

**FINANCIAL AUDIT OF THE  
DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

Fiscal Year Ended June 30, 2014

**Submitted by  
The Auditor  
State of Hawaii**



March 13, 2015

Ms. Jan Yamane, Acting State Auditor  
Office of the Auditor  
State of Hawaii  
Board of Education  
State of Hawaii, Department of Education

Dear Ms. Yamane and the Board of Education:

This is our report on the financial audit of the Department of Education of the State of Hawaii (DOE) as of and for the fiscal year ended June 30, 2014. Our audit was conducted in accordance with the terms of our contract with the Office of the Auditor, State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the *Compliance Supplement for Single Audits of State and Local Governments*.

#### **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DOE's basic financial statements as of and for the fiscal year ended June 30, 2014, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for opinions on the fairness of the DOE's basic financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2014.
2. To consider the DOE's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the DOE's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D and 103F, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the DOE's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.

5. To provide an opinion on the DOE's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.

## SCOPE OF THE AUDIT

Our audit was conducted in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2014.

## ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the DOE as of and for the fiscal year ended June 30, 2014, and our opinions on the basic financial statements and supplementary information.
- Part II - Our report on internal control over financial reporting and on compliance and other matters.
- Part III - Our report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - Corrective action plan as provided by the Department of Education, State of Hawaii.
- Part VI - The summary schedule of prior audit findings.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DOE.

Sincerely,

N&K CPAs, Inc.



Brian Isobe  
Principal

**DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

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**DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

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**PART I**  
**FINANCIAL SECTION**

## INDEPENDENT AUDITOR'S REPORT

To the Auditor  
State of Hawaii  
Board of Education  
State of Hawaii, Department of Education

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the DOE's basic financial statements as listed in the foregoing 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 preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain public charter schools which represent 3% of the total assets and 4% of total fund balances as of June 30, 2014, and 3% of total revenues for the fiscal year ended June 30, 2014, of the DOE's governmental funds. Those financial statements were audited by other auditors, whose reports have been furnished to us, and our opinions, insofar as it relates to the amounts included for the DOE, is based on the reports of the other auditors. 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 from 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

auditor's 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 basis for our audit opinions.

### **Opinions**

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the DOE, as of June 30, 2014, and the respective changes in financial position, where applicable, the respective budgetary comparison for the General Fund and Federal Fund for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

### **Emphasis of Matter**

As discussed in Note A, the financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2014, and the changes in its financial position for the fiscal year then ended 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*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 - 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the

information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the DOE's basic financial statements. The schedule of expenditures of federal awards as required by Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards 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 basic 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 schedule of expenditures of federal awards 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 March 13, 2015, on our consideration of the DOE'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 DOE's internal control over financial reporting and compliance.

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 13, 2015

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Fiscal Year Ended June 30, 2014**

As management of the Department of Education of the State of Hawaii (the Department) we offer readers this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2014. We encourage readers to consider the information presented here in conjunction with the accompanying basic financial statements and notes to enhance their understanding of the Department's financial performance.

The basic financial statements represent the combination of Department of Education (DOE), the Hawaii State Public Library System (HSPLS), and the Public Charter Schools (PCS) where the DOE prepares entries, based on information provided by the HSPLS and PCS, to combine financial data for the three units, in aggregate known as the Department. The fiscal and oversight authority for the DOE, Library and PCS are managed independently. The DOE has determined that the PCS balances are significant, but not material, and relies on financial information which have been audited by a third-party and coordinated by the PCS.

## **FINANCIAL HIGHLIGHTS**

Key government-wide financial highlights for fiscal year ended June 30, 2014 (FY 2014) compared to the prior fiscal year ended June 30, 2013 (FY 2013) are as follows:

- Total FY 2014 revenues were \$2.748 billion, an increase of 14% or \$344 million from \$2.404 billion in FY 2013.
- Total FY 2014 expenses were \$2.508 billion, an increase of 7% or \$154 million from \$2.354 billion in FY 2013.
- Of the total FY 2014 expenses of \$2.508 billion, 94% or \$2.348 billion was spent for school-related activities. Of the total FY 2013 expenses of \$2.355 billion, 94% or \$2.205 billion was spent for school-related activities.
- Total assets exceeded liabilities as of June 30, 2014 by \$1.609 billion (net position), compared to \$1.370 billion as of June 30, 2013, an increase of 17%.
- Capital assets, net of accumulated depreciation, comprised 88% and 97% of total net position as of June 30, 2014 and 2013, respectively.

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

## **OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The Department's basic financial statements which are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

- *Government-wide financial statements* - These statements provide a broad overview of the Department's finances, in a manner similar to a private sector business.

The statement of net position presents information on all of the Department's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The statement of activities presents information showing how the Department's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

- *Fund financial statements* - A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department has two types of funds: governmental funds and fiduciary funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, the governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's near-term financial position. The Department presents four major funds in the fund financial statements: (1) General Fund, (2) Federal Fund, (3) Capital Projects Fund, and (4) Other Fund.

The Department has an annual appropriated budget for its general and federal funds. A budgetary comparison schedule has been provided for these funds to demonstrate compliance with the budget.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Department. The Department reports on agency funds (or local

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

school funds as the term is used in the schools), which are held in a custodial capacity for students' school activities that take place outside of the formal class period and are not requirements for class work or credit. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's programs.

- *Notes to Basic Financial Statements* - The notes to basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

### **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

The following discussion highlights management's understanding of the key aspects of the Department's financial activities.

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

**Exhibit A-1  
Government-Wide Statements of Net Position  
Fiscal years 2014 and 2013  
(Amounts in millions)**

	<b>Governmental activities</b>		<b>2014 - 2013</b>	
	<b>2014</b>	<b>2013</b>	<b>Increase (decrease)</b>	<b>Percentage change</b>
<b>Assets:</b>				
Current	\$ 607.5	\$ 430.0	\$ 177.5	41 %
Noncurrent (capital assets, net of depreciation)	<u>1,409.4</u>	<u>1,331.0</u>	<u>78.4</u>	6 %
Total assets	\$ <u>2,016.9</u>	\$ <u>1,761.0</u>	\$ <u>255.9</u>	15 %
<b>Liabilities:</b>				
Current	\$ 287.3	\$ 283.5	\$ 3.8	1 %
Noncurrent	<u>120.5</u>	<u>107.3</u>	<u>13.2</u>	12 %
Total liabilities	<u>407.8</u>	<u>390.8</u>	<u>17.0</u>	4 %
<b>Net position:</b>				
Net investment in capital assets	1,409.4	1,330.9	78.5	6 %
Restricted	13.2	31.7	(18.5)	(58) %
Unrestricted	<u>186.5</u>	<u>7.6</u>	<u>178.9</u>	2,354 %
Total net position	<u>1,609.1</u>	<u>1,370.2</u>	<u>238.9</u>	17 %
Total liabilities and net position	\$ <u>2,016.9</u>	\$ <u>1,761.0</u>	\$ <u>255.9</u>	15 %

**Overall Financial Position** - The Department's overall net position has increased as of June 30, 2014 compared to the prior fiscal year-end. The Department's largest portion of net position is investment in capital assets (e.g., land, buildings, equipment), which are unavailable for future spending. The Department's unrestricted portion of net position is available for future use to provide program services. Total government-wide net position increased by \$239.0 million, or 17%, primarily due to an increase in unrestricted net position.

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

**Exhibit A-2  
Government-Wide Changes of Net Position  
Fiscal years 2014 and 2013  
(Amounts in millions)**

	<b>Governmental activities</b>		<b>2014 - 2013</b>	
	<b>2014</b>	<b>2013</b>	<b>Increase (decrease)</b>	<b>Percentage change</b>
	Revenues:			
Program revenues:	\$ 53.6	\$ 56.0	\$ (2.4)	(4) %
Charges for services				
Operating grants and contributions	288.1	334.5	(46.4)	(14) %
Capital grants and contributions	5.5	--	5.5	100 %
General revenues:				
State allotted appropriations, net of lapses	1,941.3	1,578.9	362.4	23 %
Non-imposed employee wages and fringe benefits	459.1	434.4	24.7	6 %
Unrestricted investment earnings	<u>0.1</u>	<u>0.1</u>	<u>--</u>	-- %
Total	\$ <u>2,747.7</u>	\$ <u>2,403.9</u>	\$ <u>343.8</u>	14 %
Transfers, net	(0.3)	40.9	(41.2)	(101) %
Expenses:				
School-related	2,347.6	2,205.0	142.6	6 %
State and complex area administration	61.7	60.4	1.3	2 %
Public libraries	37.8	49.7	(11.9)	(24) %
Capital outlay	<u>61.4</u>	<u>39.4</u>	<u>22.0</u>	56 %
Total	<u>2,508.5</u>	<u>2,354.5</u>	<u>154.0</u>	7 %
Change in net position	\$ <u>238.9</u>	\$ <u>90.3</u>	\$ <u>148.6</u>	165 %

**Overall Results of Operations** - The Department's results of operations for FY 2014 have resulted in an increase in net position of \$239.0 million. This is somewhat higher than the increase in net position of \$90.3 million for the prior FY 2013, primarily due to an increase in state allotments for capital projects in FY 2014. Total FY 2014 expenses were \$2.508 billion, an increase of 7% or \$154 million from \$2.354 billion in FY 2013.

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

**GOVERNMENTAL FUND FINANCIAL ANALYSIS**

Within the governmental fund financial statements, the overall net change in fund balance for FY 2014 was \$172.4 million, and the total overall fund balance for the governmental funds as of June 30, 2014 was \$350.2 million.

**General Fund Budget Results** - The Department was appropriated general funds of \$1.494 billion in FY 2014. Decreases of "Final" compared to "Original" budgeted amounts as reported on the Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis) - General Fund are primarily due to legislative appropriations due to collective bargaining compensation changes.

For the General Fund, the Department is allowed to carry over up to 5% of any appropriation at the end of the fiscal year. Carryover funds enable schools to make long-range fiscal plans, save for major purchases for which single-year funding may not be sufficient, and provide funds to start the next school year. Under the DOE's single-school calendar, schools start their school year in July statewide, within weeks of the beginning of the fiscal year. For the fiscal year ended June 30, 2014, general funds carried over totaled \$37.2 million, representing 2.5% of general fund appropriations.

**Federal Fund Budget Results** - The Department expended \$16.1 million more federal funds than it received during FY 2014; this merely reflects the timing of expenditures versus federal cash that may have been received during the fiscal year.

**AGENCY FUNDS**

Agency funds, or "local school funds," are held for students in a custodial capacity and do not require deposit into the State Treasury. The fund contains monies collected and maintained by schools for students. Examples include yearbook, newspaper fund, student government dues, physical education uniform sales, and excursions. The funds are used for school activities that take place outside formal class periods and are not required for class work or credit. Agency funds due to the students and others was \$25.8 million in FY 2014 representing a 8% increase from the prior fiscal year balance of \$24.0 million.

**CAPITAL ASSETS**

The Department's capital improvement program strives to provide and maintain facilities that are well-placed, sufficient in number, flexible, functional, and creatively designed to accommodate population changes, support educational programs, and promote health and safety of students, employees, and the public.

**Department of Education  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2014**

The Department's capital assets as of June 30, 2014 amounted to \$1.409 billion (net of accumulated depreciation of \$1.441 billion), an increase of \$78 million, compared to capital assets as of June 30, 2013 which amounted to \$1.331 billion (net of accumulated depreciation of \$1.364 billion). Depreciation expense for FY 2014 amounted to \$83.8 million.

The Department is committed under contracts awarded and orders placed for construction, repairs and maintenance, and related expenses. These commitments amounted to approximately \$390.7 million as of June 30, 2014.

Additional information on the Department's capital assets and construction contract commitments can be found in Note E and Note L to the basic financial statement.

#### **REQUESTS FOR INFORMATION**

Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of the Fiscal Services, Department of Education, P.O. Box 2360, Honolulu, Hawaii 96804. General information about the Department can be found at the Department's website, [www.hawaiipublicschools.org](http://www.hawaiipublicschools.org).

**Department of Education  
State of Hawaii  
STATEMENT OF NET POSITION  
June 30, 2014**

	Governmental Activities
<b>ASSETS</b>	
Current assets	
Cash	\$ 560,757,109
Receivables	
Due from federal government	37,189,787
Due from other agencies	588,178
Accounts receivable	<u>9,005,241</u>
Total current assets	607,540,315
Capital assets, net of accumulated depreciation	<u>1,409,395,719</u>
Total assets	\$ <u><u>2,016,936,034</u></u>
<b>LIABILITIES AND NET POSITION</b>	
Current liabilities	
Vouchers and contracts payable	\$ 120,832,170
Accrued wages and employee benefits	130,527,009
Accrued compensated absences	16,099,438
Workers' compensation claims reserve	13,905,965
Due to State of Hawaii general fund	5,000,000
Due to other agency	<u>950,127</u>
Total current liabilities	287,314,709
Accrued compensated absences, less current portion	57,108,531
Workers' compensation claims reserve, less current portion	<u>63,349,398</u>
Total liabilities	<u>407,772,638</u>
Net position	
Net investment in capital assets	1,409,395,719
Restricted	13,216,809
Unrestricted	<u>186,550,868</u>
Total net position	<u>1,609,163,396</u>
Total liabilities and net position	\$ <u><u>2,016,936,034</u></u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2014**

		Program revenues				Net revenue (expenses) and change in net assets
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities	
Governmental activities:						
School-related	\$ 2,347,614,626	\$ 50,866,259	\$ 284,919,169	\$ --	\$ (2,011,829,198)	
State and complex area administration	61,670,703	602,830	1,280,549	--	(59,787,324)	
Public libraries	37,756,291	2,161,987	1,913,747	--	(33,680,557)	
Capital outlay	<u>61,404,067</u>	<u>--</u>	<u>--</u>	<u>5,482,163</u>	<u>(55,921,904)</u>	
Total governmental activities	\$ <u>2,508,445,687</u>	\$ <u>53,631,076</u>	\$ <u>288,113,465</u>	\$ <u>5,482,163</u>	(2,161,218,983)	
General revenues:						
State allotted appropriations, net of lapses					1,941,256,915	
Nonimposed employee wages and fringe benefits					459,086,481	
Unrestricted investment earnings					<u>110,526</u>	
Total general revenues					<u>2,400,453,922</u>	
Other financing sources (uses):						
Transfers in					1,972,489	
Transfers out					<u>(2,296,035)</u>	
Net transfers					<u>(323,546)</u>	
Change in net position					238,911,393	
Net position at June 30, 2013					<u>1,370,252,003</u>	
Net position at June 30, 2014					\$ <u>1,609,163,396</u>	

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
June 30, 2014**

	<u>General</u>	<u>Federal</u>	<u>Capital Projects</u>	<u>Other</u>	<u>Total</u>
<b>ASSETS</b>					
Cash and cash equivalents	\$ 150,198,241	\$ 115,655,990	\$ 211,892,348	\$ 83,010,530	\$ 560,757,109
Receivables					
Due from federal government	--	37,189,787	--	--	37,189,787
Due from other agencies	--	--	--	588,178	588,178
Accounts receivable	<u>--</u>	<u>--</u>	<u>--</u>	<u>9,005,241</u>	<u>9,005,241</u>
Total assets	<u>\$ 150,198,241</u>	<u>\$ 152,845,777</u>	<u>\$ 211,892,348</u>	<u>\$ 92,603,949</u>	<u>\$ 607,540,315</u>
<b>LIABILITIES AND FUND BALANCES (DEFICITS)</b>					
<b>LIABILITIES</b>					
Vouchers and contracts payable	\$ 52,002,971	\$ 19,731,448	\$ 44,378,340	\$ 4,719,411	\$ 120,832,170
Accrued wages and employee benefits payable	120,590,406	6,121,105	263,364	3,552,134	130,527,009
Due to State general fund	5,000,000	--	--	--	5,000,000
Due to other agency	<u>--</u>	<u>--</u>	<u>--</u>	<u>950,127</u>	<u>950,127</u>
Total liabilities	177,593,377	25,852,553	44,641,704	9,221,672	257,309,306
<b>FUND BALANCES (DEFICITS)</b>					
Restricted	--	13,216,809	--	--	13,216,809
Committed	--	--	--	83,382,277	83,382,277
Assigned	--	113,776,415	167,250,644	--	281,027,059
Unassigned	<u>(27,395,136)</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>(27,395,136)</u>
Total fund balances (deficits)	<u>(27,395,136)</u>	<u>126,993,224</u>	<u>167,250,644</u>	<u>83,382,277</u>	<u>350,231,009</u>
Total liabilities and fund balances (deficits)	<u>\$ 150,198,241</u>	<u>\$ 152,845,777</u>	<u>\$ 211,892,348</u>	<u>\$ 92,603,949</u>	<u>\$ 607,540,315</u>

See accompanying notes to the basic financial statements.

**Department of Education**  
**State of Hawaii**  
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET**  
**TO THE STATEMENT OF NET POSITION**  
**June 30, 2014**

<b>Total fund balances - governmental funds</b>	\$	350,231,009
 <b>Amounts reported for governmental activities in the statement of net position are different because:</b>		
<p>Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.</p>		
<p>Capital Assets</p>		
Governmental capital assets	\$ 2,850,247,708	
Less accumulated depreciation	<u>(1,440,851,989)</u>	1,409,395,719
<p>Accrued compensated absences are not due in the current period and therefore are not reported in the governmental funds.</p>		
		(73,207,969)
<p>Accrued workers' compensation liability is not due in the current period and, therefore, is not reported in the funds.</p>		
		<u>(77,255,363)</u>
 <b>Net position of governmental activities</b>	 \$	 <u>1,609,163,396</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
Fiscal Year Ended June 30, 2014**

	<u>General</u>	<u>Federal</u>	<u>Capital Projects</u>	<u>Other</u>	<u>Total</u>
<b>REVENUES</b>					
State allotments, net	\$ 1,529,661,142	\$ --	\$ 405,612,540	\$ 5,983,233	\$ 1,941,256,915
Nonimposed employee wages and fringe benefits	459,086,481	--	--	--	459,086,481
Intergovernmental revenues	--	284,205,779	--	1,036,838	285,242,617
Other revenues	--	--	--	62,094,613	62,094,613
	<u>1,988,747,623</u>	<u>284,205,779</u>	<u>405,612,540</u>	<u>69,114,684</u>	<u>2,747,680,626</u>
<b>EXPENDITURES</b>					
School-related	1,903,977,496	305,383,072	--	62,431,307	2,271,791,875
State and complex area administration	54,137,805	4,602,751	--	618,025	59,358,581
Public libraries	38,328,530	1,677,841	--	1,419,355	41,425,726
Capital outlay	<u>1,588,530</u>	<u>6,184,155</u>	<u>192,300,055</u>	<u>1,352,712</u>	<u>201,425,452</u>
	<u>1,998,032,361</u>	<u>317,847,819</u>	<u>192,300,055</u>	<u>65,821,399</u>	<u>2,574,001,634</u>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>	<u>(9,284,738)</u>	<u>(33,642,040)</u>	<u>213,312,485</u>	<u>3,293,285</u>	<u>173,678,992</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers in	--	--	--	1,015,745	1,015,745
Transfers out	<u>--</u>	<u>(1,015,745)</u>	<u>(1,280,290)</u>	<u>--</u>	<u>(2,296,035)</u>
Net transfers	<u>--</u>	<u>(1,015,745)</u>	<u>(1,280,290)</u>	<u>1,015,745</u>	<u>(1,280,290)</u>
<b>NET CHANGE IN FUND BALANCES (DEFICITS)</b>	(9,284,738)	(34,657,785)	212,032,195	4,309,030	172,398,702
<b>FUND BALANCES (DEFICIT) AT</b>					
JULY 1, 2013	<u>(18,110,398)</u>	<u>161,651,009</u>	<u>(44,781,551)</u>	<u>79,073,247</u>	<u>177,832,307</u>
<b>FUND BALANCES (DEFICIT) AT</b>					
JUNE 30, 2014	\$ <u>(27,395,136)</u>	\$ <u>126,993,224</u>	\$ <u>167,250,644</u>	\$ <u>83,382,277</u>	\$ <u>350,231,009</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
RECONCILIATION OF THE CHANGE IN FUND BALANCE OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2014**

<b>Net change in fund balances - total government funds</b>	<b>\$</b>	<b>172,398,702</b>
 <b>Amounts reported for governmental activities in the statement of activities are different because:</b>		
 Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets are depreciated over their estimated useful lives as depreciation expense.		
Expenditures for capital assets	\$ 172,146,101	
Loss on disposal of capital assets	(9,894,975)	
Less current fiscal year depreciation	<u>(83,832,840)</u>	78,418,286
 Change in compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds		
		(6,027,226)
 Change in workers' compensation liability reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as expenditures in governmental funds		
		<u>(5,878,369)</u>
 <b>Change in net position of governmental activities</b>	 <b>\$</b>	 <b><u>238,911,393</u></b>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS) - GENERAL FUND  
Fiscal Year Ended June 30, 2014**

	<u>Budgeted Amounts</u>		<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
	<u>Original</u>	<u>Final</u>		
<b>REVENUES</b>				
State allotments	\$ <u>1,493,598,814</u>	\$ <u>1,533,586,060</u>	\$ <u>1,528,540,692</u>	\$ <u>(5,045,368)</u>
<b>EXPENDITURES</b>				
School-related	1,422,062,042	1,461,636,350	1,420,823,875	40,812,475
State and complex area administration	42,276,161	42,062,276	40,590,023	1,472,253
Public libraries	<u>29,260,611</u>	<u>29,887,434</u>	<u>29,880,849</u>	<u>6,585</u>
	<u>1,493,598,814</u>	<u>1,533,586,060</u>	<u>1,491,294,747</u>	<u>42,291,313</u>
Excess of revenues over (under) expenditures	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>  37,245,945</u>	\$ <u>  37,245,945</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS) - FEDERAL FUND  
Fiscal Year Ended June 30, 2014**

	<u>Budgeted Amounts</u>		<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
	<u>Original</u>	<u>Final</u>		
<b>REVENUES</b>				
Federal grants	\$ <u>455,671,383</u>	\$ <u>450,280,861</u>	\$ <u>273,051,489</u>	\$ <u>(177,229,372)</u>
	<u>455,671,383</u>	<u>450,280,861</u>	<u>273,051,489</u>	<u>(177,229,372)</u>
<b>EXPENDITURES</b>				
School-related	451,633,612	441,956,364	283,865,654	158,090,710
State and complex area administration	2,672,527	5,684,737	3,714,937	1,969,800
Public libraries	<u>1,365,244</u>	<u>2,639,760</u>	<u>1,597,305</u>	<u>1,042,455</u>
	<u>455,671,383</u>	<u>450,280,861</u>	<u>289,177,896</u>	<u>161,102,965</u>
Excess of revenues over (under) expenditures	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>(16,126,407)</u>	\$ <u>(16,126,407)</u>

See accompanying notes to the basic financial statements.

**Department of Education**  
**State of Hawaii**  
**STATEMENT OF FIDUCIARY NET POSITION - AGENCY FUNDS**  
**June 30, 2014**

	Agency Funds
<b>ASSETS</b>	
Cash	\$ 23,858,375
Investments	<u>1,900,614</u>
Total assets	<u>25,758,989</u>
<b>LIABILITIES</b>	
Due to student groups and others	<u>25,758,989</u>
Total liabilities	<u>25,758,989</u>
<b>NET POSITION</b>	\$ <u><u>          --</u></u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE A - FINANCIAL REPORTING ENTITY**

- (1) **Introduction** - The Department of Education of the State of Hawaii (the Department) administers the statewide system of public schools and public libraries. Additionally, the Department is responsible for administering state laws regarding regulation of private school operations through a program of inspection and licensing and the professional certification of all teachers for every academic and noncollege type of school. Federal grants received to support public school and public library programs are administered by the Department on a statewide basis.

These financial statements represent the combination of the Department of Education (DOE), the Hawaii State Public Library System (HSPLS), and the Public Charter Schools (PCS) where the DOE prepares entries, based on information provided by the HSPLS and PCS, to combine financial data for the three units, in aggregate known as the Department. The fiscal and oversight authority for the DOE, HSPLS and PCS are managed independently. The DOE has determined that the PCS balances are significant, but not material, and relies on financial information which have been audited by a third-party and coordinated by the PCS.

The Department is a part of the executive branch of the State of Hawaii (the State). The financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2014, and the changes in its financial position for the year then ended, in conformity with U.S. generally accepted accounting principles (GAAP). The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which includes the Department's financial activities.

- (2) **Reporting Entity** - The Department has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Department are such that exclusion would cause the Department's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. The Department has determined, based on the GASB criteria, that it has no component units.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements of the Department have been prepared in conformity with GAAP as prescribed by the GASB.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (1) ***Government-Wide and Fund Financial Statements*** - The government-wide financial statements report all assets, liabilities, and activities of the Department as a whole.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments are reported as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net position is restricted when constraints placed on it are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net position. When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and fiduciary funds. The fiduciary funds, however, are excluded from the government-wide financial statements because the Department cannot use those assets to finance its operations. Major individual governmental funds are reported as separate columns in the fund financial statements. Nonmajor funds are summarized into a single column.

- (2) ***Measurement Focus, Basis of Accounting, and Financial Statement Presentation***

**Government-Wide Financial Statements**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of 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.

**Governmental Fund Financial Statements**

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Principal revenue sources considered susceptible to accrual include federal grants. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with GAAP since they have been earned and are expected to be collected within 60 days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the Department.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation and workers' compensation claims, which are recorded as expenditures when utilized or paid. The amount of accumulated vacation and reserve for workers' compensation claims at June 30, 2014 has been reported only in the government-wide financial statements.

Encumbrances are recorded obligations in the form of purchase or contracts. The State records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at fiscal year-end do not constitute expenditures or liabilities.

**Fiduciary Funds**

The financial statement of fiduciary funds is reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above. Agency funds do not have a measurement focus and report only assets and liabilities.

(3) ***Fund Accounting***

The financial transactions of the Department are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and nonmajor funds are combined in one column. Major funds are funds that have total assets, liabilities, revenues, or expenditures of the fund that are at least 10% of the same element for all funds of its fund type or at least 5% of the same element for all governmental funds combined.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Governmental Funds**

General Fund - The general fund is the main operating fund of the Department. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted for.

Federal Fund - The federal fund is used to account for federally funded programs for the Department's major activities. This fund is made up entirely by special revenue funds, which account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. In this case, the expenditures are for activities authorized by the federal agency grantor.

Capital Projects Fund - The capital projects fund includes all amounts related to the Department's capital improvement program. It is used to account for financial resources used for the acquisition or construction of major capital facilities.

Other Funds - The other funds is used to account for all financial activities not required to be accounted for in another fund. It includes special revenue and trust funds, which account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

**Fund Balance**

In the fund financial statements, Governmental Funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

The Department classifies fund balances based primarily on the extent to which a government is bound to follow constraints on how resources can be spent in accordance with GASB Statement No. 54 (GASB 54), *Fund Balance Reporting and Governmental Fund Type Definitions*. Classifications include:

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

Committed - Balances that can only be used for specific purposes pursuant to constraints imposed by formal action of the State Legislature.

Assigned - Balances that are constrained by management to be used for specific purposes, but are neither restricted nor committed.

Unassigned - Residual balances that are not contained in the other classifications.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed. When Committed, Assigned and Unassigned resources are available for use, generally it is the Department's policy that committed amounts be reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of these unrestricted fund balance classifications could be used.

**Fiduciary Funds**

Agency Fund - The agency funds are used to account for assets held by the Department on behalf of outside parties, or on behalf of individuals. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

- (4) **Cash and Cash Equivalents** - Cash and cash equivalents include certificates of deposit with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance (Director) is responsible for safekeeping of all monies paid into the State Treasury. The Director 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. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool system. Cash accounts that participate in the investment pool accrue interest based on the weighted average cash balances of each account.

Information relating to custodial credit risk of cash deposits and interest rate risk, credit risk, custodial risk, and concentration of credit risk of investments in the State Treasury is available on a statewide basis and not for individual departments or agencies.

- (5) **Capital Assets** - Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Depreciation expense is recorded in the government-wide financial statements. The Department utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. The Department has adopted the following capitalization policy:

Asset Type	Minimum Capitalization Amount	Estimated Useful Life
Land	All	Not applicable
Land improvements	\$ 100,000	15 years
Buildings and improvements	\$ 100,000	30 years
Furniture and equipment	\$ 5,000	7 years
Motor vehicles	\$ 5,000	5 years
Public library materials	All	5 years

- (6) **Accumulated Vacation** - Employees are credited with vacation at the rate of 96 to 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net position.
- (7) **Program Revenues** - Program revenues are derived directly from the programs of the Department or from parties outside of the Department and are categorized as charges for services, operating grants and contributions, or capital grants and contributions.

Charges for services - Charges for services include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided. Revenues in this category include fees charged for meals served, educational classes, use of facilities, transportation services, and use of library materials.

Operating grants and contributions - Program-specific operating and capital grants and contributions include revenues arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program. Governmental grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All other federal Reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (8) ***Intrafund and Interfund Transactions*** - Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the basic financial statements.
- (9) ***Risk Management*** - The Department is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.
- (10) ***Use of Estimates*** - The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**NOTE C - BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration, and revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and federal funds are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii. To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations such as those related to the federal funds.

However, Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to 5% each of any appropriation at the end of the fiscal year except for appropriations to fund certain financing agreements. These carryover funds, to the extent not expended or encumbered, lapse at June 30 of the first fiscal year of the next fiscal biennium. As of June 30, 2014, general funds carried over amounted to approximately \$37,200,000, representing approximately 2% of appropriations.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)**

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with GAAP. The Department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrances of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grants accruals and deferrals. These differences represent a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2014:

	<u>General</u>	<u>Federal</u>
Excess of revenues over (under) expenditures - actual on a budgetary basis	\$ 37,245,945	\$ (16,126,407)
Reserved for encumbrances at fiscal year-end	81,297,494	23,077,403
Expenditures for liquidation of prior fiscal year encumbrances	(116,214,227)	(36,123,631)
Net accrued revenues and expenditures	<u>(11,613,950)</u>	<u>(4,469,405)</u>
Excess (deficiency) of revenues over (under) expenditures - GAAP basis	\$ <u>(9,284,738)</u>	\$ <u>(33,642,040)</u>

**NOTE D - CASH AND CASH EQUIVALENTS**

The Director is responsible for the safekeeping of all monies paid into the State Treasury. The Director may invest any monies of the State, which, in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions.

Information relating to the bank balance, insurance, and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

Cash and cash equivalents at June 30, 2014 consisted of amounts held in State Treasury of approximately \$523,634,000.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE D - CASH AND CASH EQUIVALENTS (Continued)**

- (1) **Interest Rate Risk** - As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.
- (2) **Credit Risk** - The State's investment policy limits investments in State and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating.
- (3) **Custodial Credit Risk** - For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping, certain types of securities to collateralized repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.
- (4) **Concentration of Credit Risk** - The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.
- (5) **Cash in Bank** - The DOE maintains cash in banks which is held separately from cash in the State Treasury. As of June 30, 2014, the carrying amount of total bank deposits was approximately \$7,135,000 and the corresponding bank balances were approximately \$23,532,000. Of this amount, the PCS also held cash outside of the State Treasury totaling approximately \$29,989,000 at June 30, 2014.

All deposits are collateralized in accordance with State statutes. The balances are insured by the Federal Deposit Insurance Corporation (FDIC) and collateralized with securities held by the Department's agent. 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.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE E - CAPITAL ASSETS**

For the fiscal year ended June 30, 2014, capital assets activity for the DOE was as follows:

	Balance July 1, 2013	Additions	Deductions	Balance June 30, 2014
	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
Government activities:				
Capital asset, not being depreciated:				
Land	\$ 88,238,609	\$ --	\$ --	\$ 88,238,609
Construction in progress	<u>240,250,871</u>	<u>149,916,359</u>	<u>(137,199,947)</u>	<u>252,967,283</u>
Total capital assets not being depreciated	<u>328,489,480</u>	<u>149,916,359</u>	<u>(137,199,947)</u>	<u>341,205,892</u>
Capital assets, being depreciated:				
Land improvements	219,680,047	5,743,415	--	225,423,462
Buildings and improvements	1,963,150,924	87,032,862	(979,093)	2,049,204,693
Furniture and equipment	104,955,294	57,180,496	(7,979,060)	154,156,730
Vehicles	10,272,534	351,411	(253,972)	10,369,973
Public library materials	<u>68,807,714</u>	<u>3,822,224</u>	<u>(2,742,980)</u>	<u>69,886,958</u>
Total capital assets being depreciated	<u>2,366,866,513</u>	<u>154,130,408</u>	<u>(11,955,105)</u>	<u>2,509,041,816</u>
Less accumulated depreciation for:				
Land improvements	(112,739,220)	(10,579,461)	--	(123,318,681)
Buildings and improvements	(1,118,316,547)	(54,446,522)	179,500	(1,172,583,569)
Furniture and equipment	(69,467,161)	(12,462,039)	4,182,959	(77,746,241)
Vehicles	(9,099,217)	(601,770)	253,972	(9,447,015)
Public library materials	<u>(54,756,415)</u>	<u>(5,743,048)</u>	<u>2,742,980</u>	<u>(57,756,483)</u>
Total accumulated depreciation	<u>(1,364,378,560)</u>	<u>(83,832,840)</u>	<u>7,359,411</u>	<u>(1,440,851,989)</u>
Government activities, net	\$ <u>1,330,977,433</u>	\$ <u>220,213,927</u>	\$ <u>(141,795,641)</u>	\$ <u>1,409,395,719</u>

Depreciation expense was charged to functions as follows:

	<u>Governmental Activities</u>
School-related	\$ 73,005,067
State and complex area administration	2,177,911
Public libraries	<u>8,649,862</u>
Total additions to accumulated depreciation	\$ <u>83,832,840</u>

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE F - LONG-TERM LIABILITIES**

The change in long-term liabilities during the fiscal year ended June 30, 2014, was as follows:

	<u>Accrued compensated absences</u>	<u>Workers' compensation claims</u>
Balance at July 1, 2013	\$ 67,180,743	\$ 71,376,994
Additions	26,733,923	17,208,547
Reductions	<u>(20,706,697)</u>	<u>(11,330,178)</u>
Balance at June 30, 2014	73,207,969	77,255,363
Less current portion	<u>(16,099,438)</u>	<u>(13,905,965)</u>
	\$ <u>57,108,531</u>	\$ <u>63,349,398</u>

The compensated absences and workers' compensation liabilities have been paid primarily by the general fund in the past. The carrying amount of liabilities for unpaid workers' compensation claims of approximately \$79.7 million is reported at present value using a discount rate of 2.0%.

**NOTE G - FOOD DISTRIBUTION PROGRAM**

U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS), has delegated to the Hawaii Child Nutrition Programs office (HCNP) the administrative responsibility of the Food Distribution Program. HCNP is the State Agency that distributes USDA Foods to schools (public, private, and charter), institutions and organizations that participate in the National School Lunch Program (NSLP) and Summer Food Service Program (SFSP). Hawaii's entitlement is determined in part by the number of lunches reimbursed under the NSLP and SFSP of the previous school year. FNS estimates the cost to purchase the USDA Foods. The estimated prices can be found by referring to: <http://www.fns.usda.gov/fdd/pcims/Nov15CommodityFiles.htm>. The amount charged to the entitlement is based upon the net dollar values of the purchased USDA Foods. Bonus commodities are USDA Foods that are additional to Hawaii's entitlement. A portion of the entitlement is allocated for the purchase of fresh produce.

The Department received approximately \$5,138,000 of commodities for the fiscal year ended June 30, 2014. No bonus commodities were received for the fiscal year ended June 30, 2014.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE H - NONIMPOSED EMPLOYEE WAGES AND FRINGE BENEFITS**

Payroll fringe benefit costs and certain payroll costs related to backpay of the Department's employees that are funded by state appropriations are assumed by the State and are not charged to the Department's operating funds. These costs, totaling approximately \$459,086,000 for the fiscal year ended June 30, 2014, have been reported as revenues and expenditures in the general fund of the Department.

**NOTE I - LEASE COMMITMENTS**

The Department leases equipment from third-party lessors under various operating leases expiring through 2024. Future minimum lease rentals under noncancelable operating leases with terms of one year or more at June 30, 2014 were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2015	\$ 4,086,000
2016	3,266,000
2017	2,498,000
2018	1,635,000
2019	713,000
2020 - 2024	<u>159,000</u>
	<b>\$ <u>12,357,000</u></b>

Total rent expense related to the above leases for the year ended June 30, 2014 amounted to approximately \$4,283,000.

**NOTE J - RETIREMENT BENEFITS**

(1) ***Employees' Retirement System (ERS)***

All eligible employees of the Department are required by Hawaii Revised Statutes (HRS) Chapter 88, to become members of the ERS, a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits, as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813, or through the ERS's website: [ers.hawaii.gov](http://ers.hawaii.gov).

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE J - RETIREMENT BENEFITS (Continued)**

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

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

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members receive a multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Most of the new employees hired from July 1, 2006, were required to join the hybrid plan.

Effective July 1, 2012, the hybrid contributory plan was revised by Act 163, SLH of 2011. Members joining the hybrid plan on or after that date are eligible for retirement at age 65 with 10 years of credited service or age 60 with 30 years of credited service. Members will receive a benefit multiplier of 1.75% for each year of credited service in the hybrid plan. The benefit options remain similar to the current contributory plan.

Covered employees of the contributory plan who became members on or before June 30, 2012 are required to contribute 7.8% of their salary. Covered employees of the hybrid plan who became members on or before June 30, 2012 are required to contribute 6% of their salary. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The Department's contribution requirements as of June 30, 2014, 2013, and 2012 were approximately \$202,661,000, \$181,810,000, and \$175,613,000, respectively. The contribution rate for the fiscal years ended June 30, 2014, 2013, and 2012 were 16.00%, 15.51%, and 15.00%, respectively. Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the Department.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE J - RETIREMENT BENEFITS (Continued)**

**(2) *Post-Retirement Health Care and Life Insurance Benefits***

In addition to providing pension benefits, the State also provides certain health care and life insurance benefits to all qualified employees. Pursuant to Act 88, SLH 2001, the State contributes to the Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003. The EUTF was established to provide a single delivery system of health benefits for State and county workers, retirees and their dependents. The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at P.O. Box 2121, Honolulu, Hawaii 96805-2121.

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

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

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

Measurement of the actuarial valuation and the annual required contribution (ARC) are made for the State as a whole and are not separately computed for the individual state departments and agencies. The State allocates the ARC to the State component units and proprietary funds based upon a systematic methodology.

For active employees, the employees' contributions are based upon negotiated collective bargaining agreements. Employer contributions for employees not covered by collective bargaining agreements and for retirees are prescribed by the HRS.

The Department's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2014, 2013 and 2012 were approximately \$128,183,000, \$121,324,000 and \$93,191,000, respectively.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2014**

**NOTE J - RETIREMENT BENEFITS (Continued)**

(3) ***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 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 does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or the accompanying basic financial statements.

**NOTE K - RISK MANAGEMENT**

The State is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally retains the first \$1,000,000 per occurrence of property losses, the first \$4,000,000 with respect to general liability claims, and the first \$500,000 of losses due to crime. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence of property losses is \$200,000,000, except for earthquake, which individually is \$100,000,000 aggregate loss, and terrorism, which is \$50,000,000 per occurrence. The annual aggregate limit for general liability losses is \$15,000,000 per occurrence and for crime losses, the limit per occurrence is \$10,000,000 with no aggregate limit. The State also has an insurance policy to cover medical malpractice risk in the amount of \$35,000,000 per occurrence and \$39,000,000 in the aggregate.

The State is generally self-insured for workers' compensation and automobile claims. The Department administers its workers' compensation losses. A liability for workers' compensation is established if information indicates that a loss has been incurred as of June 30, 2014, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported. The amount of the estimated loss is recorded in the accompanying statement of net position, as those losses will be liquidated with future expendable resources.

**Department of Education**  
**State of Hawaii**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**June 30, 2014**

**NOTE L - COMMITMENTS AND CONTINGENCIES**

- (1) **Encumbrances** - The Department is committed under contracts awarded and orders placed for construction, repairs and maintenance, expenses, supplies, etc. These commitments as of June 30, 2014 were as follows:

Fund	Amount
General Fund	\$ 89,441,193
Federal Fund	48,844,373
Capital Projects Fund	390,746,944
Other Funds	<u>7,605,216</u>
	<u>\$ 536,637,726</u>

- (2) **Litigation** - The Department has been named as defendant in a number of lawsuits and claims arising in the normal course of operations. To the extent that the outcome of such litigation has been determined to result in probable financial loss to the Department, such loss has been accrued in the basic financial statements. Of the remaining claims, a number of claims may possibly result in adverse judgments against the Department. However, such claim amounts cannot be reasonably estimated at this time. Although the Department and its counsel are unable to express opinions as to the outcome of on-going litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the Department because any judgments against the Department are judgments against the State and would be funded by the legislative appropriation of the State General Fund.

## **SUPPLEMENTARY INFORMATION**

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2014**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number <sup>1</sup>	Pass-through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
<b>U.S. Department of Agriculture</b>				
Child Nutrition Cluster				
School Breakfast Program	10.553		\$ 11,116,614	\$ 553,086
National School Lunch Program	10.555			
Cash assistance			55,681,145	2,198,488
Cash assistance (commodities)			<u>5,138,617</u>	<u>--</u>
Subtotal - National School Lunch Program			<u>60,819,762</u>	<u>2,198,488</u>
Special Milk Program for Children	10.556		1,050	1,050
Summer Food Service Program for Children	10.559			
Cash assistance			539,755	539,755
State administrative expense			<u>22,708</u>	<u>--</u>
Subtotal - Summer Food Service Program for Children			<u>562,463</u>	<u>539,755</u>
Total - Child Nutrition Cluster			<u>72,499,889</u>	<u>3,292,379</u>
Child and Adult Care Food Program	10.558		7,099,217	7,020,181
State Administrative Expense for Child Nutrition	10.560		1,228,329	--
Team Nutrition Grant	10.574		145,112	--
Fresh Fruit and Vegetable Program	10.582		<u>654,021</u>	<u>142,530</u>
<b>Total - U.S. Department of Agriculture</b>			<u>81,626,568</u>	<u>10,455,090</u>
<b>U.S. Department of Defense</b>				
Thinking Through Science	12.030		300,398	--
Competitive Grants: Promoting K-12 Student Achievement at Military-Connected Schools	12.556			
AVID Radford Complex			260,899	--
Expanding Virtual Learning Opportunities			433,169	--
Implement Blended Learning			132,200	--
Math Learners			<u>561,683</u>	<u>--</u>
Total - DoDEA Grant Program			1,387,951	--
DoD Impact Aid	12.558		2,674,294	--
Community Investment	12.600		5,482,163	--
Passed-through U.S. Pacific Command Joint Venture Education Forum	12.N00038		<u>201,226</u>	<u>--</u>
<b>Total - U.S. Department of Defense</b>			<u>\$ 10,046,032</u>	<u>\$ --</u>

<sup>1</sup> Other identifying number used if no CFDA number available.

See accompanying note to schedule of expenditures of federal awards.

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2014**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number <sup>1</sup>	Pass-through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
<b>U.S. Department of Education</b>				
Adult Education - Basic Grants to States	84.002		\$ 1,777,619	\$ --
Title I - Grants to Local Educational Agencies	84.010		49,341,809	--
Migrant Education - State Grant Program	84.011		844,384	--
Title I - Program for Neglected and Delinquent Children	84.013		334,377	--
Special Education Cluster				
Grants to States	84.027		41,580,285	--
Preschool Grants	84.173		<u>943,685</u>	<u>--</u>
Total - Special Education Cluster			<u>42,523,970</u>	<u>--</u>
Impact Aid	84.041		67,240,797	--
Migrant Education Coordination Program	84.144		102,351	--
Education and Homeless Children and Youth	84.196		231,586	--
Even Start - Migrant Education	84.214		60,604	--
Fund for the Improvement of Education	84.215		1,068,577	--
Twenty-First Century Community Learning Centers	84.287		4,670,294	--
Advanced Placement Program	84.330		365,960	--
Native Hawaiian Education	84.362		291,627	--
English Language Acquisition Grants	84.365		3,941,494	--
Mathematics and Science Partnerships	84.366		711,244	--
Improving Teacher Quality State Grants	84.367		7,335,601	--
Grants for State Assessments and Related Activities	84.369		3,667,629	--
Statewide Longitudinal Data Systems	84.372		1,259,528	--
School Improvement Grants Cluster				
School Improvement Grants	84.377		1,517,201	--
School Improvements Grants - ARRA	84.388		<u>1,999,647</u>	<u>--</u>
Total - School Improvement Grants Cluster			<u>3,516,848</u>	<u>--</u>
NAEP State Coordinator	84.ED-08-CO-0029		202,691	--
Passed-through Office of the State of Director for Vocational Education				
Career and Technical Education - Basic Grants to States	84.048	V048A09-V048A10	2,505,148	--
Passed-through State of Department of Human Services Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	H126A70015	69,459	--

<sup>1</sup> Other identifying number used if no CFDA number available.

See accompanying note to schedule of expenditures of federal awards.

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2014**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number <sup>1</sup>	Pass-through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
<b>U.S. Department of Education (Continued)</b>				
Passed-through Alu Like, Inc. Native Hawaiian Career and Technical Education	84.259	VE1011-01-0 -2.3	\$ 205,480	\$ --
Passed-through University of Hawaii Gaining Early Awareness and Readiness	84.334	P334S110026	306,458	--
Gaining Early Awareness and Readiness	84.334A	P334A110247	191,275	--
Native Hawaiian Education	84.362A	S362A11-S362A12	1,812,167	--
College Access Challenge Grant Program	84.378A	P378A120027	<u>25,663</u>	<u>--</u>
Total - Passed-through University of Hawaii			<u>2,335,563</u>	<u>--</u>
Passed-through Office of the Governor State Fiscal Stabilization Fund, Race-to-the-Top - ARRA	84.395	S395A100051	<u>26,376,251</u>	<u>--</u>
Total - U.S. Department of Education			<u>220,980,891</u>	<u>--</u>
<b>U.S. Department of Health and Human Services</b>				
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938		133,711	--
Passed-through State Department of Human Services Child Care and Development Block Grant	93.575	DHS-11-CCPO	229,723	--
Temporary Assistance for Needy Families	93.558	DHS-10-ETPO-154	<u>2,418,974</u>	<u>--</u>
Total - Passed-through State Department of Human Services			<u>2,648,697</u>	<u>--</u>
Total - U.S. Department of Health and Human Services			<u>2,782,408</u>	<u>--</u>
<b>U.S. Department of Homeland Security</b>				
Passed-through State Department of Homeland Security Homeland Security Grant Program	97.067	EMW-2014-SS-00003-S01	<u>24,535</u>	<u>--</u>
Total - U.S. Department of Homeland Security			<u>24,535</u>	<u>--</u>
<b>U.S. Department of Interior</b>				
Economic, Social and Political Development of the Territories	15.875		<u>1,867,000</u>	<u>--</u>
Total - U.S. Department of Interior			<u>1,867,000</u>	<u>--</u>
<b>Institute of Museum and Library Services</b>				
Grants to States	45.310		<u>1,677,841</u>	<u>--</u>
Total - Institute of Museum and Library Services			<u>1,677,841</u>	<u>--</u>
<b>Grand Total</b>			<b>\$ <u>319,005,275</u></b>	<b>\$ <u>10,455,090</u></b>

<sup>1</sup> Other identifying number used if no CFDA number available.

See accompanying note to schedule of expenditures of federal awards.

**Department of Education  
State of Hawaii  
NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2014**

**Basis of Presentation**

The accompanying schedule of expenditure of federal awards (SEFA) includes federal grant activity of the Department of Education (DOE), State Library (Library), and Public Charter Schools (PCS) where the DOE prepares the SEFA, based on information provided by the Library and PCS, to combine federal financial data for the three departments, in aggregate known as the Department.

The SEFA is presented on the cash basis of accounting, and in accordance with the requirements of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organization*. Therefore, some amounts may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**PART II**

**AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS**

**REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

**INDEPENDENT AUDITOR'S REPORT**

To the Auditor  
State of Hawaii  
Board of Education  
State of Hawaii, Department of Education

We have audited, in accordance with the 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 governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the DOE's basic financial statements, and have issued our report thereon dated March 13, 2015. Our report includes a reference to other auditors who audited the financial statements of the public charter schools, as described in our report on the DOE's financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the DOE'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control. Accordingly, we do not express an opinion on the effectiveness of the DOE'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 DOE'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 was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2014-001 that we consider to be a significant deficiency.

### **Compliance and Other Matters**

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

We noted certain other matters that we reported to management of the DOE in a separate letter dated March 13, 2015.

### **DOE's Response to Findings**

The DOE's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The DOE's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **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.

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 13, 2015

**PART III**

**AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE**

**REPORT ON COMPLIANCE FOR  
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER  
COMPLIANCE REQUIRED BY OMB CIRCULAR A-133**

**INDEPENDENT AUDITOR'S REPORT**

To the Auditor  
Office of the Auditor  
Board of Education  
State of Hawaii, Department of Education

**Report on Compliance for Each Major Federal Program**

We have audited the Department of Education of the State of Hawaii's (DOE) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the DOE's major federal programs for the fiscal year ended June 30, 2014. The DOE's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of the DOE's major federal programs 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the DOE'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 each major federal program. However, our audit does not provide a legal determination of the DOE's compliance.

### ***Basis for Qualified Opinion on the Community Investment***

As described in the accompanying schedule of findings and questioned costs, the DOE did not comply with requirements regarding CFDA No. 12.600 Community Investment as described in finding number 2014-002 for Reporting. Compliance with such requirements is necessary, in our opinion, for the DOE to comply with the requirements applicable to that program.

### ***Qualified Opinion on the Community Investment***

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the DOE complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Community Investment program for the fiscal year ended June 30, 2014.

### ***Unmodified Opinion on Each of the Other Major Federal Programs***

In our opinion, the DOE complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs for the fiscal year ended June 30, 2014.

### **Other Matters**

The DOE's response to the noncompliance findings identified in our audit are described in Part V, Corrective Action Plan of this report. The DOE's response was not subjected to the 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 DOE 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 DOE's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph 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. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be a material weakness.

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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2014-002 to be a material weakness.

The DOE's response to the internal control over compliance findings identified in our audit is described in Part V, Corrective Action Plan of this report. The DOE's response was not subjected to the 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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 13, 2015

**PART IV**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Department of Education  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ended June 30, 2014**

**SECTION I - SUMMARY OF AUDITOR'S RESULTS**

**Financial Statements**

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified?  yes  no

Significant deficiency(ies) identified?  yes  none reported

Noncompliance material to the financial statements noted?  yes  no

**Federal Awards**

Internal control over major program:

Material weakness(es) identified?  yes  no

Significant deficiency(ies) identified?  yes  none reported

Type of auditor's report issued on compliance for major programs: Unmodified for all major programs except for Community Investment which was qualified.

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?  yes  no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
	Child Nutrition Cluster:
10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children
10.558	Child and Adult Care Food Program
12.600	Community Investment
84.002	Adult Education
84.010	Title I - Grants to Local Educational Agencies
	Special Education Cluster:
84.027	Special Education - Grants to State (IDEA, Part B)
84.173	Special Education - Preschool Grants (IDEA Preschool)
84.287	Twenty-First Century Community Learning Centers
84.365	English Language Acquisition State Grants
84.367	Improving Teacher Quality State Grants

**Department of Education**  
**State of Hawaii**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2014**

<u>CFDA Number</u>	<u>Name of Federal Program</u>
84.377	School Improvement Grants Cluster: School Improvement Grants
84.388	School Improvement Grants, Recovery Act
84.395	State Fiscal Stabilization Fund (SFSF) - Race-to-the-Top Incentive Grants, Recovery Act

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

Auditee qualified as a low-risk auditee?  yes  no

**Department of Education  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2014**

**SECTION II - FINANCIAL STATEMENT FINDING**

**Ref. No. Internal Control Finding**

**2014-001 Review Accounting of Compensated Absences Balances**

The DOE prepared a summary leave schedule to compile its accrued compensated absence liability balance and reported the liability to the State Comptroller. The liability was based on the balance of unused earned hours recorded in KRONOS, a computerized time and attendance system, multiplied by the employee's hourly salary rate.

The vacation and sick leave balances calculated using KRONOS as of June 30, 2014 for financial reporting purposes erroneously included leave credits earned for the subsequent fiscal year recorded in KRONOS as of July 1, 2014 for 12-month teachers. The leave hours were added as of June 30, 2014 in conformity with all other employees whose hours earned for June are recorded the following day on July 1 in KRONOS. July 1 vacation hours earned should not have been added as of June 30 for the 12-month teachers. The DOE did not detect the calculation errors in the accrued vacation and sick leave balances for the 12-month teachers. As a result, the vacation and sick leave balance as of June 30, 2014 was overstated by approximately \$2 million and \$3 million, respectively.

**Recommendation**

The DOE should review and correct its accounting of vacation and sick leave balances for financial reporting purposes to prevent and detect errors.

Department of Education  
State of Hawaii  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
Fiscal Year Ended June 30, 2014

**SECTION III - FEDERAL AWARD FINDING AND QUESTIONED COSTS**

<u>Ref. No.</u>	<u>Compliance and Internal Control Finding</u>	<u>Questioned Costs</u>
2014-002	<p><b>Strengthen Accounting and Reporting For Community Investment Grant</b></p> <p><b>Federal agency:</b> U.S. Department of Defense <b>CFDA No.:</b> 12.600 <b>Program:</b> Community Investment <b>Federal award no.:</b> HQ00051310092</p> <p><b>Criteria:</b> 32 CFR 33.20(a)(1) states in part, “A State must expend and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contractors, must be sufficient to permit preparation of reports required by this part ....”</p> <p><b>Condition:</b> The amount of federal cash receipts, federal disbursements, federal share of expenditures, and recipient share of expenditures reported on the Form SF-425, <i>Federal Financial Report</i>, as of June 30, 2014 did not agree to the accounting records.</p> <ul style="list-style-type: none"><li>• The DOE incorrectly reported no federal cash receipts and disbursements although the DOE received over \$2 million from the grantor in cost reimbursement.</li><li>• The reported amount of federal share of expenditures of approximately \$2 million was based on the sum of invoices on hand as of December 31, 2013 used for the only reimbursement claim made for the grant. The DOE’s computerized accounting system recorded federal grant expenditures totaling over \$5 million incurred during fiscal year ended June 30, 2014.</li><li>• The reported recipient share of expenditures of approximately \$2.3 million was also calculated based on the sum of invoices on hand as of December 31, 2013 instead of at least \$4.2 million that was recorded in the DOE’s computerized accounting system.</li></ul> <p>Furthermore, the amount of federal share claimed on the Form SF-271, <i>Outlay Report and Request for Reimbursement for Construction Programs</i>, although supported by invoices did not agree to the amounts totaling approximately \$79,000 classified as federal share in the DOE’s computerized accounting system. The amounts recorded in the computerized accounting system and the amounts reported on Form SF-425 or Form SF-271 were not reconciled. The DOE reached an agreement with the grantor in February 2015 on how to reconcile the amounts recorded in the computerized accounting system and the amounts reported on Form SF-425 and Form-271.</p>	

Department of Education  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2014

<u>Ref. No.</u>	<u>Compliance and Internal Control Finding (Continued)</u>	<u>Questioned Costs</u>
2014-002	<p><b>Strengthen Accounting and Reporting For Community Investment Grant (Continued)</b></p> <p><b>Cause:</b> The preparer did not know how to obtain the necessary information from the DOE's computerized accounting system to report amounts to the grantor properly. In addition, the preparer did not receive sufficient training or technical assistance in preparing the federal reports and the reports were not adequately reviewed.</p> <p><b>Effect:</b> Without adequate report preparation process and training, the DOE was unable to complete the Forms SF-271 and SF-425 properly. We were informed that until the DOE properly corrects the erroneous Form SF-425, the DOE is unable to submit further cost reimbursements from the grantor.</p> <p><b>Recommendation</b></p> <p>The DOE should strengthen the accounting and reporting for the Community Investment grant by establishing adequate report procedures and providing adequate training to ensure proper preparation and review of required federal reports.</p>	\$ <u>      --</u>

**PART V**

**CORRECTIVE ACTION PLAN**

**(Provided by the Department of Education, State of Hawaii)**

DAVID Y. IGE  
GOVERNOR



KATHRYN S. MATAYOSHI  
SUPERINTENDENT

**STATE OF HAWAII**  
**DEPARTMENT OF EDUCATION**  
P.O. BOX 2360  
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

March 13, 2015

N&K CPAs, Inc.  
American Savings Bank Tower, Suite 1700  
1001 Bishop Street  
Honolulu, HI 96813

Ladies and Gentlemen:

The Single Audit of the State of Hawaii Department of Education (HIDOE) for the fiscal year ended June 30, 2014 was completed before the March 31, 2015 Federal deadline. We are pleased that HIDOE received an unmodified opinion on its financial statements.

We have reviewed your audit findings and recommendations and corrective action plans have been prepared. In accordance with OMB Circular A-133, the following pages contain the **Corrective Action Plan** for the year ended June 30, 2014 and the **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2013.

Very truly yours,

A handwritten signature in blue ink, appearing to read "K. Matayoshi".

Kathryn S. Matayoshi  
Superintendent

KSM:dy

Attachments

c: Internal Audit Office

**STATE OF HAWAII DEPARTMENT OF EDUCATION  
CORRECTIVE ACTION PLAN  
Fiscal Year Ended June 30, 2014**

**FINANCIAL STATEMENT FINDING**

**2014-001 Review Accounting of Compensated Absences Balances**

(Page 57)

**Corrective Action Plan**

*The Kronos Time and Attendance (T&A) system is the system of record for leave transactions and balances. T&A was programmed to meet all of the leave elements that are written in the various Bargaining Unit agreements, school code, HRS, etc. When preparing the “FY 2014 Summary Leave Schedule of Leave Balances,” certain timing parameters relating to earned leave were inadvertently missed, which caused errors in the report.*

*The DOE will revise the summary report data extraction parameters, either with the assistance of the Office of Information Technology Services (OITS) programmers and/or Kronos (the T&A system vendor). The data extraction will only include transactions for the respective school year fiscal period, which begins on July 1 and ends on June 30 of the following calendar year. The DOE will also conduct a comprehensive test to ensure that the leave summary report fairly states leave balances for the respective audit period.*

*Contact Person: Tom Ishimaru, Director  
Accounting Services Branch  
Office of Fiscal Services*

*Anticipated Completion Date: June 30, 2015*

**STATE OF HAWAII DEPARTMENT OF EDUCATION  
CORRECTIVE ACTION PLAN  
Fiscal Year Ended June 30, 2014**

**FEDERAL AWARD FINDINGS**

**2014-002 Strengthen Accounting and Reporting For Community Investment Grant**

*(Pages 58 to 59)*

**Corrective Action Plan**

*The Facilities Development Branch, Office of School Facilities and Support Services (OSFSS) will correct the Form SF-425 for the period ending June 30, 2014 to match the accounting records. Corrections to include the amount of federal cash receipts and disbursements (\$2,322,940), the federal share of expenditures (\$5,482,163), and the state share of expenditures (\$4,251,498).*

*Per the agreement reached with the grantor in February 2015, the Grant Performance Report for Period 4 (January 1, 2014 through March 31, 2014) will be updated to explain the corrections made to SF-425 and will provide the correct back-up information for the first payment reimbursement, SF-271 to reconcile the amounts on both forms.*

*Going forward, quarterly performance reports and payment requests will be prepared by the DOE's grant program manager in the Facilities Development Branch (FDB) Planning Section in collaboration with FDB's Work Program Specialist in order to correctly report on state and federal payments.*

*In addition, starting with the March 2015 payment request, monthly payment requests for the grant project from the construction contractor will include a form identifying the proper accounts (state or federal) from which the payments are to be made.*

*Contact Person: Keenan Chang, Work Program Specialist  
Facilities Development Branch  
Office of School Facilities and Support Services*

*Anticipated Completion Date: July 31, 2015*

**PART VI**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

**(Provided by the Department of Education, State of Hawaii)**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**Prior Fiscal Year Ended June 30, 2013**

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**SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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**2013-01 Perform Eligibility Determinations in Timely Manner**  
*(Page 59 of the Prior Year June 30, 2013 Report)*

**Status** -- *Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.*

**2013-02 Review Indirect Costs Assessment Calculation Carefully**  
*(Page 60 of the Prior Year June 30, 2013 Report)*

**Status** -- *Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.*

**2013-03 Obtain Clarification and Approval of Methodology to Ensure Compliance with Earmarking Requirement**  
*(Page 61 of the Prior Year June 30, 2013 Report)*

**Status** -- *Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.*