

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

Fiscal Year Ended June 30, 2017

**Submitted by
The Auditor
State of Hawaii**



March 28, 2018

Mr. Leslie Kondo, State Auditor
Office of the Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education

Dear Mr. Kondo 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, 2017. 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 Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

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 financial statements as of and for the fiscal year ended June 30, 2017, and to comply with the requirements of the Uniform Guidance, 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 financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2017.
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 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 each 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 Uniform Guidance. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2017.

ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I - The financial statements and related notes of the DOE as of and for the fiscal year ended June 30, 2017, and our opinions on the 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 - Response 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.

**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 (Department), as of and for the fiscal year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the 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 1% of the total assets and 1% of total fund balances as of June 30, 2017, and 3% of total revenues for the fiscal year ended June 30, 2017, of the Department's governmental funds. Those 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 Department, 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 audit and the reports 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 Department, as of June 30, 2017, and the respective changes in financial position, and, where applicable, the respective budgetary comparison for the General Fund and Federal Fund 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 A, 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 of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2017, and the changes in its financial position for the fiscal year then ended in accordance 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 8 - 14 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 Department's basic financial statements. The schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, 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 28, 2018, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's 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 Department's internal control over financial reporting and compliance.

N + K CPAs, INC.

Honolulu, Hawaii
March 28, 2018

**Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year Ended June 30, 2017**

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, 2017. We encourage readers to consider the information presented here in conjunction with the accompanying financial statements and notes to enhance their understanding of the Department's financial performance.

The 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, HSPLS and PCS are managed independently. The DOE has determined that the PCS balances are significant, but not material, and relies on certain financial information which have been audited by other auditors and coordinated by the PCS.

FINANCIAL HIGHLIGHTS

Key government-wide financial highlights for fiscal year ended June 30, 2017 (FY 2017) compared to the prior fiscal year ended June 30, 2016 (FY 2016) are as follows:

- Total FY 2017 revenues were \$2.915 billion, a decrease of 6% or \$183 million from \$3.098 billion in FY 2016.
- Total FY 2017 expenses were \$2.818 billion, an increase of 5% or \$139 million from \$2.679 billion in FY 2016.
- Of the total FY 2017 expenses of \$2.818 billion, 92% or \$2.596 billion was spent for school-related activities. Of the total FY 2016 expenses of \$2.679 billion, 93% or \$2.498 billion was spent for school-related activities.
- Total assets exceeded liabilities as of June 30, 2017 by \$2.330 billion (net position), compared to \$2.233 billion as of June 30, 2016, an increase of 4%.
- Capital assets, net of accumulated depreciation, comprised 70% of total net position as of June 30, 2017 and 2016, respectively.

**Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2017**

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2017

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

Fiduciary funds are used to account for resources held for the benefit of parties outside the Department. The Department reports on agency funds (or student activity 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 Financial Statements* - The notes to 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, 2017**

Exhibit A-1
Government-wide Statements of Net Position
Fiscal years 2017 and 2016
(Amounts in millions)

	Governmental activities		2017 - 2016	
	2017	2016	Increase (decrease)	Percentage change
Assets:				
Current	\$ 1,175.7	\$ 1096.4	\$ 79.3	7 %
Noncurrent (capital assets, net of depreciation)	<u>1,631.5</u>	<u>1,561.2</u>	<u>70.3</u>	5 %
Total assets	\$ <u>2,807.2</u>	\$ <u>2,657.6</u>	\$ <u>149.6</u>	6 %
Liabilities:				
Current	\$ 341.4	\$ 300.6	\$ 40.8	14 %
Noncurrent	<u>135.8</u>	<u>123.7</u>	<u>12.1</u>	10 %
Total liabilities	<u>477.2</u>	<u>424.3</u>	<u>52.9</u>	12 %
Net position:				
Investment in capital assets	1,631.5	1,561.2	70.3	5 %
Restricted	--	2.2	(2.2)	(100) %
Unrestricted	<u>698.5</u>	<u>669.9</u>	<u>28.6</u>	4 %
Total net position	<u>2,330.0</u>	<u>2,233.3</u>	<u>96.7</u>	4 %
Total liabilities and net position	\$ <u>2,807.2</u>	\$ <u>2,657.6</u>	\$ <u>149.6</u>	6 %

Overall Financial Position - The Department's overall net position has increased as of June 30, 2017 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 \$97 million, or 4%, 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, 2017

Exhibit A-2
Government-wide Changes of Net Position
Fiscal years 2017 and 2016
(Amounts in millions)

	Governmental activities		2017 - 2016	
	2017	2016	Increase (decrease)	Percentage change
	<u>2017</u>	<u>2016</u>	<u>(decrease)</u>	<u>change</u>
Revenues:				
Program revenues:				
Charges for services	\$ 59.4	\$ 62.3	\$ (2.9)	(5) %
Operating grants and contributions	269.0	265.5	3.5	1 %
Capital grants and contributions	1.7	7.7	(6.0)	(78) %
General revenues:				
State allotted appropriations, net of lapses	1,987.6	2,223.3	(235.7)	(11) %
Non-imposed employee wages and fringe benefits	597.1	538.6	58.5	11 %
Unrestricted investment earnings	<u>0.6</u>	<u>0.4</u>	<u>0.2</u>	50 %
Total	\$ <u>2,915.4</u>	\$ <u>3,097.8</u>	\$ <u>(182.4)</u>	(6) %
Transfers, net	\$ (1.0)	(0.9)	(0.1)	11 %
Expenses:				
School-related	\$ 2,596.1	2,498.0	98.1	4 %
State and complex area administration	66.5	67.7	(1.2)	(2) %
Public libraries	50.4	46.8	3.6	8 %
Capital outlay	<u>104.8</u>	<u>66.0</u>	<u>38.8</u>	59 %
Total	<u>2,817.8</u>	<u>2,678.5</u>	<u>139.3</u>	5 %
Change in net position	\$ <u><u>96.6</u></u>	\$ <u><u>418.4</u></u>	\$ <u><u>(321.8)</u></u>	(77) %

Overall Results of Operations - The Department's results of operations for FY 2017 have resulted in an increase in net position of \$97 million. This is lower than the increase in net position of \$418 million for the prior FY 2016. Total FY 2017 expenses were \$2.818 billion, an increase of 5% or \$140 million from \$2.678 billion in FY 2016.

**Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2017**

GOVERNMENTAL FUND FINANCIAL ANALYSIS

Within the governmental fund financial statements, the overall net change in fund balance for FY 2017 was \$40.5 million, and the total overall fund balance for the governmental funds as of June 30, 2017 was \$871.6 million.

General Fund Budget Results - The Department was appropriated general funds of \$1.677 billion in FY 2017. Increases 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, 2017, general funds carried over totaled \$70.2 million, representing 4% of general fund appropriations.

Federal Fund Budget Results - The Department expended \$23.4 million more federal funds than was appropriated during FY 2017; this reflects the timing of expenditures versus federal cash that may have been received during the fiscal year.

AGENCY FUNDS

Agency funds, or "student activity 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 \$27.1 million in FY 2017 representing a 5% increase from the prior fiscal year balance of \$25.9 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, 2017**

The Department's capital assets as of June 30, 2017 amounted to \$1.631 billion (net of accumulated depreciation of \$1.778 billion), an increase of \$70 million, compared to capital assets as of June 30, 2016 which amounted to \$1.561 billion (net of accumulated depreciation of \$1.668 billion). Depreciation expense for FY 2017 amounted to \$119.8 million.

The Department is committed under contracts awarded and orders placed for construction, repairs and maintenance, and related expenses. These commitments amounted to approximately \$658.2 million.

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

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.

**Department of Education
State of Hawaii
STATEMENT OF NET POSITION
June 30, 2017**

	Governmental Activities
ASSETS	
Current assets	
Cash	\$ 1,124,950,527
Receivables	
Due from federal government	34,384,295
Due from other agencies	5,438,858
Accounts receivable	<u>10,907,535</u>
Total current assets	1,175,681,215
Capital assets, net of accumulated depreciation	<u>1,631,471,843</u>
Total assets	\$ <u><u>2,807,153,058</u></u>
LIABILITIES AND NET POSITION	
Current liabilities	
Vouchers and contracts payable	\$ 157,308,949
Accrued wages and employee benefits	141,806,594
Accrued compensated absences	21,692,928
Workers' compensation claims reserve	15,566,830
Due to State of Hawaii general fund	<u>5,000,000</u>
Total current liabilities	341,375,301
Accrued compensated absences, less current portion	47,591,604
Workers' compensation claims reserve, less current portion	<u>88,212,039</u>
Total liabilities	<u>477,178,944</u>
Net position	
Net investment in capital assets	1,631,471,843
Unrestricted	<u>698,502,271</u>
Total net position	<u>2,329,974,114</u>
Total liabilities and net position	\$ <u><u>2,807,153,058</u></u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2017**

		Program revenues			Net revenue (expenses) and change in net position
	Expenses	Charges for services	Operating grants and contributions	Capital grants and contributions	Governmental activities
Governmental activities:					
School-related	\$ 2,596,070,128	\$ 57,613,547	\$ 265,785,295	\$ --	\$ (2,272,671,286)
State and complex area administration	66,481,941	--	1,034,000	--	(65,447,941)
Public libraries	50,366,602	1,785,546	2,215,310	--	(46,365,746)
Capital outlay	<u>104,843,787</u>	<u>--</u>	<u>--</u>	<u>1,733,315</u>	<u>(103,110,472)</u>
Total governmental activities	<u>\$ 2,817,762,458</u>	<u>\$ 59,399,093</u>	<u>\$ 269,034,605</u>	<u>\$ 1,733,315</u>	(2,487,595,445)
General revenues:					
State allotted appropriations, net of lapses					1,987,563,028
Nonimposed employee wages and fringe benefits					597,047,295
Unrestricted investment earnings					<u>562,758</u>
Total general revenues					<u>2,585,173,081</u>
Other financing sources (uses):					
Transfers in					225,785
Transfers out					<u>(1,222,161)</u>
Net transfers					<u>(996,376)</u>
Change in net position					96,581,260
Net position at June 30, 2016					<u>2,233,392,854</u>
Net position at June 30, 2017					\$ <u>2,329,974,114</u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2017**

	<u>General</u>	<u>Federal</u>	<u>Capital Projects</u>	<u>Other</u>	<u>Total</u>
ASSETS					
Cash and cash equivalents	\$ 200,201,944	\$ 120,819,485	\$ 713,548,334	\$ 90,380,764	\$ 1,124,950,527
Receivables					
Due from federal government	--	34,384,295	--	--	34,384,295
Due from other agencies	--	--	--	5,438,858	5,438,858
Accounts receivable	--	--	--	10,907,535	10,907,535
Total assets	\$ <u>200,201,944</u>	\$ <u>155,203,780</u>	\$ <u>713,548,334</u>	\$ <u>106,727,157</u>	\$ <u>1,175,681,215</u>
LIABILITIES AND FUND BALANCES					
LIABILITIES					
Vouchers and contracts payable	\$ 50,386,367	\$ 19,462,462	\$ 82,386,245	\$ 5,073,875	\$ 157,308,949
Accrued wages and employee benefits payable	132,006,298	5,580,175	274,339	3,945,782	141,806,594
Due to State of Hawaii general fund	5,000,000	--	--	--	5,000,000
Total liabilities	<u>187,392,665</u>	<u>25,042,637</u>	<u>82,660,584</u>	<u>9,019,657</u>	<u>304,115,543</u>
FUND BALANCES					
Committed	--	--	--	97,707,500	97,707,500
Assigned	12,809,279	130,161,143	630,887,750	--	773,858,172
Unassigned	--	--	--	--	--
Total fund balances	<u>12,809,279</u>	<u>130,161,143</u>	<u>630,887,750</u>	<u>97,707,500</u>	<u>871,565,672</u>
Total liabilities and fund balances	\$ <u>200,201,944</u>	\$ <u>155,203,780</u>	\$ <u>713,548,334</u>	\$ <u>106,727,157</u>	\$ <u>1,175,681,215</u>

See accompanying notes to the financial statements.

Department of Education
State of Hawaii
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION
June 30, 2017

Total fund balances - governmental funds		\$	871,565,672
Amounts reported for governmental activities in the statement of net position are different because:			
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.			
Capital Assets			
Governmental capital assets	\$	3,409,623,112	
Less accumulated depreciation		<u>(1,778,151,269)</u>	1,631,471,843
Accrued compensated absences are not due in the current period and therefore are not reported in the governmental funds.			(69,284,532)
Workers' compensation claims reserve is not due in the current period and, therefore, is not reported in the funds.			<u>(103,778,869)</u>
Net position of governmental activities		\$	<u><u>2,329,974,114</u></u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Fiscal Year Ended June 30, 2017**

	General	Federal	Capital Projects	Other	Total
REVENUES					
State allotments, net	\$ 1,703,602,406	\$ --	\$ 278,248,237	\$ 5,712,385	\$ 1,987,563,028
Nonimposed employee wages and fringe benefits	597,047,295	--	--	--	597,047,295
Intergovernmental revenues	--	259,179,296	--	590,459	259,769,755
Other revenues	--	--	--	70,960,016	70,960,016
	<u>2,300,649,701</u>	<u>259,179,296</u>	<u>278,248,237</u>	<u>77,262,860</u>	<u>2,915,340,094</u>
EXPENDITURES					
School-related	2,160,361,223	264,097,372	--	60,433,115	2,484,891,710
State and complex area administration	61,380,232	3,047,782	--	294,125	64,722,139
Public libraries	43,902,200	1,294,639	--	3,486,892	48,683,731
Capital outlay	1,084,322	1,733,315	270,226,245	2,324,538	275,368,420
	<u>2,266,727,977</u>	<u>270,173,108</u>	<u>270,226,245</u>	<u>66,538,670</u>	<u>2,873,666,000</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES					
	<u>33,921,724</u>	<u>(10,993,812)</u>	<u>8,021,992</u>	<u>10,724,190</u>	<u>41,674,094</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	--	1,620	1,620
Transfers out	--	(1,620)	(1,220,541)	--	(1,222,161)
Total other financing sources (uses)	<u>--</u>	<u>(1,620)</u>	<u>(1,220,541)</u>	<u>1,620</u>	<u>(1,220,541)</u>
NET CHANGE IN FUND BALANCES					
	33,921,724	(10,995,432)	6,801,451	10,725,810	40,453,553
FUND BALANCES (DEFICITS) AT					
JULY 1, 2016	<u>(21,112,445)</u>	<u>141,156,575</u>	<u>624,086,299</u>	<u>86,981,690</u>	<u>831,112,119</u>
FUND BALANCES AT					
JUNE 30, 2017	<u>\$ 12,809,279</u>	<u>\$ 130,161,143</u>	<u>\$ 630,887,750</u>	<u>\$ 97,707,500</u>	<u>\$ 871,565,672</u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2017**

Net change in fund balances - total government funds		\$ 40,453,553
 Amounts reported for governmental activities in the statement of activities are different because:		
 Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets are depreciated over their estimated useful lives as depreciation expense.		
Expenditures for capital assets	\$ 193,552,121	
Loss on disposal of capital assets	(3,484,644)	
Less current fiscal year depreciation	<u>(119,766,463)</u>	70,301,014
 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		
		(1,219,347)
 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>(12,953,960)</u>
 Change in net position of governmental activities		 \$ <u>96,581,260</u>

See accompanying notes to the 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, 2017

	<u>Budgeted Amounts</u>		<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
State allotments	\$ <u>1,677,273,953</u>	\$ <u>1,704,310,298</u>	\$ <u>1,703,050,756</u>	\$ <u>(1,259,542)</u>
EXPENDITURES				
School-related	1,595,013,216	1,622,104,652	1,551,897,321	70,207,331
State and complex area administration	48,599,682	48,113,751	45,817,429	2,296,322
Public libraries	<u>33,661,055</u>	<u>34,091,895</u>	<u>34,090,994</u>	<u>901</u>
	<u>1,677,273,953</u>	<u>1,704,310,298</u>	<u>1,631,805,744</u>	<u>72,504,554</u>
Excess of revenues over expenditures	\$ <u> --</u>	\$ <u> --</u>	\$ <u> 71,245,012</u>	\$ <u> 71,245,012</u>

See accompanying notes to the 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, 2017

	<u>Budgeted Amounts</u>		<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
	<u>Original</u>	<u>Final</u>		
REVENUES				
Federal grants	\$ 477,169,946	\$ 445,349,254	\$ 236,996,142	\$ (208,353,112)
	<u>477,169,946</u>	<u>445,349,254</u>	<u>236,996,142</u>	<u>(208,353,112)</u>
EXPENDITURES				
School-related	470,404,056	438,581,410	257,974,258	180,607,152
State and complex area administration	5,042,536	6,267,844	2,061,342	4,206,502
Public libraries	<u>1,723,354</u>	<u>500,000</u>	<u>316,941</u>	<u>183,059</u>
	<u>477,169,946</u>	<u>445,349,254</u>	<u>260,352,541</u>	<u>184,996,713</u>
Deficiency of revenues under expenditures	\$ <u><u> --</u></u>	\$ <u><u> --</u></u>	\$ <u><u>(23,356,399)</u></u>	\$ <u><u>(23,356,399)</u></u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
STATEMENT OF FIDUCIARY NET POSITION - AGENCY FUNDS
June 30, 2017**

	<u>Agency Funds</u>
ASSETS	
Cash and cash deposits in financial institutions	\$ <u>27,123,338</u>
Total assets	<u>27,123,338</u>
LIABILITIES	
Due to student groups and others	<u>27,123,338</u>
Total liabilities	<u>27,123,338</u>
NET POSITION	\$ <u><u> --</u></u>

See accompanying notes to the financial statements.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

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 certain financial information which have been audited by other auditors 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, 2017, and the changes in its financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America (GAAP). The State Comptroller maintains the central accounts for all state funds and publishes the State's Comprehensive Annual Financial Report, 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 accordance with GAAP as prescribed by the GASB.

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

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 for workers' compensation claims reserve at June 30, 2017 has been reported only in the government-wide financial statements.

Encumbrances are recorded obligations in the form of purchase orders 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.

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 framework within which the resources and obligations of the general fund are accounted for.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 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.

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.

Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 FINANCIAL STATEMENTS
June 30, 2017**

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.

(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 financial statements.

Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (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 financial statements and the amount of the loss is reasonably estimable.
- (10) **Use of Estimates** - The preparation of the financial statements in accordance 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, 2017, general funds carried over amounted to approximately \$70,200,000 representing approximately 4% of appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in accordance 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.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2017:

	<u>General</u>	<u>Federal</u>
Excess (deficiency) of revenues over (under) expenditures - actual on a budgetary basis	\$ 71,245,012	\$ (23,356,399)
Reserved for encumbrances at fiscal year-end	92,909,582	20,814,356
Expenditures for liquidation of prior fiscal year encumbrances	(124,510,932)	(16,222,604)
Net accrued revenues and expenditures	<u>(5,721,938)</u>	<u>7,770,835</u>
Excess (deficiency) of revenues over (under) expenditures - GAAP basis	\$ <u>33,921,724</u>	\$ <u>(10,993,812)</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, 2017 consisted of amounts held in State Treasury of approximately \$1,078,733,000.

- (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.

Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017

NOTE D - CASH AND CASH EQUIVALENTS (Continued)

- (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, 2017, the carrying amount of total bank deposits was approximately \$6,485,000 and the corresponding bank balances were approximately \$39,411,000. The PCS also held cash outside of the State Treasury totaling approximately \$39,732,000 at June 30, 2017.

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 FINANCIAL STATEMENTS
June 30, 2017**

NOTE E - CAPITAL ASSETS

For the fiscal year ended June 30, 2017, capital assets activity for the DOE was as follows:

	Balance July 1, 2016	Additions	Deductions	Balance June 30, 2017
	<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>196,984,565</u>	<u>174,009,277</u>	<u>(176,765,392)</u>	<u>194,228,450</u>
Total capital assets not being depreciated	<u>285,223,174</u>	<u>174,009,277</u>	<u>(176,765,392)</u>	<u>282,467,059</u>
Capital assets, being depreciated:				
Land improvements	262,228,780	42,027,216	--	304,255,996
Buildings and improvements	2,313,941,238	106,708,185	--	2,420,649,423
Furniture and equipment	291,150,117	40,267,919	(6,225,152)	325,192,884
Vehicles	11,104,076	1,016,357	(258,851)	11,861,582
Public library materials	<u>65,589,722</u>	<u>4,327,447</u>	<u>(4,721,001)</u>	<u>65,196,168</u>
Total capital assets being depreciated	<u>2,944,013,933</u>	<u>194,347,124</u>	<u>(11,205,004)</u>	<u>3,127,156,053</u>
Less accumulated depreciation for:				
Land improvements	(147,657,278)	(14,435,174)	--	(162,092,452)
Buildings and improvements	(1,294,407,783)	(64,982,969)	--	(1,359,390,752)
Furniture and equipment	(160,548,429)	(35,628,841)	4,789,106	(191,388,164)
Vehicles	(10,145,755)	(735,380)	171,365	(10,709,770)
Public library materials	<u>(55,307,033)</u>	<u>(3,984,099)</u>	<u>4,721,001</u>	<u>(54,570,131)</u>
Total accumulated depreciation	<u>(1,668,066,278)</u>	<u>(119,766,463)</u>	<u>9,681,472</u>	<u>(1,778,151,269)</u>
Government activities, net	\$ <u>1,561,170,829</u>	\$ <u>248,589,938</u>	\$ <u>(178,288,924)</u>	\$ <u>1,631,471,843</u>

Depreciation expense was charged to functions as follows:

	<u>Governmental Activities</u>
School-related	\$ 110,667,017
State and complex area administration	1,727,138
Public libraries	<u>7,372,308</u>
Total additions to accumulated depreciation	\$ <u>119,766,463</u>

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE F - LONG-TERM LIABILITIES

The change in long-term liabilities during the fiscal year ended June 30, 2017, was as follows:

	<u>Accrued compensated absences</u>	<u>Workers' compensation claims</u>
Balance at July 1, 2016	\$ 68,065,185	\$ 90,824,909
Additions	28,803,218	26,119,354
Reductions	<u>(27,583,870)</u>	<u>(13,165,394)</u>
Balance at June 30, 2017	69,284,532	103,778,869
Less current portion	<u>(21,692,928)</u>	<u>(15,566,830)</u>
	\$ <u>47,591,604</u>	\$ <u>88,212,039</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 \$111.2 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 \$5,576,000 of commodities for the fiscal year ended June 30, 2017. No bonus commodities were received for the fiscal year ended June 30, 2017.

NOTE H - NONIMPOSED EMPLOYEE WAGES AND FRINGE BENEFITS

Payroll fringe benefit costs 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 \$597,047,000 for the fiscal year ended June 30, 2017, have been reported as revenues and expenditures in the statement of activities and general fund of the Department.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE I - LEASE COMMITMENTS

The Department leases equipment from third-party lessors under various operating leases expiring through 2027. Future minimum lease rentals under noncancelable operating leases with terms of one year or more at June 30, 2017 were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2018	\$ 4,662,000
2019	3,636,000
2020	2,710,000
2021	1,790,000
2022	820,000
2023 - 2027	<u>754,000</u>
	\$ <u>14,372,000</u>

Total rent expense related to the above leases for the fiscal year ended June 30, 2017 amounted to approximately \$4,884,000.

NOTE J - RETIREMENT BENEFITS

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

Plan Description - Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: <http://www.ers.ehawaii.gov>.

Benefits Provided - The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability and death benefits with three membership classes known as the noncontributory, contributory and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for members hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation for members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE J - RETIREMENT BENEFITS (Continued)

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012 receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012 receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class.

Noncontributory Class

Retirement Benefits - General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with ten years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or dependent children, no benefit is payable.

Ordinary death benefits are available to employees who were active at time of death with at least ten years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/reentry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of the member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension and the dependent children receive a percentage of the member's accrued maximum allowance unreduced for age.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE J - RETIREMENT BENEFITS (Continued)

Contributory Plan for Members Hired Prior to July 1, 2012

Retirement Benefits - General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member's contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least one year of service. Ordinary death benefits consist of a lump-sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributory Plan for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 60.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE J - RETIREMENT BENEFITS (Continued)

Disability and Death Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability.

Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

Hybrid Plan for Members Hired Prior to July 1, 2012

Retirement Benefits - General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

Death Benefits - For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least five years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE J - RETIREMENT BENEFITS (Continued)

Hybrid Plan for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and emergency medical technicians may retire with 25 years of credited service at age 55.

Disability and Death Benefits - Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least ten years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributions - Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rate for fiscal year 2017 was 17.00% for general employees. Contributions to the pension plan from the Department were approximately \$235,167,000 for the fiscal year ended June 30, 2017.

The employer is required to make all contributions for noncontributory members. Contributory members hired prior to July 1, 2012 are required to contribute 7.8% of their salary. Contributory members hired after June 30, 2012 are required to contribute 9.8% of their salary. Hybrid members hired prior to July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

State Policy - 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. It is the State's policy on the accounting and reporting for pension benefits to allocate a portion of the net pension liability, pension expense, and related deferred inflows and outflows of resources to only component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR). The State's CAFR includes the note disclosures and required supplementary information on the State's pension plan.

Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017

NOTE J - RETIREMENT BENEFITS (Continued)

(2) ***Post-Employment Healthcare and Life Insurance Benefits***

Plan Description - 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.

Contributions - Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years ended June 30, 2017, 2016, and 2015 were approximately \$111,635,000, \$128,075,000, and \$130,946,000.

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

(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 an unforeseeable emergency.

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

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 terrorism, which is

**Department of Education
State of Hawaii
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2017**

NOTE K - RISK MANAGEMENT (Continued)

\$50,000,000 per occurrence. The annual aggregate limit for general liability losses is \$7,500,000 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, 2017, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported and loss adjustment expenses. 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.

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, 2017 were as follows:

Fund	Amount
General Fund	\$ 103,425,527
Federal Fund	22,895,213
Capital Projects Fund	527,263,562
Other Funds	4,631,164
	\$ 658,215,466

- (2) **Litigation** - The Department has been named as defendant in a number of lawsuits and claims arising in the normal course of operations. 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, 2017**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Agriculture				
Child Nutrition Cluster				
School Breakfast Program	10.553		\$ 11,369,530	\$ 678,862
National School Lunch Program	10.555			
Cash assistance			51,664,247	2,398,536
Cash assistance (commodities)			<u>5,575,926</u>	<u>--</u>
Subtotal - National School Lunch Program			<u>57,240,173</u>	<u>2,398,536</u>
Summer Food Service Program for Children	10.559			
Cash assistance			584,202	582,202
State administrative expense			<u>54,927</u>	<u>--</u>
Subtotal - Summer Food Service Program for Children			<u>639,129</u>	<u>582,202</u>
Total - Child Nutrition Cluster			<u>69,248,832</u>	<u>3,659,600</u>
Child and Adult Care Food Program	10.558		7,516,190	7,396,023
State Administrative Expenses for Child Nutrition	10.560		1,308,805	--
Team Nutrition Grant	10.574		18,547	--
Child Nutrition Discretionary Grants Limited Availability	10.579		38,291	28,546
Fresh Fruit and Vegetable Program	10.582		<u>255,966</u>	<u>142,443</u>
Total - U.S. Department of Agriculture			<u>78,386,631</u>	<u>11,226,612</u>
U.S. Department of Commerce				
Office for Coastal Management	11.473		<u>2,526</u>	<u>--</u>
Total - U.S. Department of Commerce			<u>2,526</u>	<u>--</u>
U.S. Department of Defense				
Competitive Grants: Promoting K-12 Student Achievement at Military-Connected Schools	12.556			
AVID Radford Complex			58,297	--
Expanding Virtual Learning Opportunities			14,293	--
Math Learners			20,086	--
Comprehensive Stem			209,971	--
Readying Radford Complex			143,001	--
Visible Learning			65,803	--
Stem Leilehua Complex			<u>63,377</u>	<u>--</u>
Total - DoDEA Grant Program			574,828	--
Invitational Grants for Military-Connected Schools	12.557		222,737	--
Department of Defense Impact Aid	12.558		2,536,659	--
Community Investment	12.600		1,733,315	--
Passed-through U.S. Pacific Command				
Joint Venture Education Forum	12.N00038		<u>(762)</u>	<u>--</u>
Total - U.S. Department of Defense			<u>\$ 5,066,777</u>	<u>\$ --</u>

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2017**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Education				
Adult Education - Basic Grants to States	84.002		\$ 1,860,544	\$ --
Title I - Grants to Local Educational Agencies	84.010		50,809,373	--
Migrant Education - State Grant Program	84.011		886,715	--
Title I - State Agency Program for Neglected and Delinquent Children	84.013		66,137	--
Special Education Cluster				
Grants to States	84.027		40,544,711	--
Preschool Grants	84.173		<u>853,638</u>	<u>--</u>
Total - Special Education Cluster			<u>41,398,349</u>	<u>--</u>
Impact Aid	84.041		50,895,625	--
Migrant Education Coordination Program	84.144		138,891	--
Safe and Drug-Free Schools and Communities - National Programs	84.184		505,967	--
Education and Homeless Children and Youth	84.196		119,168	--
Twenty-First Century Community Learning Centers	84.287		5,446,963	1,989,959
Advanced Placement Program	84.330		110,866	--
English Language Acquisition State Grants	84.365		4,339,956	--
Mathematics and Science Partnerships	84.366		833,342	--
Supporting Effective Instruction State Grant	84.367		13,342,651	--
Grants for State Assessments and Related Activities	84.369		2,620,884	--
Statewide Longitudinal Data Systems	84.372		1,165,447	--
School Improvement Grants	84.377		1,962,028	--
Common Core of Data Survey Project	84.ED-08-CO-0029		7,208	--
NAEP State Coordinator	84.ED-08-CO-0029		209,844	--
Passed-through Office of the State of Director for Vocational Education				
Career and Technical Education - Basic Grants to States	84.048	V048A14-V048A16	2,615,556	--
Passed-through State Department of Human Services Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	H126A150015-160015	62,124	--
Passed-through Alu Like, Inc. Native Hawaiian Career and Technical Education	84.259	VE-CAS1314-01	265,055	--

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2017**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Education (Continued)				
Passed-through University of Hawaii				
Gaining Early Awareness and Readiness	84.334	P334S110026	\$ 716,919	\$ --
Gaining Early Awareness and Readiness	84.334A	P334A110247	224,773	--
Native Hawaiian Education	84.362A	S362A12,S362A14	597,012	--
College Access Challenge Grant Program	84.378A	P378A140027	<u>58,985</u>	<u>--</u>
Total - Passed-through University of Hawaii			<u>1,597,689</u>	<u>--</u>
Total - U.S. Department of Education			<u>181,260,382</u>	<u>1,989,959</u>
U.S. Department of Health and Human Services				
Substance Abuse and Mental Health Services_Projects of Regional and National Significance				
	93.243		1,259,749	--
Passed-through State Department of Human Services				
Child Care and Development Block Grant	93.575	DHS-15-CCPO	199,230	--
Temporary Assistance for Needy Families	93.558	DHS-14-ETPO-1029	<u>2,719,494</u>	<u>--</u>
Total - Passed-through State Department of Human Services			<u>2,918,724</u>	<u>--</u>
Head Start	93.600		110,870	--
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems				
	93.938		<u>58,201</u>	<u>--</u>
Total - U.S. Department of Health and Human Services			<u>4,347,544</u>	<u>--</u>
U.S. Department of Homeland Security				
Passed-through State Department of Homeland Security Homeland Security Grant Program				
	97.067	EMW-2014-SS-00003-S01	<u>10,467</u>	<u>--</u>
Total - U.S. Department of Homeland Security			<u>10,467</u>	<u>--</u>
U.S. Department of Interior				
Economic, Social and Political Development of the Territories				
	15.875		<u>1,276,000</u>	<u>--</u>
Total - U.S. Department of Interior			<u>1,276,000</u>	<u>--</u>
U.S. Department of Justice				
Passed-through State Department of Human Services Juvenile Justice and Delinquency Prevention_Allocation to States				
	16.540	DHS-14-OYS-411	<u>382</u>	<u>--</u>
Total - U.S. Department of Justice			<u>382</u>	<u>--</u>
Institute of Museum and Library Services				
Grants to States				
	45.310		<u>1,294,639</u>	<u>--</u>
Total - Institute of Museum and Library Services			<u>1,294,639</u>	<u>--</u>
Total Expenditures of Federal Awards			<u>\$ 271,645,348</u>	<u>\$ 13,216,571</u>

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2017**

NOTE 1 - BASIS OF PRESENTATION

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

The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Department, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Department.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the cash basis of accounting. Such expenditures are recognized following as applicable, either the cost principles in the Office of Management and Budget Circular A-87 *Cost Principles for State, Local and Indian Tribe Governments*, or the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

NOTE 3 - INDIRECT COST RATE

The Department has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

PART II

**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 (Department) as of and for the fiscal year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated March 28, 2018. Our report includes a reference to other auditors who audited the financial statements of certain public charter schools, as described in our report on the Department's financial statements. This report does not include the results of the other auditors' 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 Department'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 Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department'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 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 have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as item 2017-001 that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department'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*.

Department's Response to Findings

The Department's response to the findings identified in our audit is described in Part V, Corrective Action Plan. The Department'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 28, 2018

PART III

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE REQUIRED
BY THE UNIFORM GUIDANCE**

**REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

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 (Department) compliance with the types of compliance requirements described in the Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the fiscal year ended June 30, 2017. The Department'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 federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Department'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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Department's compliance.

Opinion on Each Major Federal Programs

In our opinion, the Department 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 major federal programs for the fiscal year ended June 30, 2017.

Report on Internal Control Over Compliance

Management of the Department 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 Department'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 the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

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

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. 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 Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

N + K CPAs, INC.

Honolulu, Hawaii

March 28, 2018

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, 2017**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued on whether the financial statements audited were prepared in accordance with GAAP: 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 federal programs:
 Material weakness(es) identified? yes no
 Significant deficiency(ies) identified? yes none reported

Type of auditor's report issued on compliance for major federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? yes no

Identification of major federal programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
	Special Education Cluster:
84.027	Grants to States
84.173	Preschool Grants
84.287	Twenty-First Century Community Learning Centers
84.365	English Language Acquisition State Grants
84.367	Supporting Effective Instruction State Grants

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, 2017**

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref. No. Internal Control Findings

2017-001 Tracking and Accounting for Capital Assets

Criteria:

Accounting principles generally accepted in the United States of America require that costs incurred that extends the useful life of an asset, expands the capacity of an asset, or to acquire, including construction of, an asset with a useful life over one year should be capitalized. Repairs and maintenance should be expensed as incurred and not capitalized.

Condition:

The DOE's Office of School Facilities and Support Services (OSFSS) is responsible for planning and directing capital projects, repairs and maintenance, and the related funds released for such projects.

The Office of Fiscal Services, Accounting Services Branch (Accounting) relies on information provided by the OSFSS to prepare the construction projects in progress (CIP) and fixed assets schedules for the Department's government-wide financial statements. Complete, accurate, and timely information provided by the OSFSS is crucial for proper reporting of capital assets and repairs and maintenance in the Department's financial statements. These schedules track costs incurred by jobs.

During our audit of capital assets, we noted the following conditions related to the schedules summarizing projects managed by OSFSS:

1. Certain jobs are comprised of multiple contracted projects. Five of these jobs classified as CIP included repairs and maintenance projects of approximately \$30.9 million as of June 30, 2017, of which approximately \$4.8 million of costs were incurred in previous years. As a result of the misclassification, CIP was overstated by approximately \$30.9 million as of June 30, 2017.
2. Nine electrical upgrade jobs and three heat abatement jobs classified as repairs and maintenance should have been classified as CIP. The cumulative costs for these jobs totaled approximately \$14.5 million as of June 30, 2017, of which approximately \$6.2 million of costs were incurred in previous years. As a result of the misclassification, CIP was understated by approximately \$14.5 million as of June 30, 2017.

**Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2017**

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No. Internal Control Findings (Continued)

2017-001 Tracking and Accounting for Capital Assets (Continued)

Cause:

The above discrepancies occurred due to the following:

1. The DOE classified jobs that comprised of multiple contracts or projects at the consolidated job level instead of at the individual contract or project level.
2. The DOE incorrectly classified certain heat abatement and electrical upgrade projects as repairs and maintenance instead of capital projects.

Effect:

The DOE had a net overstatement in capital assets of approximately \$16.4 million, a net understatement in expenses by approximately \$17.8 million for the fiscal year ended June 30, 2017 and a net understatement in beginning net position of approximately \$1.4 million as of June 30, 2016.

The DOE decided to correct the above known errors in the current fiscal year and not restate the beginning net position.

Identification as a Repeat Finding, if applicable:

See finding 2016-001 included in the Summary Schedule of Prior Audit Findings.

Recommendation:

The OSFSS should classify jobs with multiple contracts or projects at the individual contract or project level to ensure costs are properly classified as repairs and maintenance or capital projects. In addition, the OSFSS should classify heat abatement and electrical upgrade projects with a total contract amount above the DOE's capitalization threshold as capital projects. The OSFSS should also provide accurate and timely information to Accounting for financial reporting purposes. In general, capital asset reports and schedules should be reviewed more carefully to ensure accuracy.

Views of Responsible Official(s) and Planned Corrective Action:

Management agrees with the finding and recommendation. See Corrective Action Plan on page 61.

**Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2017**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None

PART V

DEPARTMENTAL RESPONSE

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

DAVID Y. IGE
GOVERNOR



DR. CHRISTINA M. KISHIMOTO
SUPERINTENDENT

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

OFFICE OF THE SUPERINTENDENT

March 28, 2018

N&K CPAs, Inc.
American Savings Bank Tower, Suite 1700
1001 Bishop St
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, 2017 was completed before the March 31, 2018 Federal deadline. We are pleased that the 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 2 CFR 200.508, the following pages contain the **Corrective Action Plan** for the year ended June 30, 2017 and the **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2016.

Sincerely,

A handwritten signature in blue ink, appearing to read "C. Kishimoto".

Dr. Christina M. Kishimoto
Superintendent

CMK:dy
Attachments

c: Internal Audit Office

AN AFFIRMATIVE ACTION AND EQUAL OPPORTUNITY EMPLOYER

**STATE OF HAWAII DEPARTMENT OF EDUCATION
CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2017**

FINANCIAL STATEMENT FINDING

2017-001 Tracking and Accounting for Capital Assets (Page 57)

View of Responsible Officials

The Branch agrees with the findings.

Corrective Action Plan

Since the FY 2017 audit, OSFSS has commenced a reorganization plan of the accounting duties of the Facilities Development Branch (FDB). The intent is to transfer the fiscal responsibilities to the Auxiliary Services Branch where a new fiscal section will be responsible for tracking fixed assets. A lead CIP planner position responsible for this section was created, recruited for, and recently filled. OSFSS is also building tools and systems to facilitate better tracking of fiscal matters.

The process that FDB put in place will still work at the individual contract or project level. Auxiliary Services Branch will be more diligent in analyzing situations where projects are consolidated together.

*Contact Person: Riki Fujitani, Auxiliary Services Director
Auxiliary Services Branch
Office of School Facilities and Support Services*

Anticipated Completion Date: August 1, 2018

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, 2016

SECTION II – FINANCIAL STATEMENT FINDINGS

2016-001 Tracking and Accounting for Capital Assets

(Page 56 to 58 of the Prior Year June 30, 2016 Report)

Status -- *Condition #1: The Public Libraries has assigned an individual to be responsible for all accounting and reporting of all HSPLS capital asset costs and related accumulated depreciation. Reports of construction projects are reviewed before they are submitted to DAGS. The errors noted in the prior year findings have been corrected and current fixed asset reports are up to date.*

Condition #2: The Facilities Development Branch implemented procedures to allow branch personnel access project acceptance notices to signify the completion of a project which improved the department's ability to classify projects as CIP or fixed assets. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2017-001.

Condition #3: Due to turnover in the department, the DOE Accounting Section was unable to review fixed asset equipment additions for keypunch and clerical errors without jeopardizing the ability to perform daily necessary accounting functions. The department intends to complete the original corrective action plan of reviewing fixed asset equipment additions for keypunch and clerical errors at least once a year when the necessary positions are filled.

2016-002 Preparation of the Schedule of Expenditures of Federal Awards

(Page 58 to 59 of the Prior Year June 30, 2016 Report)

Status -- *The DOE Accounting Section created an expenditure object code within the Financial Management System (FMS) to separately classify and record payments to subrecipients for subawards. The DOE Accounting Section also issued written guidance to program managers of Federal grants with subawards to notify them of the new expenditure object code for subrecipients, to request that copies of all executed subawards be sent to the DOE Accounting Section and to remind the program managers of the Federal requirement that the DOE must prepare a Schedule of Expenditure of Federal Awards (SEFA) which must include the total amount provided to subrecipients from each Federal program.*