

**State of Hawaii
Water Pollution Control
Revolving Fund
Financial Statements
June 30, 2012**

Submitted by
The Auditor
State of Hawaii

**State of Hawaii
Water Pollution Control Revolving Fund
Index
June 30, 2012**

	Page(s)
Report of Independent Auditors	
Financial Statements	
Statement of Net Assets	3
Statement of Revenues, Expenses and Change in Net Assets.....	4
Statement of Cash Flows	5
Notes to Financial Statements	6–13
Supplementary Information	
Schedule of Cash Receipts, Disbursements and Cash Balance	14
Combining Statement of Net Assets	15
Combining Statement of Revenues, Expenses and Change in Net Assets	16
Schedule of Operating Expenses	17
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 <i>Government Auditing Standards</i>	
Report of Independent Auditors on Compliance with the Requirements Applicable to the United States Environmental Protection Agency’s Clean Water State Revolving Funds Program in Accordance with <i>Government Auditing Standards</i>	

Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Water Pollution Control Revolving Fund (the "Fund") as of June 30, 2012, and the related statements of revenues, expenses and change in net assets, and cash flows for the year then ended, which collectively comprise the Fund's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2012, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2012 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and 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 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.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Fund's financial statements as a whole. The supplementary information on pages 14 through 17 is presented for purposes of additional analysis and is not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relate 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 in relation to the financial statements as a whole.

Accuity LLP

Honolulu, Hawaii
December 5, 2012

Financial Statements

State of Hawaii
Water Pollution Control Revolving Fund
Statement of Net Assets
June 30, 2012

Assets

Current assets

Equity in cash and cash equivalents and investments in State Treasury	\$ 107,108,422
Loan fees receivable	404,359
Accrued interest on loans	688,316
Other accrued interest	56,392
Current maturities of loans receivable	<u>29,834,212</u>
Total current assets	138,091,701

ARRA advances	9,616,711
Loans receivable, net of current maturities	294,647,677
Capital assets, net of accumulated depreciation	<u>36,884</u>
Total assets	<u>\$ 442,392,973</u>

Liabilities and Net Assets

Current liabilities

Accounts payable and other accrued liabilities	<u>\$ 141,057</u>
Total current liabilities	141,057

Accrued vacation, net of current portion	213,048
Other postemployment benefits	<u>843,601</u>
Total liabilities	1,197,706

Commitments and contingencies

Net assets

Invested in capital assets	36,884
Restricted – expendable	<u>441,158,383</u>
Total net assets	<u>441,195,267</u>
Total liabilities and net assets	<u>\$ 442,392,973</u>

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

State of Hawaii
Water Pollution Control Revolving Fund
Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2012

Operating revenues	
Interest income from loans	\$ 2,904,650
Administrative loan fees	1,776,548
Total operating revenues	<u>4,681,198</u>
Operating expenses	
Administrative	<u>1,790,582</u>
Total operating expenses	<u>1,790,582</u>
Operating income	2,890,616
Nonoperating revenues and expenses	
State contributions	3,157,000
Federal contributions	17,546,590
Federal ARRA contributions	7,370,596
Principal forgiveness for SRF	(2,000,000)
Principal forgiveness for ARRA	(17,263,909)
Other interest income	155,187
Total nonoperating revenues and expenses	<u>8,965,464</u>
Change in net assets	11,856,080
Net assets	
Beginning of year	<u>429,339,187</u>
End of year	<u>\$ 441,195,267</u>

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

State of Hawaii
Water Pollution Control Revolving Fund
Statement of Cash Flows
Year Ended June 30, 2012

Cash flows from operating activities	
Interest income from loans	\$ 2,895,373
Administrative loan fees	1,757,425
Principal repayments on loans	27,615,449
Disbursement of loan proceeds	(48,510,298)
Payments to employees	(1,417,773)
Payments to vendors	(191,338)
	<u>(17,851,162)</u>
Net cash used in operating activities	
Cash flows from noncapital financing activities	
State contributions	3,157,000
Federal contributions	17,546,590
Federal ARRA contributions	7,370,596
Disbursement of ARRA advances	(7,239,628)
	<u>20,834,558</u>
Net cash provided by noncapital financing activities	
Cash flows from capital and related financing activities	
Purchased equipment	(39,612)
	<u>(39,612)</u>
Net cash used in capital and related financing activities	
Cash flows from investing activities	
Other interest income	226,035
	<u>226,035</u>
Net cash provided by investing activities	
Net increase in cash	
	<u>3,169,819</u>
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	<u>103,938,603</u>
End of year	<u>\$ 107,108,422</u>
Reconciliation of operating income to net cash used in operating activities	
Operating income	\$ 2,890,616
Adjustment to reconcile operating income to net cash used in operating activities	
Depreciation expense	2,728
Principal forgiveness for SRF	(2,000,000)
Change in assets and liabilities	
Loan fees receivable	(19,124)
Accrued interest on loans	(9,277)
Loans receivable	(18,894,848)
Accounts payable and other accrued liabilities	(44,547)
Other postemployment benefits	223,290
	<u>223,290</u>
Net cash used in operating activities	
	<u>\$ (17,851,162)</u>

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

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

1. Establishment and Purpose of the Fund

The Clean Water Act of 1987 (the "Act") provides for the U.S. Environmental Protection Agency ("EPA") to make grants to states for the purpose of making loans to finance the construction of publicly owned wastewater treatment works, implementation of a non-point source pollution control management program, and implementation of an estuary conservation and management program. Under the Act, the State of Hawaii ("State") was eligible to receive up to \$72 million in federal capitalization grants. Although the Act expired on September 30, 1995, the State continues to receive capitalization grants from the EPA.

In 1988, the State Legislature established the Water Pollution Control Revolving Fund (the "Fund") to implement the federal loan program. The Fund is administered by the Wastewater Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to county and State agencies for the construction of wastewater treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years, with the first repayment of principal and interest occurring no later than one year after the notice to proceed for construction or the final agreement date, whichever is later.

2. Summary of Significant Accounting Policies

Basis of Presentation

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

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

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

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

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates relate to the allowances for doubtful accounts, depreciable lives of capital assets, fair value of equity in cash and cash equivalents and investments in State Treasury, and other postemployment benefits ("OPEB") liability.

Equity in Cash and Cash Equivalents and Investments in State Treasury

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

At June 30, 2012, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

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 a loss for the year ended June 30, 2012 and that each participating State agency would be allocated a portion of the loss. The Fund's allocated loss for 2012 amounted to \$366,375.

ARRA Advances

The Fund received American Recovery and Reinvestment Act ("ARRA") stimulus money that was used to provide construction grants with no interest or loan fees and 100 percent principal forgiveness upon completion of approved projects. The Fund is allowed to use up to 4 percent of the ARRA funds for administrative costs, and has elected to use \$600,000 for administrative costs, with the remaining amount committed to grants. ARRA funds provided to counties have been classified as "ARRA Advances" on the Statement of Net Assets 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 Fund. Interest is calculated from the date that loan funds are disbursed. 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. The capitalization grants for federal fiscal years 2011 and 2010 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

Administrative Loan Fees

In June 1996, the Department implemented an administrative loan fee program to pay for the Fund's administration, including employee salaries and benefits. The program applies an administrative fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

Capital Assets

Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than \$5,000. Such assets consist principally of equipment, and are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5-7 years) of the respective assets.

Accrued Vacation

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

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in ERS. At June 30, 2012, accumulated sick leave was approximately \$853,000.

Net Assets

The Fund's net assets are classified as restricted expendable. These net assets are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

Administrative Costs

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

Fund Accounts

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

Expenses

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

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

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 Fund's financial statements.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources and a governmental entity's net position. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to reclassify assets and liabilities as deferred outflows of resources and deferred inflow of resources for consistency in financial reporting. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 66, *Technical Corrections*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The objective of this Statement is to establish accounting and financial reporting requirements for pensions of governments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

3. Loans Receivable

At June 30, 2012, loans receivable from government entities were as follows:

Twenty-six loans receivable from the City & County of Honolulu; due in annual or semi-annual payments, including interest ranging from 0.50% 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.	\$ 224,734,976
Eighteen loans receivable from the County of Hawaii; due in annual or semi-annual payments, including interest ranging from 0.50% 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.	29,050,626
Twenty-two loans receivable from the County of Maui; due in annual or semi-annual payments, including interest ranging from 0.50% to 2.60%, 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.	52,669,178
Ten loans receivable from the County of Kauai; due in semi-annual or quarterly payments, including interest ranging from 0.50% to 2.78%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	<u>18,027,109</u>
	324,481,889
Less: Current maturities	<u>29,834,212</u>
	<u>\$ 294,647,677</u>

Loans are expected to mature at various dates through 2031. The scheduled principal payments on loans maturing in subsequent years are as follows:

2013	\$ 29,834,212
2014	27,596,190
2015	23,908,067
2016	23,547,255
2017	22,482,746
Thereafter	<u>197,113,419</u>
	<u>\$ 324,481,889</u>

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

In fiscal year 2012, \$2,000,000 and \$17,264,000 in loans and ARRA advances, respectively, were forgiven. All loans and advances forgiven were in accordance with the required conditions.

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

At June 30, 2012, \$17,047,000, \$2,464,000, and \$6,823,000 were committed to be loaned out to the County of Hawaii, County of Kauai, and County of Maui, respectively, under existing loan agreements.

4. Contributed Capital

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2012:

Budget Period	Amount	Total Draws at June 30, 2011	Total 2012 Cash Draws	Funds Available
10/01/08 – 06/30/16	\$ 5,223,500	\$ 5,014,560	\$ 57	\$ 208,883
10/01/08 – 06/30/14 (ARRA)	30,352,300	20,110,024	7,370,596	2,871,680
12/31/09 – 06/30/16	5,223,500	-	5,014,750	208,750
04/01/11 – 06/30/17	15,781,000	-	12,531,725	3,249,275
09/30/11 – 06/30/18	11,436,000	-	58	11,435,942
	<u>\$ 68,016,300</u>	<u>\$ 25,124,584</u>	<u>\$ 24,917,186</u>	<u>\$ 17,974,530</u>

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. The State is not required to match funds for ARRA awards. Through June 30, 2012, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2012 approximated \$48.2 million, of which approximately \$45.9 million has been utilized and approximately \$2.3 million was available to be loaned out at June 30, 2012.

ARRA funds available are budgeted to be spent on grants and administrative expenses. Grants have been committed to counties and will be disbursed upon request for reimbursement.

5. Capital Assets

Summary of capital assets at June 30, 2012, is as follows:

	Balance at July 1, 2011	Additions	Retirements/ Disposals	Balance at June 30, 2012
Equipment	\$ 38,598	\$ 39,612	\$ -	\$ 78,210
Accumulated depreciation	(38,598)	(2,728)	-	(41,326)
	<u>\$ -</u>	<u>\$ 36,884</u>	<u>\$ -</u>	<u>\$ 36,884</u>

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

6. Accrued Vacation

At June 30, 2012, long-term obligations included accrued vacation as follows:

Balance at July 1, 2011	\$ 311,610
Increase	95,322
Decrease	<u>(120,731)</u>
Balance at June 30, 2012	286,201
Less: Current portion	<u>73,153</u>
Noncurrent portion	<u>\$ 213,048</u>

7. Employee Benefit Plans

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

Employees' Retirement System

The ERS is a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

Deferred Compensation Plan

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

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

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 OPEB information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution ("ARC"), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR. The basis for the allocation is the proportionate share of contributions made by each component unit or proprietary fund for retiree health benefits.

State of Hawaii
Water Pollution Control Revolving Fund
Notes to Financial Statements
June 30, 2012

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 Fund's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Fund for the year ended June 30, 2012:

Annual OPEB cost	\$ 305,720
Less: contributions made	<u>(82,430)</u>
Increase in net OPEB obligation	223,290
Net OPEB obligation	
Beginning of year	<u>620,311</u>
End of year	<u>\$ 843,601</u>

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the years ended June 30, 2012, 2011, and 2010, approximated \$82,000, \$69,000, and \$65,000, respectively.

Required Supplementary Information and Disclosures

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

8. Insurance Coverage

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

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

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

Supplementary Information

State of Hawaii
Water Pollution Control Revolving Fund
Schedule of Cash Receipts, Disbursements and Cash Balance
Year Ended June 30, 2012

Receipts

Principal repayments on loans	\$ 27,615,449
Interest income from loans	2,895,373
State contributions	3,157,000
Federal contributions	17,546,590
Federal ARRA contributions	7,370,596
Administrative loan fees	1,757,425
Other interest income	<u>226,035</u>
Total receipts	<u>60,568,468</u>

Disbursements

Disbursement of loan proceeds	48,510,298
Disbursement of ARRA advances	7,239,628
Administrative	<u>1,648,723</u>
Total disbursements	<u>57,398,649</u>
Excess of receipts over disbursements	3,169,819

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

Beginning of year	<u>103,938,603</u>
End of year	<u>\$ 107,108,422</u>

State of Hawaii
Water Pollution Control Revolving Fund
Combining Statement of Net Assets
June 30, 2012

	State Revolving Fund Activity	State Activity	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 103,858,221	\$ 3,250,201	\$ 107,108,422
Loan fees receivable	-	404,359	404,359
Accrued interest on loans	688,316	-	688,316
Other accrued interest	56,392	-	56,392
Current maturities of loans receivable	<u>26,583,717</u>	<u>3,250,495</u>	<u>29,834,212</u>
Total current assets	131,186,646	6,905,055	138,091,701
ARRA advances	9,616,711	-	9,616,711
Loans receivable, net of current maturities	290,583,556	4,064,121	294,647,677
Capital assets, net of accumulated depreciation	<u>-</u>	<u>36,884</u>	<u>36,884</u>
Total assets	<u>\$ 431,386,913</u>	<u>\$ 11,006,060</u>	<u>\$ 442,392,973</u>
Liabilities and Net Assets			
Current liabilities			
Accounts payable and other accrued liabilities	<u>\$ -</u>	<u>\$ 141,057</u>	<u>\$ 141,057</u>
Total current liabilities	-	141,057	141,057
Accrued vacation, net of current portion	-	213,048	213,048
Other postemployment benefits	<u>-</u>	<u>843,601</u>	<u>843,601</u>
Total liabilities	-	1,197,706	1,197,706
Net assets			
Invested in capital assets	-	36,884	36,884
Restricted – expendable	<u>431,386,913</u>	<u>9,771,470</u>	<u>441,158,383</u>
Total net assets	<u>431,386,913</u>	<u>9,808,354</u>	<u>441,195,267</u>
Total liabilities and net assets	<u>\$ 431,386,913</u>	<u>\$ 11,006,060</u>	<u>\$ 442,392,973</u>

State of Hawaii
Water Pollution Control Revolving Fund
Combining Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2012

	State Revolving Fund Activity	State Activity	Total
Operating revenues			
Interest income from loans	\$ 2,739,276	\$ 165,374	\$ 2,904,650
Administrative loan fees	-	1,776,548	1,776,548
Total operating revenues	2,739,276	1,941,922	4,681,198
Operating expenses			
Administrative	57,471	1,733,111	1,790,582
Total operating expenses	57,471	1,733,111	1,790,582
Operating income	2,681,805	208,811	2,890,616
Nonoperating revenues and expenses			
State contributions	3,157,000	-	3,157,000
Federal contributions	17,546,590	-	17,546,590
Federal ARRA contributions	7,370,596	-	7,370,596
Principal forgiveness for SRF	(2,000,000)	-	(2,000,000)
Principal forgiveness for ARRA	(17,263,909)	-	(17,263,909)
Other interest income	155,187	-	155,187
Total nonoperating revenues and expenses	8,965,464	-	8,965,464
Interfund transfers	4,196,307	(4,196,307)	-
Change in net assets	15,843,576	(3,987,496)	11,856,080
Net assets			
Beginning of year	415,543,337	13,795,850	429,339,187
End of year	\$ 431,386,913	\$ 9,808,354	\$ 441,195,267

Note: Interest earnings from State Activity are deposited into the State Revolving Fund Activity.

State of Hawaii
Water Pollution Control Revolving Fund
Schedule of Operating Expenses
Year Ended June 30, 2012

	State Revolving Fund Activity	State Activity	Total
Personnel	\$ (2,217)	\$ 1,597,808	\$ 1,595,591
Travel	-	54,857	54,857
Professional services	-	21,928	21,928
Services rendered by other State agencies	-	21,571	21,571
Telephone	302	8,821	9,123
Rental	-	7,615	7,615
Office and other supplies	-	7,368	7,368
Training	-	2,892	2,892
Depreciation	-	2,728	2,728
Repairs and maintenance	-	649	649
Miscellaneous	59,386	6,874	66,260
Total	<u>\$ 57,471</u>	<u>\$ 1,733,111</u>	<u>\$ 1,790,582</u>



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Water Pollution Control Revolving Fund (the "Fund"), as of and for the year ended June 30, 2012, and have issued our report thereon dated December 5, 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 Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A 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.

Our consideration of internal control over financial reporting 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 financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and 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*.

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

Accuity LLP

Honolulu, Hawaii
December 5, 2012



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Water Pollution Control Revolving Fund (the "Fund") as of and for the year ended June 30, 2012, and have issued our report thereon dated December 5, 2012.

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

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

that are applicable to its Capitalization Grants for Clean Water State Revolving Funds program (CFDA No. 66.458) for the year ended June 30, 2012. The management of the Fund is responsible for the Fund's compliance with these requirements. Our responsibility is to express an opinion on those requirements based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the United States *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on the Capitalization Grants for Clean Water State Revolving Funds program (CFDA No. 66.458) occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with the compliance requirements referred to above 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 Fund's compliance with the compliance requirements referred to above.

In our opinion, the Fund complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its Capitalization Grants for Clean Water State Revolving Funds program (CFDA No. 66.458) for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the Fund 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 Fund's internal control over compliance with the requirements that could have a direct and material effect on its Capitalization Grants for Clean Water State Revolving Funds program (CFDA No. 66.458) to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Fund'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.

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

Accuity LLP

Honolulu, Hawaii
December 5, 2012