Accuity LLP
CERTIFIED PUBLIC ACCOUNTANTS

State of Hawaii
Water Pollution Control Revolving Fund

Financial Statements

June 30, 2013

Submitted by
The Auditor
State of Hawaii

Quality *Integrity* *Insight*

State of Hawaii
Water Pollution Control Revolving Fund
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June 30, 2013

CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

The Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying statement of net position of the State of Hawaii, Water Pollution Control Revolving Fund (the "Fund") as of June 30, 2013, and the related statements of revenues, expenses and change in net position, and cash flows for the year then ended, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinion.

Opinion

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, 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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Emphasis of Matter
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. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information
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.

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. 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 relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2013 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* in considering the Fund's internal control over financial reporting and compliance.

Accuity LLP

Honolulu, Hawaii
November 15, 2013

Financial Statements

State of Hawaii
Water Pollution Control Revolving Fund
Statement of Net Position
June 30, 2013

Assets	
Current assets	
Equity in cash and cash equivalents and investments in State Treasury	$ 148,844,338
Loan fees receivable	280,708
Accrued interest on loans	504,550
Other accrued interest	94,184
Due from federal government – SRF	101,592
Current maturities of loans receivable	26,199,474
Total current assets	176,024,846
ARRA advances	12,198,183
Loans receivable, net of current maturities	279,296,020
Capital assets, net of accumulated depreciation	26,982
Total assets	$ 467,546,031
Liabilities and Net Position	
Current liabilities	
Accounts payable and other accrued liabilities	$ 162,747
Total current liabilities	162,747
Accrued vacation, net of current portion	212,568
Other postemployment benefits	1,123,640
Total liabilities	1,498,955
Commitments and contingencies	
Net position	
Invested in capital assets	26,982
Restricted – expendable	466,020,094
Total net position	466,047,076
Total liabilities and net position	$ 467,546,031

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 Position
Year Ended June 30, 2013

Operating revenues	
Interest income from loans	$ 2,478,653
Administrative loan fees	1,838,180
Total operating revenues	4,316,833
Operating expenses	
Administrative	1,926,407
Total operating expenses	1,926,407
Operating income	2,390,426
Nonoperating revenues and expenses	
State contributions	3,157,000
Federal contributions	16,376,424
Federal ARRA contributions	2,581,472
Principal forgiveness for SRF	(1,000,000)
Other interest income	1,346,487
Total nonoperating revenues and expenses	22,461,383
Change in net position	24,851,809
Net position	
Beginning of year	441,195,267
End of year	$ 466,047,076

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, 2013

Cash flows from operating activities	
Interest income from loans	$ 2,662,419
Administrative loan fees	1,961,831
Principal repayments on loans	46,522,800
Disbursement of loan proceeds	(28,536,404)
Payments to employees	(1,466,488)
Payments to vendors	(148,765)
Net cash provided by operating activities	20,995,393
Cash flows from noncapital financing activities	
State contributions	3,157,000
Federal contributions	16,274,831
Federal ARRA contributions	2,581,472
Disbursement of ARRA advances	(2,581,472)
Net cash provided by noncapital financing activities	19,431,831
Cash flows from investing activities	
Other interest income	1,308,692
Net cash provided by investing activities	1,308,692
Net increase in cash	41,735,916
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	107,108,422
End of year	$ 148,844,338
Reconciliation of operating income to net cash provided by operating activities	
Operating income	$ 2,390,426
Adjustment to reconcile operating income to net cash provided by operating activities	
Depreciation expense	9,902
Principal forgiveness for SRF	(1,000,000)
Change in assets and liabilities	
Loan fees receivable	123,651
Accrued interest on loans	183,766
Loans receivable	18,986,395
Accounts payable and other accrued liabilities	21,214
Other postemployment benefits	280,039
Net cash provided by operating activities	$ 20,995,393

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

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, including the adoption of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, ("GASB Statement No. 62") in fiscal year 2013.

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.

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, 2013, 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.

The State Department of Accounting and General Services (“DAGS”) informed State agencies that the State Treasury Investment Pool sold auction rate securities at par value in March 2013, which resulted in a gain. The Fund’s portion of the allocated gain for 2013 amounted to approximately $989,000 and is included in other interest income.

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 Position 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 2010 through 2012 allow for portions of loans to be forgiven upon satisfaction of certain requirements.

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 the Employees' Retirement System of the State of Hawaii ("ERS"). At June 30, 2013, accumulated sick leave was approximately $799,000.

Net Position
The Fund's net position is classified as restricted expendable, as it is 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 position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplemental schedule of operating expenses.

New Accounting Pronouncements
Effective for the year ended June 30, 2013, the Fund adopted GASB Statement No. 62. The adoption statement did not have a material effect on the Fund's financial statements.

Effective for the year ended June 30, 2013, the Fund adopted GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The adoption of this statement did not have a material effect on the Fund's financial statements in fiscal year 2013. However, this statement may have a more material effect on the Fund's financial statements upon the adoption of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB Statement No. 65").

In April 2012, GASB issued Statement No. 65. 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.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. This statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. The provisions of this statement are effective for reporting periods beginning after June 15, 2013 with earlier application encouraged. Management has not yet determined the effect this statement will have on the Fund's financial statements.

3. Loans Receivable

At June 30, 2013, loans receivable from government entities were as follows:

Twenty-five 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.	$ 223,152,767
Six loans receivable from the County of Hawaii; due in annual or semi-annual payments, including interest ranging from 0.50% to 2.50%, 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.	21,206,283
Eighteen 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.	40,942,048
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.	20,194,396
	305,495,494
Less: Current maturities	26,199,474
	$ 279,296,020

Loans are expected to mature at various dates through 2033. The scheduled principal payments on loans maturing in subsequent years are as follows:

2014	$ 26,199,474
2015	22,846,426
2016	22,793,222
2017	22,232,746
2018	21,986,477
Thereafter	189,437,149
	$ 305,495,494

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 2013, $1,000,000 in loans were forgiven. All loans forgiven were in accordance with the required conditions.

At June 30, 2013, $21,047,000, $6,064,000 and $5,663,000 were committed to be loaned 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, 2013:

Budget Period	Amount	Total Draws at June 30, 2012	Total 2013 Cash Draws	Funds Available
10/01/08 – 06/30/16	$ 5,223,500	$ 5,014,617	$ 180,382	$ 28,501
10/01/08 – 06/30/14 (ARRA)	30,352,300	27,480,620	2,581,472	290,208
12/31/09 – 06/30/16	5,223,500	5,014,750	48,680	160,070
04/01/11 – 06/30/17	15,781,000	12,531,725	2,618,063	631,212
09/30/11 – 06/30/18	11,436,000	58	10,978,587	457,355
09/28/12 – 06/30/19	10,946,000	-	2,449,119	8,496,881
	$ 78,962,300	$ 50,041,770	$ 18,856,303	$ 10,064,227

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, 2013, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2013 approximated $50.4 million, of which approximately $50.1 million has been utilized and approximately $317,000 was available to be loaned out.

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, 2013, is as follows:

	Balance at July 1, 2012	Additions	Retirements/ Disposals	Balance at June 30, 2013
Equipment	$ 78,210	$ -	$ -	$ 78,210
Accumulated depreciation	(41,326)	(9,902)	-	(51,228)
	$ 36,884	$ (9,902)	$ -	$ 26,982

6. Accrued Vacation

At June 30, 2013, long-term obligations included accrued vacation as follows:

Balance at July 1, 2012	$ 286,201
Increase	57,841
Decrease	(71,204)
Balance at June 30, 2013	272,838
Less: Current portion	60,270
Noncurrent portion	$ 212,568

7. Employee Benefit Plans

Substantially all employees of the Fund participate in the State's various employee benefit plans, including the ERS, the 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 DAGS website: ags.hawaii.gov/reports/financials-reports/. 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.

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, 2013:

Annual OPEB cost	$ 385,409
Less: contributions made	(105,370)
Increase in net OPEB obligation	280,039
Net OPEB obligation	
Beginning of year	843,601
End of year	$ 1,123,640

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, 2013, 2012 and 2011, approximated $105,000, $82,000 and $69,000, 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, 2013

Receipts	
Principal repayments on loans	$ 46,522,800
Interest income from loans	2,662,419
State contributions	3,157,000
Federal contributions	16,274,831
Federal ARRA contributions	2,581,472
Administrative loan fees	1,961,831
Other interest income	1,308,692
Total receipts	74,469,045
Disbursements	
Disbursement of loan proceeds	28,536,404
Disbursement of ARRA advances	2,581,472
Administrative	1,615,253
Total disbursements	32,733,129
Excess of receipts over disbursements	41,735,916
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	107,108,422
End of year	$ 148,844,338

State of Hawaii
Water Pollution Control Revolving Fund
Combining Statement of Net Position
June 30, 2013

	State Revolving Fund Activity	State Activity	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	$ 145,133,124	$ 3,711,214	$ 148,844,338
Loan fees receivable	-	280,708	280,708
Accrued interest on loans	504,550	-	504,550
Other accrued interest	94,184	-	94,184
Due from the Federal Government	101,592	-	101,592
Due from SRF (to State)	(89,042)	89,042	-
Current maturities of loans receivable	23,254,536	2,944,938	26,199,474
Total current assets	168,998,944	7,025,902	176,024,846
ARRA advances	12,198,183	-	12,198,183
Loans receivable, net of current maturities	279,039,808	256,212	279,296,020
Capital assets, net of accumulated depreciation	-	26,982	26,982
Total assets	$ 460,236,935	$ 7,309,096	$ 467,546,031
Liabilities and Net Position			
Current liabilities			
Accounts payable and other accrued liabilities	$ 19,671	$ 143,076	$ 162,747
Total current liabilities	19,671	143,076	162,747
Accrued vacation, net of current portion	-	212,568	212,568
Other postemployment benefits	-	1,123,640	1,123,640
Total liabilities	19,671	1,479,284	1,498,955
Net position			
Invested in capital assets	-	26,982	26,982
Restricted – expendable	460,217,264	5,802,830	466,020,094
Total net position	460,217,264	5,829,812	466,047,076
Total liabilities and net position	$ 460,236,935	$ 7,309,096	$ 467,546,031

State of Hawaii
Water Pollution Control Revolving Fund
Combining Statement of Revenues, Expenses and Change in Net Position
Year Ended June 30, 2013

	State Revolving Fund Activity	State Activity	Total
Operating revenues			
Interest income from loans	$ 2,388,001	$ 90,652	$ 2,478,653
Administrative loan fees	-	1,838,180	1,838,180
Total operating revenues	2,388,001	1,928,832	4,316,833
Operating expenses			
Administrative	439,425	1,486,982	1,926,407
Total operating expenses	439,425	1,486,982	1,926,407
Operating income	1,948,576	441,850	2,390,426
Nonoperating revenues and expenses			
State contributions	3,157,000	-	3,157,000
Federal contributions	16,376,424	-	16,376,424
Federal ARRA contributions	2,581,472	-	2,581,472
Principal forgiveness for SRF	(1,000,000)	-	(1,000,000)
Other interest income	1,346,487	-	1,346,487
Total nonoperating revenues and expenses	22,461,383	-	22,461,383
Interfund transfers	4,420,392	(4,420,392)	-
Change in net position	28,830,351	(3,978,542)	24,851,809
Net position			
Beginning of year	431,386,913	9,808,354	441,195,267
End of year	$ 460,217,264	$ 5,829,812	$ 466,047,076

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, 2013

	State Revolving Fund Activity	State Activity	Total
Personnel	$ 391,386	$ 1,352,827	$ 1,744,213
Services rendered by other State agencies	47,695	20,248	67,943
Travel	-	42,114	42,114
Professional services	-	23,076	23,076
Depreciation	-	9,902	9,902
Telephone	282	9,113	9,395
Rental	-	7,428	7,428
Office and other supplies	62	6,814	6,876
Training	-	5,332	5,332
Miscellaneous	-	10,128	10,128
Total	$ 439,425	$ 1,486,982	$ 1,926,407

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, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State of Hawaii, Water Pollution Control Revolving Fund (the "Fund"), as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon dated November 15, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

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. 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.

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 material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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*.

999 Bishop Street, Suite 1900
Honolulu, Hawaii 96813
Telephone: 808 531 3400 Facsimile: 808 531 3433

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Accuity LLP

Honolulu, Hawaii
November 15, 2013

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, 2013, and have issued our report thereon dated November 15, 2013.

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 Fund's program (CFDA No. 66.458) (the "Program") for the year ended June 30, 2013.

Management's Responsibility

The management of the Fund is responsible for the Fund's compliance with the requirements of laws, regulations, contracts, and grants applicable to the Program.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance based on our audit of the types of compliance requirements referred to above. 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 Program occurred. An audit includes examining, on a test basis, evidence about the Fund'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 on compliance for the Program. However, our audit does not provide a legal determination of the Fund's compliance with the compliance requirements referred to above.

Opinion
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, 2013.

Other Matters
The results of our auditing procedures disclosed instances of noncompliance with those compliance requirements, which are required to be reported in accordance with the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Funds* and which are described in the accompanying schedule of findings and questioned costs as Finding Nos. 13-01 and 13-02. Our opinion on the Program is not modified with respect to this matter.

The Fund's response to the findings identified in our audit is described in the Fund's Corrective Action Plan. The Fund's response was not subjected to auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the Fund is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Fund's internal control over compliance with the types of requirements that could have a direct and material effect on the Program to determine the auditing procedures that are appropriate in the circumstances 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 the 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 the Program will not be prevented, or detected and corrected, on a timely basis. 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 the 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.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. 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. 13-01.

The Fund's response to the internal control over compliance findings identified in our audit is described in the Fund's Corrective Action Plan. The Fund's response was not subjected to auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Accordingly, this report is not suitable for any other purpose.

Accuity LLP

Honolulu, Hawaii
November 15, 2013

Schedule of Findings and Questioned Costs

			Questioned Cost
Finding No. 13-01:	**Reporting (Significant Deficiency)**		**$ –**
Federal Agency:	Environmental Protection Agency ("EPA")		
CFDA Number and Title:	66.458 – Capitalization Grants for Clean Water State Revolving Funds		
Award Number and Award Year:	FS-15000112-0 FS-15000113-0	9/30/2011–6/30/2018 9/28/2012–9/30/2019	

Finding and Cause and Effect

During our testing of the reporting compliance requirement, we noted that the Fund did not meet the deadline for submission of reports under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2011 and 2012 federal awards. The Fund did not establish adequate policies and procedures to ensure compliance with FFATA reporting requirements.

Noncompliance with FFATA reporting requirements reduces transparency of federal awards and could result in sanctions by the EPA including increased oversight and/or reduction or elimination of federal awards.

Criteria

In accordance with 2 Code of Federal Regulations Part 170, the Fund is 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 on FSRS.gov no later than the last day of the month following the month in which the subaward obligation was made.

Recommendation

We recommend that the fund implement policies and procedures to ensure reports are submitted in a timely matter for applicable subrecipient awards.

		Questioned Cost
Finding No. 13-02:	**Earmarking – Green Project Reserve**	$ –
Federal Agency:	Environmental Protection Agency	
CFDA Number and Title:	66.458 – Capitalization Grants for Clean Water State Revolving Funds	
Award Number and Award Year:	FS-15000113-0 9/28/2012–9/30/2019	

Finding and Cause and Effect

During our testing of the green projects reserve requirement, we noted that the Fund did not allocate the minimum 20 percent of its federal fiscal year 2010 award to green projects as required in the grant award.

We understand the Program management believed that the Program had until the end of the capitalization grant period to meet the requirement for green projects. We also understand the Program intends to allocate amounts from other capitalization grants to cover the amount that was required for the federal fiscal year 2010 capitalization grant.

Noncompliance with earmarking requirements could result in sanctions by the EPA including increased oversight and/or reduction or elimination of federal awards.

Criteria

In accordance with the federal fiscal year 2010 award, the Fund is required to identify and assign green projects to the respective year's capitalization grants and provide the green projects' reserve funds by the end of the following year.

Recommendation

We recommend that the fund implement policies and procedures to ensure the minimum required percentage of each year's capitalization grants are designated through final loan agreements by the end of the year following the grant award.

Corrective Action Plan
(Unaudited)

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
HONOLULU, HI 96801-3378

In reply, please refer to:
File:

November 13, 2013

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

Dear State Auditor:

Attached is the Department of Health's Corrective Action Plan to findings in the SFY 2013 audit report on the Water Pollution Control Revolving Fund.

We appreciate the opportunity to comment on the report.

Sincerely,

SINA PRUDER, P.E., CHIEF
Wastewater Branch

AM:

Attachment

Water Pollution Control Revolving Fund
Federal Award Finding and Questioned Costs

Finding No. 13-01: Reporting (Significant Deficiency)

Finding and Cause and Effect

During our testing of the reporting compliance requirement, we noted that the Fund did not meet the deadline for submission of reports under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2011 and 2012 federal awards. The Fund did not establish adequate policies and procedures to ensure compliance with FFATA reporting requirements.

In accordance with 2 Code of Federal Regulations Part 170, the Fund is 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 FFATA Subaward Reporting System on FSRS.gov no later than the last day of the month following the month in which the subaward obligation was made.

Corrective Action Plan

The Wastewater Branch completed reports to FSRS.gov on October 22, 2013. For future FFATA reporting on FSRS, the date that the loan is "made and entered into," as stated in the first paragraph of the final loan, will be tracked to ensure that CBR and FSRS.gov reporting is completed no later than the last day of the month following the month in which the final loan was "made and entered into."

Person Responsible for Corrective Action

Wastewater Branch Chief

Completion Date

November 13, 2013

Water Pollution Control Revolving Fund
Federal Award Finding and Questioned Costs

Finding No. 13-02: Earmarking - Green Project Reserve

During our testing of the green project reserve requirement, we noted that the Fund did not allocate the minimum 20 percent of its federal fiscal year 2010 award to green projects as required in the grant award.

In accordance with the federal fiscal year 2010 award, the Fund is required to identify and assign green projects to the respective year's capitalization grants and provide the green projects' reserve funds by the end of the following year.

Corrective Action Plan

GPR requirements in the federal appropriations law (P.L. 111-88), passed in the 2010 federal fiscal year, required that *to the extent that there are sufficient eligible project applications*, not less than 20% of the funds made available under the appropriations law shall be used by the state for projects to address green infrastructure, water or energy efficiency improvements or other environmentally innovative activities.

Although the Program made a good faith solicitation effort to fund the *North Kona Sewer and Effluent reuse - Phase 1* project in the FFY 2010 Intended Use Plan (IUP), the project was held up due to a bid protest and archaeological findings which were beyond the Program's control. The 20% GPR requirement only applies to the extent that *there are sufficient eligible project applications*. Since there were insufficient applications, the Program could not allocate 20% of funds to GPR projects, which is not inconsistent with the requirement, given the qualifying clause.

The Program will continue to make a good faith effort to fund GPR projects when available and update EPA on its progress in our Annual Report.

Person Responsible for Corrective Action

Wastewater Branch Chief

Completion Date

November 13, 2013