

**FINANCIAL AUDIT OF THE
STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND**

Fiscal Year Ended June 30, 2014

**Submitted by
The Auditor
State of Hawaii**



**STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND**

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**STATE OF HAWAII
DEPARTMENT OF HEALTH
DRINKING WATER TREATMENT REVOLVING LOAN FUND**

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PART I
FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

To the Auditor
State of Hawaii

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of and for the fiscal year then ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 reasonable basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2014, and the changes in its financial position and its cash flows for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note B, the financial statements of the Fund are intended to present the financial position, the changes in financial position and cash flows of only that portion of the business-type activities and proprietary fund type activities of the State of Hawaii and the State of Hawaii, Department of Health that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the respective financial position of the State of Hawaii and the State of Hawaii, Department of Health as of June 30, 2014, the respective changes in its financial position, or its cash flows 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

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the Fund's basic financial statements. The supplementary information on pages 21 through 24 is presented for purposes of additional analysis and is not a required part of the financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 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 supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 2014 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

N&K CPAs, Inc.

Honolulu, Hawaii
November 28, 2014

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF NET POSITION
June 30, 2014

ASSETS

Current assets		
Equity in cash and cash equivalents and investments in State Treasury	\$	69,443,219
Loan fees receivable		638,962
Accrued interest on loans		77,600
Other accrued interest		58,591
Due from federal government		54,961
Current maturities of loans receivable		<u>5,477,446</u>
Total current assets		75,750,779
Loans receivable, net of current maturities		72,893,917
Capital assets, net of accumulated depreciation		<u>236,515</u>
Total assets	\$	<u><u>148,881,211</u></u>

LIABILITIES AND NET POSITION

Current liabilities		
Accounts payable and other accrued liabilities	\$	<u>529,407</u>
Total current liabilities		529,407
Accrued vacation, net of current portion		105,095
Other postemployment benefits		<u>599,990</u>
Total liabilities		<u><u>1,234,492</u></u>
Commitments and contingencies		
Net position		
Net investment in capital assets		236,515
Restricted - expendable		<u>147,410,204</u>
Total net position		<u><u>147,646,719</u></u>
Total liabilities and net position	\$	<u><u>148,881,211</u></u>

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2014

OPERATING REVENUES	
Interest income from loans	\$ 243,295
Administrative loan fees	<u>2,043,442</u>
Total operating revenues	2,286,737
 OPERATING EXPENSES	
Administrative	950,457
State program management	581,834
Water protection	1,687,143
Principal forgiveness for SRF	<u>1,959,164</u>
Total operating expenses	<u>5,178,598</u>
Operating loss	(2,891,861)
 NONOPERATING REVENUES	
State contributions	1,825,000
Federal contributions	21,821,807
Other interest income	<u>192,810</u>
Total nonoperating revenues	<u>23,839,617</u>
Change in net position	20,947,756
 NET POSITION	
Beginning of year	<u>126,698,963</u>
End of year	\$ <u><u>147,646,719</u></u>

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
STATEMENT OF CASH FLOWS
Fiscal Year Ended June 30, 2014

Cash flows from operating activities	
Interest income from loans	\$ 227,760
Administrative loan fees	2,033,018
Principal repayment on loans	4,769,474
Disbursement of loan proceeds	(23,763,260)
Payments to employees	(958,392)
Payments to vendors	<u>(1,930,883)</u>
Net cash used in operating activities	<u>(19,622,283)</u>
Cash flows from noncapital financing activities	
State contributions	1,825,000
Federal contributions	<u>22,259,217</u>
Net cash provided by noncapital financing activities	<u>24,084,217</u>
Cash flows from capital and related financing activities	
Purchase of equipment	<u>(119,252)</u>
Net cash used in capital and related financing activities	(119,252)
Cash flows from investing activities	
Other interest income	<u>176,345</u>
Net cash provided by investing activities	<u>176,345</u>
Net increase in cash	4,519,027
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	<u>64,924,192</u>
End of year	\$ <u><u>69,443,219</u></u>
Reconciliation of operating loss to net cash used in operating activities	
Operating loss	(2,891,861)
Adjustments to reconcile operating loss to net cash used in operating activities	
Depreciation expense	67,420
Principal forgiveness for SRF	1,959,164
Change in assets and liabilities	
Loans receivable	(18,993,786)
Accrued interest on loans	(15,535)
Loan fees receivable	(10,424)
Accounts payable and other accrued liabilities	152,563
Other postemployment benefits	<u>110,176</u>
Net cash used in operating activities	\$ <u><u>(19,622,283)</u></u>

See accompanying notes to the financial statements.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE A - ESTABLISHMENT AND PURPOSE OF THE FUND

The 1996 Amendments to the Safe Drinking Water Act (the "Act") provide for the U.S. Environmental Protection Agency ("EPA") to make capitalization grants to states for the purpose of providing loans and other types of financial assistance to public water systems for drinking water infrastructure, including construction of public drinking water systems.

In 1997, the State of Hawaii ("State") Legislature established the Drinking Water Treatment Revolving Loan Fund (the "Fund") to receive federal capitalization grants from the EPA. The Fund is administered by the Safe Drinking Water Branch, Environmental Management Division of the State of Hawaii, Department of Health (the "Department"). The Fund's primary purpose is to provide loans in perpetuity to public drinking water systems for the construction of drinking water treatment facilities. Such loans may be at or below market interest rates and must be fully amortized within twenty years, with the first repayment of principal and interest occurring no later than one year after the notice to proceed for construction or the final agreement date, whichever is later.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

- (1) ***Basis of Presentation*** - The accompanying financial statements are intended to present the financial position, results of operations and cash flows of only that portion of the State and Department that is attributable to the transactions of the Fund and do not purport to present the financial position, results of operations or cash flows of the State or Department.

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds.

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

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services or goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal operating revenues of the Fund are interest income and administrative loan fees on loans made to county governments. Federal grants, state matching funds, and interest income from sources other than loans are reported as nonoperating revenues. Principal forgiveness for loans is reported as operating expenses. Prior to July 1, 2013, management reported principal forgiveness for loans as nonoperating expenses. Management believes that reporting principal forgiveness of loans as operating expenses better corresponds to the substance of the event being recognized.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (2) **Use of Estimates** - In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates, among others, include the allowances for uncollectible accounts, depreciable lives of capital assets, and the other postemployment benefits ("OPEB") liability.
- (3) **Equity in Cash and Cash Equivalents and Investments in State Treasury** - All monies of the Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2014, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or the United States of America. 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.

- (4) **Loans Receivable** - Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period. The capitalization grants for federal fiscal years 2010 through 2013 allow for portions of loans to be forgiven upon satisfaction of certain requirements. Management of the Fund considers these loans to be program loans, as they are undertaken to fulfill a governmental responsibility. All loans made and collected (including interest) are considered to be operating cash outflows and inflows, respectively.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (5) **Administrative Loan Fees** - In May 2000, the Department implemented an administrative loan fee program to pay for the Fund's administration, including employee salaries and benefits. The program applies an administrative loan fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.
- (6) **Capital Assets** - Capital assets are defined as those assets with estimated useful lives greater than one year and with an acquisition cost greater than \$5,000. Such assets consist principally of equipment, and are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5-7 years) of the respective assets.
- (7) **Accrued Vacation** - Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. The current portion of the accrued vacation balance is included in the accounts payable and other accrued liabilities balance.
- (8) **Accumulated Sick Leave** - Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in Employees' Retirement System of the State of Hawaii ("ERS"). At June 30, 2014, accumulated sick leave was approximately \$324,000.
- (9) **Net Position** - The Fund's net position is classified into two net position categories.

Net investment in capital assets consists of capital assets, net of accumulated depreciation and outstanding debt attributable to the acquisition, construction or improvement of those assets.

Restricted-expendable consists of restricted assets less liabilities whose use by the Fund are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

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

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (11) **Fund Accounts** - The Fund consists of the State revolving fund ("SRF") and non-SRF activity. The SRF activity consists exclusively of federal capitalization grant loans, state matching contributions, principal loan repayments, and interest from loans and other earning assets. Non-SRF activity consists of administrative loan fees and federal set aside funds.
- (12) **Expenses** - The statement of revenues, expenses and changes in fund net position presents expenses on a functional basis. The natural classifications of expenses are presented in the supplemental schedule of operating expenses.
- (13) **New Accounting Pronouncements** - Effective for the year ended June 30, 2014, the Fund adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this statement is to reclassify certain assets and liabilities as deferred outflows of resources and deferred inflow of resources and recognizes certain assets and liabilities as outflows of resources or inflows of resources. The adoption of this statement did not have a material effect on the Fund's financial statements.

Effective for the year ended June 30, 2014, the Fund adopted GASB Statement No. 66, *Technical Corrections*. The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The adoption of this statement did not have a material effect on the Fund's financial statements.

Effective for the year ended June 30, 2014, the Fund adopted GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this statement is to enhance comparability of financial statements among governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees. The statement also will enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees as well as augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee. The adoption of this statement did not have a material effect on the Fund's financial statements.

**State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014**

NOTE C - LOANS RECEIVABLE

At June 30, 2014, loans receivable from government entities were as follows:

Eleven loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.00%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	\$ 21,430,046
Twelve loans receivable from the County of Hawaii, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	13,658,717
Eleven loans receivable from the County of Maui, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.00%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	17,712,379
Fourteen loans receivable from the County of Kauai, Department of Water due in semi-annual payments, including interest ranging from 0.16% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	<u>25,570,221</u>
	78,371,363
Less: Current maturities	<u>(5,477,446)</u>
	\$ <u>72,893,917</u>

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

	Amount
2015	\$ 5,477,446
2016	5,509,928
2017	5,531,907
2018	5,553,300
2019	5,575,102
Thereafter	<u>50,723,680</u>
	\$ <u>78,371,363</u>

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE C - LOANS RECEIVABLE (Continued)

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

In fiscal year 2014, \$1,959,164 in loans were forgiven. All loans and advances were forgiven in accordance with the required conditions.

At June 30, 2014, \$15,838,183, \$6,110,667, and \$21,798,311 were committed to be loaned to the County of Hawaii, City and County of Honolulu, and County of Maui, respectively, under existing loan agreements.

NOTE D - CONTRIBUTED CAPITAL

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2014:

Budget Period	Amount	Total Draws at June 30, 2013	EPA Draws	Total 2014 Cash Draws	Funds Available
09/01/06 - 06/30/16	\$ 8,285,500	\$ 7,563,751	\$ 2,500	\$ 373,064	\$ 346,185
07/01/07 - 06/30/17	8,229,300	6,467,162	--	1,502,426	259,712
03/01/08 - 06/30/17	8,229,000	7,178,815	--	851,562	198,623
03/01/09 - 06/30/18	8,146,000	981,765	--	4,887,805	2,276,430
01/01/10 - 06/30/19	8,146,000	175,939	--	1,710,795	6,259,266
04/01/11 - 06/30/17	13,573,000	1,359,319	--	4,271,330	7,942,351
09/30/11 - 06/30/18	9,268,000	1,551,566	--	3,256,617	4,459,817
09/28/12 - 06/30/19	9,125,000	182	--	5,405,618	3,719,200
09/30/13 - 06/30/20	8,421,000	--	450,000	--	7,971,000
	\$ <u>81,422,800</u>	\$ <u>25,278,499</u>	\$ <u>452,500</u>	\$ <u>22,259,217</u>	\$ <u>33,432,584</u>

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2014, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2014 approximated \$29.7 million, of which approximately \$23.2 million has been utilized and \$6.5 million was available to be loaned out at June 30, 2014.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE E - CAPITAL ASSETS

Summary of capital assets at June 30, 2014 is as follows:

	Balance at June 30, 2013	Additions	Retirements/ Disposals	Balance at June 30, 2014
Equipment	\$ 1,236,989	\$ 119,252	\$ --	\$ 1,356,241
Accumulated Depreciation	<u>(1,052,306)</u>	<u>(67,420)</u>	<u>--</u>	<u>(1,119,726)</u>
	<u>\$ 184,683</u>	<u>\$ 51,832</u>	<u>\$ --</u>	<u>\$ 236,515</u>

NOTE F - ACCRUED VACATION

At June 30, 2014, long-term obligations included accrued vacation as follows:

	<u>Amount</u>
Balance at July 1, 2013	\$ 156,621
Increase	48,359
Decrease	<u>(57,850)</u>
Balance at June 30, 2014	147,130
Less: Current portion	<u>(42,035)</u>
Noncurrent portion	\$ <u>105,095</u>

NOTE G - EMPLOYEE BENEFIT PLANS

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

- (1) **Employees' Retirement System** - The ERS is a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.
- (2) **Deferred Compensation Plan** - The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseeable emergency.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE G - EMPLOYEE BENEFIT PLANS (Continued)

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

- (3) **Post-Employment Healthcare and Life Insurance Benefits** - The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

State Policy - The actuarial valuation of the EUTF does not provide OPEB information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution ("ARC"), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in stand-alone departmental financial statements or in the State's CAFR. The basis for the allocation is the proportionate share of the State's total covered employee headcount by each component unit or proprietary fund for retiree health benefits.

Annual OPEB Cost - The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the Fund's financial statements. The following table shows the allocated annual OPEB cost that has been allocated to the Fund for the year ended June 30, 2014:

	Amount
Annual OPEB cost	\$ 179,280
Less: contributions made	(69,104)
Increase in net OPEB obligation	110,176
Net OPEB obligation	
Beginning of year	489,814
End of year	\$ 599,990

Amount of Contributions Made - Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the years ended June 30, 2014, 2013, and 2012 approximated \$69,000, \$61,000, and \$47,000, respectively.

Required Supplementary Information and Disclosures - The State's CAFR includes the required footnote disclosures and supplementary information on the State's OPEB plan.

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2014

NOTE H - INSURANCE COVERAGE

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

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

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

SUPPLEMENTARY INFORMATION

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF CASH RECEIPTS, DISBURSEMENTS AND CASH BALANCE
Fiscal Year Ended June 30, 2014

RECEIPTS

Principal repayment on loans	\$	4,769,474
Interest income from loans		227,760
State contributions		1,825,000
Federal contributions		22,259,217
Administrative loan fees		2,033,018
Other interest income		<u>176,345</u>
Total receipts		<u>31,290,814</u>

DISBURSEMENTS

Disbursement of loan proceeds		23,763,260
Administrative		2,889,275
Purchase of equipment		<u>119,252</u>
Total disbursements		<u>26,771,787</u>
Excess of receipts over disbursements		<u>4,519,027</u>

EQUITY IN CASH AND CASH EQUIVALENTS AND INVESTMENTS IN STATE TREASURY

Beginning of year		<u>64,924,192</u>
End of year	\$	<u><u>69,443,219</u></u>

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF NET POSITION
June 30, 2014

	State Revolving Fund Activity	Non-SRF Activity	Total
ASSETS			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 65,826,236	\$ 3,616,983	\$ 69,443,219
Loan fees receivable	--	638,962	638,962
Accrued interest on loans	77,600	--	77,600
Other accrued interest	58,591	--	58,591
Due from federal government	52,063	2,898	54,961
Current maturities of loans receivable	5,477,446	--	5,477,446
Total current assets	71,491,936	4,258,843	75,750,779
Loans receivable, net of current maturities	72,893,917	--	72,893,917
Capital assets, net of accumulated depreciation	--	236,515	236,515
Total assets	\$ 144,385,853	\$ 4,495,358	\$ 148,881,211
LIABILITIES AND NET POSITION			
Current liabilities			
Accounts payable and other accrued liabilities	\$ --	\$ 529,407	\$ 529,407
Total current liabilities	--	529,407	529,407
Accrued vacation, net of current portion	--	105,095	105,095
Other postemployment benefits	--	599,990	599,990
Total liabilities	--	1,234,492	1,234,492
Net position			
Net investment in capital assets	--	236,515	236,515
Restricted - expendable	144,385,853	3,024,351	147,410,204
Total net position	144,385,853	3,260,866	147,646,719
Total liabilities and net position	\$ 144,385,853	\$ 4,495,358	\$ 148,881,211

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
Fiscal Year Ended June 30, 2014

	<u>State Revolving Fund Activity</u>	<u>Non-SRF Activity</u>	<u>Total</u>
OPERATING REVENUES			
Interest income from loans	\$ 243,295	\$ --	\$ 243,295
Administrative loan fees	<u>--</u>	<u>2,043,442</u>	<u>2,043,442</u>
Total operating revenues	243,295	2,043,442	2,286,737
OPERATING EXPENSES			
Administrative	--	950,457	950,457
State program management	--	581,834	581,834
Water protection	--	1,687,143	1,687,143
Principal forgiveness for SRF	<u>1,959,164</u>	<u>--</u>	<u>1,959,164</u>
Total operating expenses	<u>1,959,164</u>	<u>3,219,434</u>	<u>5,178,598</u>
Operating loss	(1,715,869)	(1,175,992)	(2,891,861)
NONOPERATING REVENUES			
State contributions	1,825,000	--	1,825,000
Federal contributions	19,233,329	2,588,478	21,821,807
Other interest income	<u>192,810</u>	<u>--</u>	<u>192,810</u>
Total nonoperating revenues	21,251,139	2,588,478	23,839,617
Interfund transfers	<u>2,282,921</u>	<u>(2,282,921)</u>	<u>--</u>
Change in net position	21,818,191	(870,435)	20,947,756
NET POSITION			
Beginning of year	<u>122,567,662</u>	<u>4,131,301</u>	<u>126,698,963</u>
End of year	\$ <u><u>144,385,853</u></u>	\$ <u><u>3,260,866</u></u>	\$ <u><u>147,646,719</u></u>

State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SCHEDULE OF OPERATING EXPENSES
Fiscal Year Ended June 30, 2014

	State Revolving Fund Activity	Non-SRF Activity	Total
Principal forgiveness for SRF	\$ 1,959,164	\$ --	\$ 1,959,164
Personnel	--	1,072,565	1,072,565
Professional services	--	766,472	766,472
Services rendered by other State agencies	--	1,093,778	1,093,778
Travel	--	80,742	80,742
Depreciation	--	67,420	67,420
Telephone	--	2,138	2,138
Repairs and maintenance	--	84,689	84,689
Rental	--	4,488	4,488
Training	--	10,706	10,706
Office and other supplies	--	15,506	15,506
Miscellaneous	--	20,930	20,930
	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	\$ <u>1,959,164</u>	\$ <u>3,219,434</u>	\$ <u>5,178,598</u>

PART II

**INDEPENDENT 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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Funds' basic financial statements, and have issued our report thereon dated November 28, 2014.

Internal Control Over Financial Reporting

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

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

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
November 28, 2014

PART III

**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE FOR A FEDERAL PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE**

**REPORT ON COMPLIANCE WITH THE REQUIREMENTS
APPLICABLE TO THE UNITED STATES ENVIRONMENTAL PROTECTION
AGENCY'S DRINKING WATER STATE REVOLVING FUNDS PROGRAM IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITOR'S REPORT

To the Auditor
State of Hawaii

**Report on Compliance for Capitalization Grants for Drinking Water State
Revolving Funds**

We have audited the State of Hawaii, Department of Health, Drinking Water Treatment Revolving Fund's (the "Fund") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Funds Program (the "Program") for the year ended June 30, 2014.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Fund's Program 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; OMB Circular A-133, *Audits of State and Local Governments, and Non-Profit Organizations* and the United States *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards and OMB Circular A-133, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the Program. However, our audit does not provide a legal determination of the Fund's compliance with the compliance requirements referred to above.

Opinion on Compliance for Capitalization Grants for Drinking Water State Revolving Funds

In our opinion, the Fund complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its Program for the year ended June 30, 2014.

Report on Internal Control Over Compliance

Management of the Fund is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Fund's internal control over compliance with the types of requirements that could have a direct and material effect on the Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over compliance.

A *deficiency* in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of the Program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of the Program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of the Program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

N&K CPAs, Inc.

ACCOUNTANTS | CONSULTANTS

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

N&K CPAs, Inc.

Honolulu, Hawaii
November 28, 2014

PART IV
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Fiscal Year Ended June 30, 2014**

**Ref.
No.**

13-01 Reporting (Significant Deficiency)

Federal agency: Environmental Protection Agency (“EPA”)
CFDA No.: 66.468
Program: Capitalization Grants for Drinking Water State
Revolving Funds
**Federal award no.
and award year:** FS-99986513-0 9/28/2012 – 6/30/2019

During the prior year testing of the reporting compliance requirement, it was noted that the Fund did not report subawards in the Federal Funding Accountability and Transparency Subaward Reporting System on FRS.gov required under the Federal Funding Accountability Transparency Act (“FFATA”) for subrecipient awards made from its 2013 federal awards.

It was recommended that the Fund implement policies and procedures to ensure required subawards are properly reported on FRS.gov to comply with FFATA.

Status

Resolved. No similar instances were noted.