

# **State of Hawaii Drinking Water Treatment Revolving Loan Fund**

**Financial Statements**

**June 30, 2008**

**Submitted by  
The Auditor  
State of Hawaii**

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Index**  
**June 30, 2008**

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CERTIFIED PUBLIC ACCOUNTANTS

## Report of Independent Auditors

The Auditor  
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2008, and the related statements of revenues, expenses and change in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2008, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 9, the Fund has revised its June 30, 2008 financial statements from amounts previously reported on in our report dated November 24, 2008.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 24, 2008 (except for Notes 7 and 9 to the financial statements, as to which the date is May 20, 2009) on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters.

The Fund's management has not presented the management's discussion and analysis for the year ended June 30, 2008 that accounting principles generally accepted in the United States of America require to supplement, although not to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the Fund's financial statements. The supplementary information presented on pages 14 through 17 is presented for purposes of additional analysis and is not a required part of the Fund's financial statements. Such information has been subjected to the auditing procedures applied in the audit of the Fund's financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the Fund's financial statements taken as a whole.

*Accuity LLP*

Honolulu, Hawaii  
November 24, 2008  
(except for Notes 7 and 9, as to  
which the date is May 20, 2009)

# **Financial Statements**

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Statement of Net Assets**  
**June 30, 2008**

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**Assets**

Current assets

Cash held in State Treasury	\$ 21,227,345
Loan fees receivable	466,862
Accrued interest on loans	55,503
Other accrued interest	109,038
Due from federal government	408,850
Current maturities of loans receivable	<u>2,927,592</u>

Total current assets 25,195,190

Loans receivable, net of current maturities 46,735,528

Capital assets, net of accumulated depreciation of \$768,659 357,495

Total assets \$ 72,288,213

**Liabilities and Net Assets**

Current liabilities

Accounts payable and other accrued liabilities	\$ 288,816
Total current liabilities	<u>288,816</u>

Accrued vacation, net of current portion 38,225

Other postemployment benefits 34,892

Total liabilities 361,933

Commitments and contingencies

Net assets

Invested in capital assets	357,495
Restricted – expendable	<u>71,568,785</u>
Total net assets	<u>71,926,280</u>

Total liabilities and net assets \$ 72,288,213

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

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Statement of Revenues, Expenses and Change in Net Assets**  
**Year Ended June 30, 2008**

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**Operating revenues**

Interest income from loans	\$ 232,078
Administrative loan fees	<u>1,471,804</u>
Total operating revenues	1,703,882

**Operating expenses**

Administrative	535,374
State program management	1,250,213
Water protection	44,193
Small systems	<u>313,339</u>
Total operating expenses	<u>2,143,119</u>
Operating loss	(439,237)

**Nonoperating revenues**

State contributions	1,671,000
Federal contributions	9,918,777
Other interest income	<u>312,835</u>
Total nonoperating revenues	<u>11,902,612</u>
Change in net assets	11,463,375

**Net assets**

Beginning of year	<u>60,462,905</u>
End of year	<u>\$ 71,926,280</u>

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

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Statement of Cash Flows**  
**Year Ended June 30, 2008**

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**Cash flows from operating activities**

Interest income from loans	\$ 227,839
Administrative loan fees	1,290,048
Principal repayments on loans	2,290,182
Disbursement of loan proceeds	(11,073,824)
Payments to employees	(450,110)
Payments to other state agencies for services rendered	(40,328)
Payments to vendors	(1,355,038)
Net cash used in operating activities	<u>(9,111,231)</u>

**Cash flows from noncapital financing activities**

State contributions	1,671,000
Federal contributions	9,996,414
Repayments from other funds	392,700
Net cash provided by noncapital financing activities	<u>12,060,114</u>

**Cash flows from capital and related financing activities**

Purchased equipment	<u>(171,214)</u>
Net cash used in capital and related financing activities	<u>(171,214)</u>

**Cash flows from investing activities**

Other interest	<u>365,889</u>
Net cash provided by investing activities	<u>365,889</u>
Net increase in cash	3,143,558

**Cash balance**

Beginning of year	<u>18,083,787</u>
End of year	<u>\$ 21,227,345</u>

**Reconciliation of operating loss to net cash used in operating activities**

Operating loss	\$ (439,237)
Adjustments to reconcile operating loss to net cash used in operating activities	
Depreciation expense	83,822
Change in assets and liabilities	
Loans receivables	(8,783,641)
Accrued interest on loans	(4,240)
Loan fees receivable	(181,757)
Accounts payable and other accrued liabilities	178,930
Other postemployment benefits	34,892
Net cash used in operating activities	<u>\$ (9,111,231)</u>

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



**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**1. Establishment and Purpose of the Fund**

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

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

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

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

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

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

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

**Use of Estimates**

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates, among others, include the allowances for uncollectible accounts and depreciable lives of capital assets.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**Cash in State Treasury**

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

At June 30, 2008, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

**Loans Receivable**

Loans made to the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period.

**Administrative Loan Fees**

In May 2000, the Department implemented an administrative loan fee program to pay for the Fund's administration, including employee salaries and benefits. The program applies an administrative loan fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

**Capital Assets**

Capital assets consist principally of equipment, and are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis (three to seven years) over the estimated useful lives of the respective assets.

**Accrued Vacation**

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

**Net Assets**

The Fund's net assets are classified into two net asset categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted expendable: Net assets whose use by the Fund are subject to externally-imposed stipulations that can be fulfilled by actions of the Fund pursuant to those stipulations or that expire by the passage of time.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**Administration Costs**

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

**Fund Accounts**

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

**Expenses**

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

**New Accounting Pronouncements**

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The provisions of this Statement are effective for the fiscal year beginning after December 15, 2007. Management does not expect this Statement to have a material effect on the Fund's financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The provisions of this Statement establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement also results in a more faithful representation of the service capacity of intangible assets — and therefore the financial position of governments — and of the periodic cost associated with the usage of such service capacity in governmental financial statements. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2009. Management does not expect this Statement to have a material effect on the Fund's financial statements.

In November 2007, the GASB issued Statement No. 52, *Land and Other Real Estate Held As Investments by Endowments*, effective for the Department's fiscal year beginning July 1, 2008. Statement No. 52 requires that land and other real estate held as investments by endowments be reported at fair value at the reporting date. Changes in fair value during the period should be reported as investment income. Management is currently evaluating the effect that this statement will have on its financial statements.

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. The objective of this Statement is to enhance the usefulness and comparability of derivative instrument information reported by state and local governments. This Statement provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009. Management does not expect this Statement to have a material effect on the Fund's financial statements.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**3. Loans Receivable**

At June 30, 2008, loans receivable from government entities were as follows:

Eight loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 0.31%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. \$ 18,451,629

Seven loans receivable from the County of Hawaii, Water Board, due in semi-annual payments, including interest ranging from 0.41% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. 5,423,551

Two loans receivable from the County of Maui, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.15% to 1.55%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. 12,989,986

Nine loans receivable from the County of Kauai, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.16% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. 12,797,954

49,663,120

Less: Current portion 2,927,592

Noncurrent portion \$ 46,735,528

Loans are expected to mature at various dates through 2027. The scheduled principal payments on loans maturing in subsequent years are as follows:

2009	\$ 2,927,592
2010	2,942,302
2011	2,958,272
2012	2,974,206
2013	2,990,955
Thereafter	<u>34,869,793</u>
	<u>\$ 49,663,120</u>

Accrued interest on loans amounted to \$55,503 at June 30, 2008. Interest income from loans amounted to \$232,078 for the year ended June 30, 2008.

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

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

At June 30, 2008, the following amounts were committed to be loaned out under existing loan agreements:

County of Kauai, Board of Water Supply	\$ 6,840,159
City and County of Honolulu, Board of Water Supply	<u>1,473,527</u>
Total	<u>\$ 8,313,686</u>

**4. Contributed Capital**

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2008:

Budget Period	Amount	Total Draws at June 30, 2007	Total 2008 Cash Draws	Funds Available
12/05/97 – 06/30/06	\$ 12,558,800	\$ 12,558,800	\$ -	\$ -
09/24/98 – 09/30/08	7,121,300	7,100,164	21,136	-
02/04/00 – 09/30/07	7,463,800	7,277,656	186,144	-
02/26/01 – 06/30/08	7,757,000	5,312,354	2,324,355	120,291
09/01/02 – 09/30/08	7,789,100	6,323,094	782,617	683,389
10/01/03 – 06/30/11	8,052,500	2,754,988	2,736,773	2,560,739
04/01/04 – 06/30/11	8,004,100	730,800	387,692	6,885,608
10/01/05 – 06/30/13	8,303,100	305,107	3,557,697	4,440,296
09/01/06 – 06/30/16	8,285,500	2,500	-	8,283,000
07/01/07 – 06/30/17	8,229,300	-	-	8,229,300
03/01/08 – 06/30/17	8,229,000	-	-	8,229,000
	<u>\$ 91,793,500</u>	<u>\$ 42,365,463</u>	<u>\$ 9,996,414</u>	<u>\$ 39,431,623</u>

The State is required to match 20% of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. Through June 30, 2008, the Fund was in compliance with the 20% State matching requirement. The required State match through June 30, 2008 approximated \$18.4 million, of which approximately \$11.4 million has been utilized and \$7.0 million was available to be loaned out at June 30, 2008.

**5. Capital Assets**

Summary of capital assets at June 30, 2008 is as follows:

	Balance at June 30, 2007	Additions	Retirements/ Transfers	Balance at June 30, 2008
Equipment	\$ 954,940	\$ 171,214	\$ -	\$ 1,126,154
Accumulated depreciation	(684,837)	(83,822)	-	(768,659)
	<u>\$ 270,103</u>	<u>\$ 87,392</u>	<u>\$ -</u>	<u>\$ 357,495</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**6. Accrued Vacation**

The accrued vacation liability as of June 30, 2008 was as follows:

Balance at June 30, 2008	\$	48,571
Less: Current portion		<u>10,346</u>
Noncurrent portion	\$	<u>38,225</u>

**7. Employee Benefit Plans**

**Employees' Retirement System**

Substantially all eligible employees of the Department are members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the contributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, or highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State general fund.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the remaining period of 29 years from July 1, 2000.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan will be eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits and other aspects of the ERS is also not available on a department or agency basis.

Effective July 1, 2007, the State adopted the provisions of GASB Statement No. 50, *Pension Disclosures – An Amendment to GASB Statements No. 25 and 27*. Management of the Fund believes that the State's adoption of this statement will not have a material impact on the Fund's financial statements. Accordingly, the Fund has not recorded a liability for pension benefits in its statement of net assets as of June 30, 2008.

ERS issues a Comprehensive Annual Financial Report ("CAFR") that includes financial statements and required supplementary information, which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii  
201 Merchant Street, Suite 1400  
Honolulu, Hawaii 96813

**Post-retirement Health Care 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 that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The State also contributes to the Hawaii State Teachers Association ("HSTA") Voluntary Employees Beneficiary Association ("VEBA") Trust that was established effective March 1, 2006. HSTA VEBA provides health benefits only to HSTA members, retirees and their dependents. The eligibility requirements for retiree health benefits are the same for both plans as follows:

- For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.
- For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.
- For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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*State Policy*

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

*Allocated OPEB Cost*

The following table shows the components of the annual OPEB cost that have been allocated to the Fund for year ended June 30, 2008:

Annual required contribution	\$ 55,714
Contributions made	<u>(20,822)</u>
Increase in net OPEB obligation	34,892
Net OPEB obligation, beginning of year	<u>-</u>
Net OPEB obligation, end of year	<u>\$ 34,892</u>

*Amount of Contributions Made*

Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the years ended June 30, 2008, 2007 and 2006 approximated \$20,800, \$9,600, and \$14,700, respectively.

*Required Supplementary Information and Disclosures*

The State's CAFR includes the required footnote disclosures and supplementary information on the State's OPEB plan. The State's CAFR can be found at the Department of Accounting and General Services' ("DAGS") website: <http://hawaii.gov/dags/rpts>.

**Deferred Compensation Plan**

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

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

**Accumulated Sick Leave**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in ERS. At June 30, 2008, accumulated sick leave was approximately \$67,300.



**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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**8. Commitments and Contingencies**

**Insurance Coverage**

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

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

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

**9. Revisions to the Financial Statements**

The Fund has revised its fiscal 2008 financial statements and supplementary information, from amounts previously reported on November 24, 2008, for the following reasons:

- In April 2009, DAGS issued Comptroller's Memorandum No. 2009-11, informing State agencies participating in the State Treasury Investment Pool that the State's investments in auction rate securities were impaired as of and for the year ended June 30, 2008 and that each participating State agency would be allocated a portion of the impairment. The Fund's allocated impairment loss for fiscal 2008 amounted to \$585,333.
- In December 2008, DAGS issued Comptroller's Memorandum No. 2008-22, informing discretely presented component units and proprietary funds of the State of their allocated portion of the State's other postemployment benefit ("OPEB") obligation as of June 30, 2008 and ARC for the year ended June 30, 2008. The Fund's allocated ARC and OPEB for fiscal 2008 amounted to \$34,892.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2008**

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The effects of the aforementioned revisions on the Fund's fiscal 2008 financial statements are as follows:

	<b>As Previously Reported</b>	<b>Adjustments</b>	<b>As Revised</b>
<b>Current assets</b>			
Cash held in State Treasury	\$ 21,812,678	\$ (585,333)	\$ 21,227,345
Total current assets	25,780,523	(585,333)	25,195,190
Total assets	72,873,546	(585,333)	72,288,213
<b>Liabilities</b>			
Other postemployment benefits	-	34,892	34,892
Total liabilities	327,041	34,892	361,933
<b>Net assets</b>			
Restricted – expendable	72,189,010	(620,225)	71,568,785
Total net assets	72,546,505	(620,225)	71,926,280
Total liabilities and net assets	72,873,546	(585,333)	72,288,213
<b>Operating expenses</b>			
Administrative expenses	500,482	34,892	535,374
Total operating expenses	2,108,227	34,892	2,143,119
Operating loss	(404,345)	(34,892)	(439,237)
<b>Nonoperating revenues</b>			
Other interest income	898,168	(585,333)	312,835
Total nonoperating revenues	12,487,945	(585,333)	11,902,612
Change in net assets	12,083,600	(620,225)	11,463,375
<b>Cash flows from investing activities</b>			
Other interest	951,222	(585,333)	365,889
Net cash provided by investing activities	951,222	(585,333)	365,889
Net increase in cash	3,728,891	(585,333)	3,143,558
<b>Cash balance</b>			
End of year	21,812,678	(585,333)	21,227,345
<b>Reconciliation of operating loss to net cash used in operating activities</b>			
Operating loss	(404,345)	(34,892)	(439,237)
Change in other postemployment benefits	-	34,892	34,892
Net cash used in operating activities	(9,111,231)	-	(9,111,231)

## **Supplementary Information**

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Schedule of Cash Receipts, Disbursements and Cash Balance**  
**Year Ended June 30, 2008**

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**Receipts**

Principal repayments on loans	\$ 2,290,182
Interest income from loans	227,839
State contributions	1,671,000
Federal contributions	9,996,414
Administrative loan fees	1,290,048
Other interest	365,889
Repayments from other funds	<u>392,700</u>
Total receipts	16,234,072

**Disbursements**

Disbursement of loan proceeds	11,073,824
State program management	1,177,180
Administrative	479,720
Water protection program	46,451
Small systems	<u>313,339</u>
Total disbursements	<u>13,090,514</u>
Excess of receipts over disbursements	3,143,558

**Cash balance**

Beginning of year	<u>18,083,787</u>
End of year	<u>\$ 21,227,345</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Combining Statement of Net Assets**  
**June 30, 2008**

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	<b>State Revolving Fund Activity</b>	<b>Non-SRF Activity</b>	<b>Total</b>
<b>Assets</b>			
Current assets			
Cash held in State Treasury	\$ 19,321,028	\$ 1,906,317	\$ 21,227,345
Loan fees receivable	-	466,862	466,862
Accrued interest on loans	55,503	-	55,503
Other accrued interest	109,038	-	109,038
Due from federal government	-	408,850	408,850
Current maturities of loans receivable	2,927,592	-	2,927,592
Total current assets	22,413,161	2,782,029	25,195,190
Loans receivable, net of current maturities	46,735,528	-	46,735,528
Capital assets, net of accumulated depreciation	-	357,495	357,495
Total assets	<u>\$ 69,148,689</u>	<u>\$ 3,139,524</u>	<u>\$ 72,288,213</u>
<b>Liabilities and Net Assets</b>			
Current liabilities			
Accounts payable and other accrued liabilities	\$ -	\$ 288,816	\$ 288,816
Total current liabilities	-	288,816	288,816
Accrued vacation, net of current portion	-	38,225	38,225
Other postretirement benefits	-	34,892	34,892
Total liabilities	-	361,933	361,933
Net assets			
Invested in capital assets	-	357,495	357,495
Restricted – expendable	69,148,689	2,420,096	71,568,785
Total net assets	69,148,689	2,777,591	71,926,280
Total liabilities and net assets	<u>\$ 69,148,689</u>	<u>\$ 3,139,524</u>	<u>\$ 72,288,213</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Combining Statement of Revenues, Expenses and Change in Net Assets**  
**Year Ended June 30, 2008**

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	State Revolving Fund Activity	Non-SRF Activity	Total
<b>Operating revenues</b>			
Interest income from loans	\$ 232,078	\$ -	\$ 232,078
Administration loan fees	-	1,471,804	1,471,804
Total operating revenues	232,078	1,471,804	1,703,882
<b>Operating expenses</b>			
Administrative	-	535,374	535,374
State program management	-	1,250,213	1,250,213
Water protection	-	44,193	44,193
Small systems	-	313,339	313,339
Total operating expenses	-	2,143,119	2,143,119
Operating income (loss)	232,078	(671,315)	(439,237)
<b>Nonoperating revenues</b>			
State contributions	1,671,000	-	1,671,000
Federal contributions	8,294,855	1,623,922	9,918,777
Other interest income	312,835	-	312,835
Total nonoperating revenues	10,278,690	1,623,922	11,902,612
Interfund transfers	574,783	(574,783)	-
Change in net assets	11,085,551	377,824	11,463,375
<b>Net assets</b>			
Beginning of year	58,063,138	2,399,767	60,462,905
End of year	\$ 69,148,689	\$ 2,777,591	\$ 71,926,280

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Schedule of Expenses**  
**Year Ended June 30, 2008**

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	<b>State Revolving Fund Activity</b>	<b>Non-SRF Activity</b>	<b>Total</b>
Professional services	\$ -	\$ 1,216,033	\$ 1,216,033
Personnel	-	467,904	467,904
Repairs and maintenance	-	103,870	103,870
Depreciation	-	83,822	83,822
Office and other supplies	-	71,874	71,874
Travel	-	63,742	63,742
Training	-	52,937	52,937
Services rendered by other state agencies	-	42,423	42,423
Equipment – small tool and supplies	-	7,452	7,452
Utilities	-	5,613	5,613
Advertising and printing	-	2,755	2,755
Rental	-	2,195	2,195
Telephone	-	1,165	1,165
Miscellaneous	-	21,334	21,334
	<hr/>	<hr/>	<hr/>
Total	\$ -	\$ 2,143,119	\$ 2,143,119

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

The Auditor  
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the year ended June 30, 2008, and have issued our report thereon dated November 24, 2008 (except for Notes 7 and 9, as to which the date is May 20, 2009). We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.



## **Compliance and Other Matters**

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

We noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated November 24, 2008.

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

*Accuity LLP*

Honolulu, Hawaii  
November 24, 2008  
(except for Notes 7 and 9 to the financial statements,  
as to which the date is May 20, 2009)



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor  
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of and for the year ended June 30, 2008, and have issued our report thereon dated November 24, 2008 (except for Notes 7 and 9, as to which the date is May 20, 2009).

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

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

that are applicable to its major federal program for the year ended June 30, 2008. The management of the Fund is responsible for the Fund's compliance with these requirements. Our responsibility is to express an opinion on those requirements based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Fund complied, in all material respects, with the requirements governing types of activities and types of service and types of costs allowed or unallowed; matching; level of effort or earmarking requirements; special reporting requirements; special tests and provisions; and claims for advances and reimbursements that are applicable to its major Federal financial assistance program for the year ended June 30, 2008. We noted certain matters that we have reported to the Auditor and management of the Fund in a separate letter dated November 24, 2008.

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

*Accuity LLP*

Honolulu, Hawaii

November 24, 2008

(except for Notes 7 and 9 to the financial statements,  
as to which the date is May 20, 2009)

## **Prior Year Findings and Questioned Costs**

This section updates the status of findings and questioned costs that were reported in prior years. Finding numbers relate to the sequence reported in the respective year.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2008**

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**Finding No. 07-01: Filing of SF-272 (Material Weakness)**

During our prior audit, we noted that the Department's Administrative Service Office ("ASO") prepares and submits the Standard Form (SF)-272 reports to the U.S. Environmental Protection Agency (the "EPA") on behalf of the Fund. As of September 30, 2007, we noted that due to a staffing shortage and changes in personnel, ASO did not submit the SF-272 report for the period July 1, 2006 to December 31, 2006, which was due on January 15, 2007.

We recommended that ASO designate a competent individual to submit all federal reports in an accurate and timely manner. We also recommend that ASO maintain a document, which includes all federal reporting requirements and submission deadlines, in order to ensure that the designated ASO personnel are aware of all federal guidelines and significant reporting dates. In the case of a staffing shortage, ASO management should ensure that the reports are submitted by another competent individual.

**Status**

Resolved. In our current year audit, we noted that the SF-272 report for the period July 1, 2006 to December 31, 2006 and January 1, 2007 to December 31, 2007 were submitted to the EPA. We also reviewed the spreadsheet maintained by the ASO Accountant V, which included deadlines and due dates for Federal reporting requirements.