeping of property which includes affixing of property identification or decal (maintaining a decal number log, assignment of decal numbers to items and ensuring each item is properly tagged or identified); documentation for authorized loan, movement from location, and transfer to another agency; guidelines pertaining to property declared excess, surplus, obsolete, beyond economical repair, lost, or stolen; guidelines for sale of property.”
- Chapter 9 – “At the end of each quarter, but no later than the 15<sup>th</sup> of the following month, the designated property custodian submits AGS Form 17-A (Detail Inventory of Property) to the Inventory Management Office, reporting all property acquisition and changes to their master inventory balances.”
- Chapter 10 – “After the fourth quarter, before September 16 of each year, each designated property custodian must submit to the SPO, Inventory Management Office Form AGS 17-B, Annual Inventory Report.”

**Recommendation**

We recommend that the Department adhere to State and internal policies and procedures over capital asset management. The State's and Department's policies are designed to achieve appropriate accounting, financial reporting and compliance. Department administration must hold programs accountable for adhering to policies and procedures through regular monitoring and application of consequences for noncompliance.

**State of Hawaii  
 Department of Health  
 Federal Awards Findings  
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**Section III – Federal Award Findings and Questioned Costs**

		<b>Questioned Cost</b>
<b>Finding No. 11-04:</b>	<b>Reporting (Significant Deficiency)</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable	Not applicable

**Finding and Cause and Effect**

During our testing of the reporting compliance requirement, we noted that the Department did not have policies and procedures in place to address the Federal Funding Accountability and Transparency Act (“FFATA”) reporting requirements for its programs that receive federal grants.

**Criteria**

In accordance with 2 CFR part 170, the Department’s programs are required to report executive compensation and first-tier subcontract awards on contracts and orders expected to be \$25,000 or more made with a new Federal Assistance Identification Number effective October 1, 2010 through the Federal Funding Accountability and Transparency Subaward Reporting System.

**Recommendation**

We recommend that the Department implement its policies and procedures that were subsequently developed in order to comply with federal regulations and submit any required FFATA reports for its programs.

**State of Hawaii  
 Department of Health  
 Special Supplemental Nutrition Program for Women, Infants, and Children  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-05:</b>	<b>Eligibility</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	Department of Agriculture	
<b>CFDA Number and Title:</b>	10.557 – Special Supplemental Nutrition Program for Women, Infants, and Children (“WIC”)	
<b>Award Number and Award Year:</b>	7HI700HI7 7HI700HI7	10/01/09 – 9/30/10 10/01/10 – 9/30/11

**Finding and Cause and Effect**

We noted the following instances of noncompliance with eligibility requirements for the WIC program:

- For 1 out of 60 participant records tested, we noted a non-certified Competent Professional Authority’s (“CPA”) signature on the Certification form.
- For 3 out of 60 participant records tested, the program was unable to provide written documentation apart from authorization noted in the program’s computer system that the signor of the food instrument was authorized to use the food instrument.

The lack of written support was largely due to human resource constraints at the WIC client site (local agency) level.

**Criteria**

Applicants for WIC program benefits are screened at WIC clinic sites to determine eligibility. In order to be certified eligible, a participant must meet categorical and income requirements, be able to show proof of residency, and have a nutritional risk.

The State Plan sets the guidelines for the requirements of the State’s WIC program. It specifies that a participant’s nutritional risk must be certified by a CPA as defined in 7 CFR Section 246.2. In addition, the participant’s categorical, income, and residency eligibility must be verified by a WIC staff member. The State Plan requires written documentation for eligibility and the authorized representative’s signature apart from the program’s computer system.

**Recommendation**

We recommend that the WIC program maintain written documentation apart from the computer system to evidence the eligibility of all WIC participants.

**State of Hawaii  
 Department of Health  
 Aging Cluster  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-06:</b>	<b>Reporting</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	DHHS	
<b>CFDA Number and Title:</b>	Aging Cluster 93.044 – Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers  93.045 – Special Programs for the Aging – Title III Part C – Nutrition Services Incentive Program  93.053 – Nutrition Services Incentive Program  93.705 – ARRA – Aging Home-Delivered Nutrition Services for States  93.707 – ARRA – Aging Congregate Nutrition Services for States	
<b>Award Number and Award Year:</b>	11AAHIT3SP                      10/01/10 – 09/30/11 10AAHIT3SP                      10/01/09 – 09/30/10  11AAHINSIP                      10/01/10 – 09/30/11 10AAHINSIP                      10/01/09 – 09/30/10  09AAHIC2RR                      03/18/09 – 09/30/10  09AAHIC1RR                      03/17/09 – 09/30/10	

**Finding and Cause and Effect**

During our current year audit for the Aging Cluster, we noted that the program did not submit the annual, semi-annual, and final Financial Status Report, Standard Form (“SF”)-425s as required.

**Criteria**

Part IV of the June 2011 OMB A-133 Compliance Supplement and the grant agreement state that the SF-425 is required annually, semi-annually, and at the final close of the grant. Failure to comply with the reporting requirements may result in deferral or additional restrictions of future funding decisions.

**Recommendation**

We recommend that the ASO and program personnel develop and implement procedures to ensure that accurate and complete financial reports are submitted to federal awarding agencies. Supporting documentation should be maintained to support the accuracy of data reported.

**State of Hawaii  
 Department of Health  
 Aging Cluster  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-07:</b>	<b>Matching and Earmarking</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	DHHS	
<b>CFDA Number and Title:</b>	Aging Cluster 93.044 – Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers  93.045 – Special Programs for the Aging – Title III Part C – Nutrition Services Incentive Program  93.053 – Nutrition Services Incentive Program  93.705 – ARRA – Aging Home-Delivered Nutrition Services for States  93.707 – ARRA – Aging Congregate Nutrition Services for States	
<b>Award Number and Award Year:</b>	11AAHIT3SP                      10/01/10 – 09/30/11 10AAHIT3SP                      10/01/09 – 09/30/10  11AAHINSIP                      10/01/10 – 09/30/11 10AAHINSIP                      10/01/09 – 09/30/10  09AAHIC2RR                      03/18/09 – 09/30/10  09AAHIC1RR                      03/17/09 – 09/30/10	

**Finding and Cause and Effect**

During our testing for the Aging Cluster, we noted that the program did not keep any supporting information to monitor the matching and earmarking compliance requirements. The requirements are monitored using the SF-425 reports which were not submitted by the program for the current year. We were unable to ensure if the program was in compliance for matching and earmarking.

**Criteria**

In accordance with 45 CFR Section 1321.47, the State must contribute at least 25% of the cost of the State plan administration as its matching share. In addition, overall expenditures earmarked for administration are limited to the greater of 5% of the overall allotment to a State under Title III unless a waiver is granted by the Assistant Secretary on Aging in accordance with 42 USC 3028.

**Recommendation**

We recommend that the Aging Cluster properly monitor compliance with the awards' matching and earmarking requirements. The program should be able to monitor the compliance requirements without relying solely on the SF-425 reports.

**State of Hawaii  
 Department of Health  
 Aging Cluster  
 Centers for Disease Control and Prevention –  
 Investigations and Technical Assistance  
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 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-08:</b>	<b>Certification for Federally Funded Employees</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	DHHS	
<b>CFDA Number and Title:</b>	Aging Cluster 93.044 – Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers  93.045 – Special Programs for the Aging – Title III Part C – Nutrition Services Incentive Program  93.053 – Nutrition Services Incentive Program  93.705 – ARRA – Aging Home-Delivered Nutrition Services for States  93.707 – ARRA – Aging Congregate Nutrition Services for States  93-283 – Centers for Disease Control and Prevention – Investigations and Technical Assistance (“CDC”)	
<b>Award Number and Award Year:</b>	11AAHIT3SP                      10/01/10 – 09/30/11 10AAHIT3SP                      10/01/09 – 09/30/10  11AAHINSIP                      10/01/10 – 09/30/11 10AAHINSIP                      10/01/09 – 09/30/10  09AAHIC2RR                      03/18/09 – 09/30/10  09AAHIC1RR                      03/17/09 – 09/30/10  5U58DP001962-03                03/29/11 – 03/28/12 5U58DP001962-02                03/29/10 – 03/28/11	

**Finding and Cause and Effect**

During our testing of the allowable costs compliance requirement for the Aging Cluster and CDC programs, we noted that the programs had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or their supervisors (per requirement stated below), confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 guidelines for payroll.

**State of Hawaii  
Department of Health  
Aging Cluster  
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Although proper controls are in place to ensure that only employees that spend time on grant-related activities actually charged time to the programs' appropriation, there was no documentation maintained to confirm that this control was in place and that the time allocated to the programs for these employees were periodically reviewed by the employees or their supervisors.

**Criteria**

In accordance with OMB Circular A-87 (the "Circular"), compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular. In accordance with the Circular, where employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first-hand knowledge of the work performed by the employee.

**Recommendation**

We recommend that the programs obtain semi-annual certifications from all employees that spend 100% of their time on federally funded grants, confirming that they worked solely on grant related activities. The certification should be signed by either the employees or their supervisors.

**State of Hawaii  
 Department of Health  
 Centers for Disease Control and Prevention –  
 Investigations and Technical Assistance  
 Schedule of Findings and Questioned Costs  
 Year Ended June 30, 2011**

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		<b>Questioned Cost</b>
<b>Finding No. 11-09:</b>	<b>Matching</b>	<b>\$ _____ –</b>
<b>Federal Agency:</b>	DHHS	
<b>CFDA Number and Title:</b>	93.283 – Centers for Disease Control and Prevention – Investigations, Technical Assistance	
<b>Award Number and Award Year:</b>	5U58DP001962-02 5U58DP001962-03	03/29/10 – 03/28/11 03/29/11 – 03/28/12

**Finding and Cause and Effect**

During our audit of the CDC program’s compliance, we were not able to validate that the Diabetes Prevention and Control Component of the program complied with the grant-specific matching requirements. The grant allows the matching requirement for the component to be fulfilled through a combination of sources, including payroll expenditures and services donated by several partners of the Department. Based on the CDC program’s estimates, the matching requirement was met if the estimated time and effort donated by the Department’s program partners are included. However, due to the lack of a formal policy, we noted that the program did not track the donated services and cannot provide support to verify that sufficient services were provided by its partners to meet the required match for the federal award.

**Criteria**

The Grant Award Letter states:

*“Matching funds are required from non-federal sources in an amount not less than \$1 for each \$4 of federal funds awarded to Tobacco Control, Diabetes Prevention and Control, Behavioral Risk Factor Surveillance System and Healthy Communities.”*

We confirmed with the award’s CDC grants management specialist that the specified match must be met for each component (e.g., tobacco, diabetes, etc.) of the subject federal award. If the match for one component exceeds the required match, the excess cannot be applied to another component to meet that component’s required match.

**Recommendation**

We recommend that the program develop and implement a formal process for monitoring all matching sources, including time and effort donated by the Department’s partners.

# **PART V**

## **Prior Year Findings And Questioned Costs**

This section updates the status of findings and questioned costs that were reported in prior years. Finding numbers relate to the sequence reported in the respective year.

**State of Hawaii**  
**Department of Health**  
**Financial Statement Findings**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2011**

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**Finding No. 10-01: Department of Human Services Transaction (Material Weakness)**

In prior year audits, it was noted that the Department had difficulty determining the amounts due to and due from DHS related to the Medicaid funds.

We recommended that the Department develop a policy for establishing contracts and maintaining records and balances due to and from DHS for the programs that are eligible to receive Medicaid reimbursement. A consistent policy will assist in ensuring that the data that is recorded is appropriate. In addition, if the Department is aware that DHS has to reconcile the data at the end of the year, which might result in the Department owing or receiving more Medicaid funds, the Department should ensure that the programs are following up with DHS on the status of the reconciliations. If the Department needs to cut current year costs to repay the prior years' shortfalls, it should ensure that it is aware of these shortfalls and can include them in the budget that is approved. On the other hand, any additional money that the Department could receive would help to alleviate other funding sources that are required to provide the required services.

**Status**

Unresolved. The Department continues to struggle with accurately accounting for and reporting Medicaid services transactions with DHS. Since the Department continues to address our recommendations in this finding in connection with our recommendations in current year Finding No. 11-01, this finding will not carry forward.

**Finding No. 10-02: Compensated Absences (Significant Deficiency)**

The Department's process for tracking compensated absences is decentralized. Each program is responsible for maintaining and tracking its own vacation, sick and compensatory time records. On an annual basis, the programs report their compensated absence information to the Department's ASO for purposes of preparation of the year-end financial statements and submission to DAGS. We noted the following matters during our prior year audits:

- Each division maintained its own vacation and sick leave records and submitted year-end totals to the fiscal office in the form of detailed division schedules. However, we noted that not all programs used the proper version of the G-1 system developed by the Health Information Systems Office.
- We noted an instance where a time keeper and another employee both entered the time keeper's compensatory absence earned which resulted in an overstatement of the time keeper's balance.
- Although employees are entitled to payment for their residual balances of accrued vacation and compensatory time upon termination of their employment, we noted that there are no Department-wide policies or procedures to ensure timely payment of vested compensated absence balances.
- We continued to note discrepancies in the amount of vacation/sick/comp hours between the "Annual Vacation and Sick Leave Accrual Report" and the DPS-7, Employee Leave Record forms.
- We also noted several instances where the individual entries were summed improperly, resulting in incorrect totals.

**State of Hawaii  
Department of Health  
Financial Statement Findings  
Status of Prior Year Findings and Questioned Costs  
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- We noted that the majority of programs did not use the system-wide G-1 report “Annual Vacation and Sick Leave Accrual Report” summary to report their vacation balances.

We recommended the following:

- Personnel responsible for maintenance, tracking and reporting of compensated absence information should receive formal training on how to properly use the G-1 tracking system and understand the purpose for tracking such information. The Department should establish a standardized format for reporting vacation, sick and compensatory time balances to ensure consistency across programs. Furthermore, someone in ASO familiar with governmental accounting principles should review the Department-wide compensated absence reports for accuracy and completeness.
- The Department should maintain a listing of all time keepers and ensure that time keepers are not maintaining their own compensated absence balances.
- The Department should develop, implement and communicate Department-wide procedures over the payment of accrued vacation and compensatory time balances to terminated employees in a timely manner.

**Status**

Unresolved. We continued to note errors in our testing of the accrued vacation balance. Since the Department continues to address our recommendations in this finding in connection with our recommendations in current year Finding No. 11-02, this finding will not carry forward.

**Finding No. 10-03: Equipment Management (Significant Deficiency)**

During our prior year audits, we noted that various programs did not update the FAIS records to ensure additions, transfers, and disposals were properly reflected in a timely manner. In addition, we noted that the programs did not use decals on new assets. These are violations of the State’s equipment management policies and procedures established in the State Inventory Manual.

We recommended that the Department follow the SPO manual and monitor its equipment, especially properly recording, safekeeping and reporting all additions and disposals of equipment acquired during the year. We also recommended that the Department adhere to the State’s established policies and procedures over equipment management in order to comply with Federal and State regulations.

**Status**

Unresolved. During our current audit, we continued to note similar instances where programs did not update the FAIS records and did not use decals on new assets. Since the Department is in the process of implementing our recommendation above in connection with our recommendations in current year Finding No.11-03, this finding will not carry forward.

**State of Hawaii  
Department of Health  
Immunization Cluster  
Status of Prior Year Findings and Questioned Costs  
Year Ended June 30, 2011**

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**Finding No. 10-04: Certification of Federally Funded Employees**

During our prior year testing of the allowable cost compliance requirement for the Immunization Cluster, we noted that the program had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or their supervisors, confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 guidelines for payroll.

We recommended that the Immunization Cluster obtain semi-annual certifications from all employees that spend 100% of their time on federally funded grants, confirming that they worked solely on grant related activities. The certification should be signed by either the employees or their supervisors.

**Status**

Resolved. In the current year, we noted that the Immunization Cluster had certifications for their federally funded employees that were properly signed. However, see Finding No. 11-08 for similar instances of noncompliance in other federally funded programs.

**State of Hawaii  
Department of Health  
HIV Care Formula Grants  
Status of Prior Year Findings and Questioned Costs  
Year Ended June 30, 2011**

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**Finding No. 10-05: Eligibility**

During our prior year testing of the eligibility compliance requirement for the HIV Care Formula Grants, we noted that for one out of the 38 AIDS Drug Assistance Program (“ADAP”) patient records tested, the participant continued to receive services without being recertified within six months as required by the Notice of Grant Award to the ADAP.

We recommended that the HIV program continue to conduct initial and semi-annual eligibility certifications of all participants as required by federal and State program guidelines in a timely manner.

**Status**

Resolved. In the current year audit, there were no instances of noncompliance.

**State of Hawaii  
Department of Health  
Aging Cluster  
Status of Prior Year Findings and Questioned Costs  
Year Ended June 30, 2011**

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**Finding No. 10-06: Allowable Costs/Cost Principles**

During our prior year testing of the allowable costs compliance requirement for the Aging Cluster, we noted that the Cluster did not maintain adequate supporting documentation for the time charged by an employee to the grant in accordance with OMB Circular A-87 guidelines for payroll.

We recommended that the program implement a procedure to obtain monthly time and effort sheets from all employees who perform work on federal grants, ensuring that expenses charged to federal grants is for actual time spent on the respective grant. The time records should be prepared monthly and signed by the employee.

**Status**

Unresolved. During our current audit, we continued to note similar instances where the Aging Cluster did not maintain adequate supporting documentation for the time charged by an employee to the grant. Since the Aging Cluster is in the process of implementing our recommendation above in conjunction with its implementation of our recommendation in the current year Finding No. 11-09, this finding will not carry forward.

**Finding No. 10-07: Reporting**

During our prior year audit, we noted that the program reported an incorrect amount of federal expenditures on the SF-269 and the Administration on Aging Supplemental Form (OMB No. 0985-0004). We noted the total expenditures for the Title III grant were misstated by \$76,536.

We recommended that the ASO and program personnel develop and implement procedures to ensure that accurate and complete financial reports are submitted to federal awarding agencies. Supporting documentation should be maintained to support the accuracy of data reported.

**Status**

Unresolved. During our current audit, we noted that the Aging Cluster did not submit the above report as the accountant position was vacant in the current year. Since the Aging Cluster is in the process of implementing our recommendation above in conjunction with its implementation of our recommendation in the current year Finding No. 11-06, this finding will not carry forward.

**State of Hawaii**  
**Department of Health**  
**Special Supplemental Nutrition Program for Women, Infants, and Children**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2011**

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**Finding No. 10-08: Eligibility**

During our prior year testing of the eligibility compliance requirement for the WIC program, we noted the following instances of noncompliance:

- For 6 out of 60 participant records tested, the program was unable to provide written documentation to evidence the eligibility of the participants.
- For 3 out of 60 participants records tested, the program was unable to provide written documentation that the signor of the food instrument was authorized to use the food instrument.

We recommended that the WIC program maintain written documentation to evidence the eligibility of all WIC participants.

**Status**

Unresolved. During our current audit, we continued to note similar instances of noncompliance. Since the WIC program is in the process of implementing our recommendation above in conjunction with its implementation of our recommendation in the current year Finding No. 11-05, this finding will not carry forward.

**State of Hawaii  
Department of Health  
Early Intervention Services Cluster  
Status of Prior Year Findings and Questioned Costs  
Year Ended June 30, 2011**

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**Finding No. 10-09: Subrecipient Monitoring**

During our prior year testing of the subrecipient monitoring compliance requirement for the Early Intervention Services (“IDEA”) Cluster, we noted that subawards to subrecipients for the IDEA Cluster did not contain the federal award number, CFDA number, or the amount of American Recovery and Reinvestment Act (“ARRA”) funds awarded. The subawards also did not require subrecipients to specifically identify ARRA funds in their Schedules of Expenditures of Federal Awards and Data Collection Forms. This was an oversight by all parties involved in the subaward process, including the ASO, Attorney General and program personnel.

We recommended that the Department incorporate ARRA specific requirements into its subrecipients’ awards containing ARRA funds.

**Status**

Resolved. In the current year audit, there were no instances of noncompliance.

**State of Hawaii**  
**Department of Health**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2011**

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**Finding No. 06-08: Cash Management**

During our prior year review of the Department's cash management procedures, we noted that we could not verify whether the time between the transfer of funds from the U.S. Treasury and disbursement by DAGS was minimized in accordance with the Cash Management Improvement Act Regulations & Guidance 31 CFR 205 (Final Rule). We also noted that the Department was not calculating or remitting any interest earnings attributable to these potential untimely disbursements. The delays were caused by the State's payment process that requires payments by all State departments to be processed through DAGS resulting in processing delays.

We recommended that the Department work with DAGS to ensure timely disbursement of federal funds. In addition, we recommended that the Department calculate and remit any interest liability to the federal government, if necessary, in accordance with federal regulations.

**Status**

Unresolved. We continued to find the Department is not calculating interest on the funds drawn down in advance.

We were also still unable to verify whether the Department and DAGS complied with the Cash Management Improvement Act's requirement to minimize the time between the transfer of funds from the U.S. Treasury and disbursement by the Department.

## **Corrective Action Plan**

NEIL ABERCROMBIE  
GOVERNOR OF HAWAII



LORETTA J. FUDDY, A.C.S.W., M.P.H.  
DIRECTOR OF HEALTH

STATE OF HAWAII  
DEPARTMENT OF HEALTH  
P. O. BOX 3378

In reply, please refer to:  
File:

ASO-F/12-644

March 22, 2012

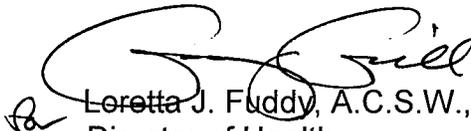
Office of the Auditor  
465 South King Street, Suite 500  
Honolulu, Hawaii 96813

Dear State Auditor:

Attached are the Department of Health's Corrective Action Plan for the findings on the audit report for fiscal year 2011 and comments regarding prior year findings.

We appreciate the opportunity to comment on the audit report.

Sincerely,

  
Loretta J. Fuddy, A.C.S.W., M.P.H.  
Director of Health

Attachment

## **II. Financial Statement Findings**

### **Finding No. 11-01: Department of Human Services Transactions (Material Weakness)**

#### **Finding and Cause and Effect**

The Department has difficulty determining the amounts due to or from the State of Hawaii, Department of Human Services ("DHS") related to services provided by the Department's Adult Mental Health Division ("AMHD") program to Medicaid eligible patients under contracts between the Department and DHS.

Due to the decentralized manner in which DHS contracts are structured and managed, and the fact that DHS does not regularly reconcile payments to the Department, the Department continually struggles with DHS to accurately determine the settlement of Medicaid related transactions for financial reporting purposes, which could lead to material misstatements in the Department's financial statements.

#### **Corrective Action Plan**

The Department will continue to strive to develop Medicaid service contracts with DHS that contain consistent terms and conditions. It is anticipated that the hiring and training of qualified staff will enable AMHD to be able to have the necessary staff to work closely with DHS to reconcile Medicaid payments with billings. In addition, AMHD will develop policies to ensure appropriate documentation is maintained to support billing to DHS. Further, provided that funds are not restricted or transferred out of AMHD, there should be adequate funds available in the event that it is determined that overpayments need to be returned to DHS.

#### **Person Responsible**

AMHD Chief and Public Health Administrator Officer VI

#### **Anticipated Date of Completion**

June 30, 2012

### **Finding No. 11-02: Compensated Absences (Significant Deficiency)**

#### **Finding and Cause and Effect**

The Department's process for tracking compensated absences is decentralized. Each program is responsible for maintaining and tracking its own vacation, sick and compensatory time records. On an annual basis, the programs report their compensated absence information to the Department's Administrative Services Office ("ASO") for purposes of preparation of the year-end financial statements and submission to the Department of Accounting and General Services ("DAGS").

### **Corrective Action Plan**

The Department's Health Information Systems Office (HISO) developed a new web-based G-1 Leave Tracking System which has been implemented in phases. This system is customizable, reliable, and uses human resource compensated absences management software that manages all types of employee absences. It automatically tracks balances for vacations, sick leave, and compensatory time earned by each employee, as well as prints the G-1 leave form and Form 7 that shows a detailed breakout of all leave taken during a calendar year.

In June 2011, a departmental policy and procedure regarding this G-1 Leave Tracking System was distributed to the programs. This new system will improve our tracking of employee leave balances and ensure that terminated employees are paid out for their vested compensated absence balances in a timely manner. A revised Accrued Vacation and Sick Leave Balance must be provided to ASO if there are any subsequent adjustments after the original submittal.

All employees responsible for inputting into this system have been trained by HISO.

### **Person Responsible**

Human Resources Officer, Health Information Systems Office Chief, and ASO Fiscal Officer

### **Anticipated Date of Completion**

June 30, 2012

### **Finding No. 11-03: Equipment Management (Significant Deficiency)**

#### **Finding and Cause and Effect**

The Department adheres to the State's policies and procedures contained in the DAGS – State Procurement Office ("SPO") – Inventory Management Branch Training Manual ("State Inventory Manual") for capital asset accounting, financial reporting, and compliance with equipment management in accordance with OMB Circular A-133. In addition, the Department requires property custodians to reconcile quarterly equipment acquisitions in the Financial Accounting and Management Information System ("FAMIS") to the DAGS computerized inventory reports ("MDB reports") from the State's Fixed Asset Inventory System ("FAIS").

During our audit, we noted the following matters that resulted in either audit adjustments or noncompliance with federal requirements:

- Quarterly reconciliations were not performed consistently and discrepancies identified went unresolved.

- The programs reported capital asset purchases to SPO for inclusion in FAIS in an untimely manner and failed to use decals on capital asset additions for physical tracking purposes.

### **Corrective Action Plan**

The Department will continue to strive to adhere to State and internal policies and procedures for capital asset management. Programs, especially those funded by federal grants, will be reminded to report capital asset purchases to SPO for inclusion in FAIS in a timely manner and to promptly affix the decals on capital asset additions for physical tracking purposes.

The ASO will work with the programs to ensure that they designate appropriate staff to be responsible for equipment management and will monitor programs for equipment inventory compliance.

### **Person Responsible**

ASO Procurement and Supply Specialist and Public Health Administrative Officer or Program Chief for each program

### **Anticipated Date of Completion**

June 30, 2012

### **Section III. Federal Award Findings and Questioned Costs**

#### **Finding No. 11-04: Reporting (Significant Deficiency)**

##### **Finding and Cause and Effect**

During our testing of the reporting compliance requirement, we noted that the Department did not have policies and procedures in place to address the Federal Funding Accountability and Transparency Act ("FFATA") reporting requirements for its programs that receive federal grants.

In accordance with 2 CFR part 170, the Department's programs are required to report executive compensation and first-tier subcontract awards on contracts and orders expected to be \$25,000 or more made with a new Federal Assistance Identification Number ("FAIN") effective October 1, 2010 through the Federal Funding Accountability and Transparency Subaward Reporting System ("FSRS").

##### **Corrective Action Plan**

The Office of Planning, Policy, and Program Development will distribute and implement the departmental FFATA reporting policy and procedures to ensure that the Department complies with the federal FFATA reporting requirements.

##### **Person Responsible:**

Office of Planning, Policy, and Program Development Chief

##### **Anticipated Date of Completion**

June 30, 2012

#### **Finding No. 11-05: Eligibility**

##### **Finding and Cause and Effect**

We noted the following instances of noncompliance with eligibility requirements for the WIC Program:

- For 1 out of 60 participant records tested, we noted a non-certified Competent Professional Authority's ("CPA") signature on the Certification form.
- For 3 out of 60 participant records tested, the program was unable to provide written documentation apart from authorization noted in the computer system that the signor of the food instrument was authorized to use the food instrument.

The lack of written support was largely due to human resource constraints at the WIC client site (local agency) level.

### **Corrective Action Plan**

Last year's audit findings of the WIC Program's inadequate written documentation on (1) CPA signature on the Certification form and (2) authorization for signor of the food instrument to use the food instrument were reviewed with Local Agency Coordinator (LACs) along with suggestions for improvement at the July 15, 2011 state-wide WIC monthly meeting. The auditor approved the WIC Services Branch's plan to revise the Second Authorized Representative forms to be collected by family instead of individual participants. This streamlined process of collecting authorization for signor of the food instruments was reviewed with LACs at the August 12, 2011 state-wide WIC monthly meeting. All five affected LACs (Kapiolani, Kokua Kalihi Valley, Wahiawa, Waianae Coast Comprehensive Health Center, and Waimanalo) have reviewed these findings and recommendations with their staff. The WIC program has implemented procedures to also maintain written documentation to provide evidence of the eligibility of their participants.

### **Person Responsible**

WIC Services Branch Chief

### **Anticipated Date of Completion**

December 31, 2011

### **Finding No. 11-06: Reporting**

#### **Finding and Cause and Effect**

During our current year audit for the Aging Cluster, we noted that the program did not submit the annual, semi-annual, and final Financial Status Report, Standard Form ("SF")-425s for Title III and NSIP as required.

#### **Corrective Action Plan**

Effective February 1, 2012, the Executive Office on Aging filled their vacant Accountant IV position. This position, which is responsible for submitting the Federal Financial Reports (FFRs) for EOA, will complete the outstanding FFRs for the Title III and NSIP grants by June 30, 2012 and ensure that all other EOA FFRs are submitted in a timely manner as required. Also, the Accountant will ensure that documentation is maintained to support the accuracy of the data provided on the FFRs.

**Person Responsible**

EOA Accountant

**Anticipated Date of Completion**

June 30, 2012

**Finding No. 11-07: Matching and Earmarking**

**Finding and Cause and Effect**

During our testing for the Aging Cluster, we noted that the program did not keep any supporting information to monitor the matching and earmarking compliance requirements. The requirements are monitored using the SF-425 reports which were not submitted by the program for the current year. We were unable to ensure if the program was in compliance for matching and earmarking.

**Corrective Action Plan**

Effective February 1, 2012, the Executive Office on Aging filled their vacant Accountant IV position. The Accountant is responsible for ensuring that EOA complies with the federal grant matching and earmarking requirements and maintains supporting documentation. Also, the Accountant will complete and submit the SF-425 reports as required in a timely manner.

**Person Responsible**

EOA Accountant

**Anticipated Date of Completion**

June 30, 2012

**Finding No. 11-08: Certification for Federally Funded Employees**

**Finding and Cause and Effect**

During our testing of the allowability compliance requirement for the Aging Cluster and CDC programs, we noted that the programs had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or their supervisors, confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 ("Circular") guidelines for payroll.

Although proper controls are in place to ensure that only employees that spend time on grant-related activities actually charged time to the program's appropriation, there was no

documentation maintained to confirm that this control was in place and that the time allocated to the program for these employees were periodically reviewed by the employees or their supervisors.

### **Corrective Action Plan**

The Executive Office on Aging (EOA), who is responsible for the Aging Cluster program, implemented procedures on July 1, 2011 to have the employees complete semi-annual certifications to document the percent of time spent on grant activities. The certifications are signed by either the employees or their supervisors. The EOA Accountant will be responsible for obtaining these certifications for federally funded employees. Those employees who have spent 100% of their time on one grant have been completing semi-annual certifications. For those employees that are funded by more than one federal program time and effort sheets have been done in accordance with OMB Circular A-87/ 2 CFR part 225, Appendix B, 8 Compensation for Salaries and Wages.

The Tobacco Prevention and Education Program (TPEP) has subsequently developed procedures to obtain semi-annual certifications from its federally funded employees to document the percentage of time spent performing grant activities to ensure compliance with federal requirements from the new grant budget year that begins March 29, 2012. In addition, the program will obtain retroactive certifications for FY 2012. These semi-annual certifications will be signed by either the employees or their supervisors.

### **Person Responsible**

Accountant IV for EOA and Program Manager for the TPEP

### **Anticipated Date of Completion**

July 1, 2011 for EOA and March 29, 2012 for TPEP

## **Finding No. 11-09: Matching**

### **Finding and Cause and Effect**

During our audit of the CDC program's compliance, we were not able to validate that the Diabetes Prevention and Control Component of the program complied with the grant-specific matching requirements. The grant allows the matching requirement for the component to be fulfilled through a combination of sources, including payroll expenditures and services donated by several partners of the Department. Based on the CDC program's estimates, the matching requirement was met if the estimated time and effort donated by the Department's program partners are included. However, due to the lack of a formal policy, we noted that the program did not track the donated services and cannot provide support to verify that sufficient services were provided by its partners to meet the required match for the federal award.

### **Corrective Action Plan**

A monitoring system will be developed to track all matching sources that are contributed by the Hawaii Diabetes Prevention and Control Program (DPCP) partners to the DPCP program effort. The system will include documentation of all matching sources such as partner's time spent at meetings; and contribution of resources such as facility space, supplies, and materials.

### **Person Responsible**

Chronic Disease Management and Control Branch Chief

### **Anticipated Date of Completion**

June 30, 2012

### **Finding No. 06-08: Cash Management**

During our prior year review of the Department's cash management procedures, we noted that we could not verify whether the time between the transfer of funds from the U.S. Treasury and disbursement by DAGS was minimized in accordance with the Cash Management Improvement Act Regulations & Guidance 31 CFR 205 (Final Rule). We also noted that the Department was not calculating or remitting any interest earnings attributable to these potential untimely disbursements. The delays were caused by the State's payment process that requires payments by all State departments to be processed through DAGS resulting in processing delays.

### **Corrective Action Plan**

The Department of Health is part of the Executive Branch of the State of Hawaii. As such, the Department must follow the accounting guidelines and procedures provided by the State Department of Accounting and General Services (DAGS). DAGS requires that all cash receipts and disbursements must be recorded in the State's Financial Accounting Management and Information System (FAMIS).

The Department is one of the largest agencies in the Hawaii State Executive Branch. We have more than 150 federal grants with multiple grant years. Each program is responsible for managing their grant, reviewing invoices, and certifying invoices for payment. Our ASO Audit Unit of the Procurement and Audit Section reviews the submitted invoices and inputs payment data to the State Accounting System. The ASO Accounting Section prepares the daily cash management requirement spreadsheets based on FAMIS reports and performs daily cash draws as needed. Because we are using the State System, we may not be able to meet the requirements of the federal government's three-day drawdown rule which results in payment delays.

**Person Responsible**

Administrative Services Officer and Fiscal Officer

**Anticipated Date of Completion**

Not applicable.