

**FINANCIAL AUDIT OF THE  
DEPARTMENT OF DEFENSE**

**STATE OF HAWAII**

**FOR THE  
FISCAL YEAR ENDED JUNE 30, 2009**

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**CHOO, OSADA & LEE, CPAs, INC.**

CERTIFIED PUBLIC ACCOUNTANTS

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Ms. Marion Higa  
Office of the Auditor  
State of Hawaii

This is our report on the financial and compliance audit of the Department of Defense of the State of Hawaii (Department) for the fiscal year ended June 30, 2009. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**AUDIT OBJECTIVES**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department's financial statements as of and for the fiscal year ended June 30, 2009, and to comply with the requirements of OMB Circular A-133.

The specific objectives of the audit were:

- 1) To provide a basis for an opinion on the fairness of the presentation of the Department's financial statements.
- 2) To satisfy the audit requirements of OMB Circular A-133.
- 3) To determine whether expenditures have been made and all revenues and other receipts to which the Department is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and, where applicable, the Federal government.
- 4) To evaluate the adequacy of the Department's system of internal accounting control in assuring that there is effective control over and proper accounting of revenues, expenditures, assets and liabilities.
- 5) To determine whether the Department has complied with the fiscal provisions of grant agreements and applicable Federal laws, regulations and circulars with regard to Federal grant activities.

## AUDIT SCOPE

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The scope of our audit included an examination of the transactions and accounting records of the Department for the fiscal year ended June 30, 2009.

\* \* \* \* \*

We wish to express our sincere appreciation for the excellent cooperation and assistance extended to us by the officer and staff of the Department.

*Choo, Asada & Lu, CPAs, Inc.*

Honolulu, Hawaii  
August 31, 2012

**CHOO, OSADA & LEE, CPAs, INC.**  
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**INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS AND SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

To the Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Defense of the State of Hawaii (Department) as of and for the year ended June 30, 2009, which collectively comprise the Department's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions 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 opinions.

As discussed in Note 2, 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 are 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, 2009 and the changes in its financial position for the year then ended 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 respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2009 and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2012, on our consideration of the Department's internal control over financial reporting and 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 the testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 5 through 10 and 29 through 30 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 Standard 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Choo, Osada & Lee, CPAs, Inc.*

Honolulu, Hawaii  
August 31, 2012

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis offers readers of these basic financial statements a narrative overview of the financial activities of the Department for the fiscal year ended June 30, 2009. This discussion and analysis is designed to assist the reader in the analysis of the Department's financial activities based on currently known facts, decisions and conditions. We encourage the readers to consider the information presented here in conjunction with the basic financial statements.

### Financial Highlights

The assets of the Department exceeded its liabilities at June 30, 2009 by \$ 96,124,910 (net assets). Of this amount, \$5,319,771 may be used to meet the Department's ongoing obligations to citizens and creditors. Net assets of governmental activities decreased by \$71,979 from the prior fiscal year.

### Fund Highlights

At June 30, 2009, the Department's governmental funds reported a combined total of \$7,284,057, a decrease of \$2,151,126 from the prior fiscal year.

### Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements which consists of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements.

### Government-Wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Department's finances in a manner similar to private-sector companies. The statement of net assets presents information on all of the Department's assets or liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets 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 assets changed during the most recent fiscal year. Functional activities are highlighted in this statement, with functional expenses shown net of related program revenue. This statement shows the extent to which the various functions depend on state appropriations and to other non-program revenues for support. The activities of the Department are principally supported by appropriations made available by the State Legislature and intergovernmental revenues from the Federal government (governmental activities). The Department does not recover any portion of its costs through user fees or charges for services (business-type activities).

The government-wide financial statements can be found immediately following this discussion and analysis.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**

### 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 uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements of the Department consist entirely of governmental type funds.

### Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund 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 financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented from governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities in the government-wide financial statements.

The Department maintains several individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for each of the major funds.

The Department adopts an annual appropriated budget for its General Fund and Special Revenue Funds. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found immediately following the government-wide financial statements.

### Notes to Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to basic financial statements can be found immediately following the governmental fund financial statements.



## MANAGEMENT'S DISCUSSION AND ANALYSIS - continued

### Government-Wide Financial Analysis

The following financial analysis focuses on the governmental activities of the Department. Net assets are a useful indicator of a government's financial position. For the Department, total assets exceeded liabilities by \$96,124,910, and decreased \$71,979 or 0.1%, over the course of this fiscal year's operations.

<b><u>Net Assets</u></b>				
<b><u>June 30, 2009 and 2008</u></b>				
<b><u>(Amounts in thousands)</u></b>				
	2009	2008	2009 -2008	
			Increase (decrease)	Percentage change
Current and other assets	\$ 22,471	21,943	528	2.4%
Capital assets	90,805	88,567	2,238	2.5%
Total assets	<u>113,276</u>	<u>110,510</u>	<u>2,766</u>	<u>2.5%</u>
Long-term liabilities	1,365	1,217	148	12.2%
Other liabilities	15,786	13,096	2,690	20.5%
Total liabilities	<u>17,151</u>	<u>14,313</u>	<u>2,838</u>	<u>19.8%</u>
Net assets:				
Invested in capital assets	90,805	88,567	2,238	2.5%
Unrestricted	<u>5,320</u>	<u>7,630</u>	<u>(2,310)</u>	<u>-30.3%</u>
Total net assets	<u>96,125</u>	<u>96,197</u>	<u>(72)</u>	<u>-0.1%</u>
Total liabilities and net assets	<u>\$ 113,276</u>	<u>110,510</u>	<u>2,766</u>	<u>2.5%</u>

### Analysis of Net Assets

By far, the largest portion of the Department's net assets reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment). The Department uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

## MANAGEMENT'S DISCUSSION AND ANALYSIS – continued

### Changes in Net Assets

The Department's net assets decreased by \$71,979 or 0.1%, during the year ended June 30, 2009. Approximately 30% of the Department's total revenues came from state allotments and state provided fringe benefits, while 70% came from federal grants. The Department's expenses cover a range of services. The largest expenses were for air and army national guard services and civil defense.

The following financial information was derived from the government-wide statement of activities and reflects how the Department's net assets changed during the fiscal year.

#### Changes in Net Assets For the Years Ended June 30, 2009 and 2008 (Amounts in thousands)

	2009	2008	2009 -2008	
			Increase (decrease)	Percentage change
<b>Revenue</b>				
Allotted appropriations, net of lapses	\$ 20,603	18,926	1,677	8.9%
Intergovernmental revenues	57,335	57,807	(472)	-0.8%
State provided fringe benefits	3,115	2,551	564	22.1%
Total revenues	<u>81,053</u>	<u>79,284</u>	<u>1,769</u>	<u>2.2%</u>
<b>Expenditures</b>				
Administration and support service	7,808	6,139	1,669	27.2%
Air and army national guard service	24,865	25,161	(296)	-1.2%
Civil defense	40,904	40,876	28	0.1%
Youth challenge program	3,213	3,379	(166)	-4.9%
Service to veterans	2,666	3,854	(1,188)	-30.8%
Total expenses	<u>79,456</u>	<u>79,409</u>	<u>47</u>	<u>0.1%</u>
<b>Other Financing Sources</b>				
Transfer out	<u>1,669</u>	<u>5,070</u>	<u>(3,401)</u>	<u>-67.1%</u>
Increase (decrease) in net assets	<u>\$ (72)</u>	<u>(5,195)</u>	<u>5,123</u>	<u>-98.6%</u>

Increase in appropriations was due to investment in State Civil Defense (SCD) for personnel and for Public Safety Interoperability Communication Grant that was awarded in the amount of \$1,600,000. Other personnel funds for SCD in the amount of \$874,853 were also approved. Hawaii Army National received \$2,100,000 in State matching funds. Temporary Assistance to Needy Families expenditures was reduced by 20% due to the lack of federal funds from the Department of Human Services. Expenditures of \$4,166,836 were transferred to DLNR for reimbursement of earthquake repair projects. The Department was limited in their expenditure due to the Legislature restricting the use of \$506,000 and the Governor applying a 4% or \$630,000 restriction.

## MANAGEMENT'S DISCUSSION AND ANALYSIS – continued

### Governmental Activities

Total of state allotted appropriations and state provided fringe benefits increased by approximately \$2,240,000 while grants and contracts from the federal government decreased by approximately \$472,000, primarily due to salary adjustments in the general fund and additional Homeland Security Grants approved for State Civil Defense to manage.

A comparison of the cost of services by function of the Department's governmental activities is shown below, along with the revenues used to cover the net expenses of the governmental activities:

#### **Governmental Activities** **For The Years Ended June 30, 2009 and 2008** **(Amounts in thousands)**

	<b>Net Cost of Services</b>		<b>2009 -2008</b>	
	<b>2009</b>	<b>2008</b>	<b>Increase (decrease)</b>	<b>Percentage change</b>
Expenses, net of program revenues				
Administration and support service	\$ (7,533)	(5,930)	1,603	27.0%
Air and army national guard service	(2,787)	(4,003)	(1,216)	-30.4%
Civil defense	(7,864)	(6,518)	1,346	20.7%
Youth challenge program	(1,271)	(1,339)	(68)	-5.1%
Service to veterans	(2,666)	(3,812)	(1,146)	-30.1%
Total expenses	<u>(22,121)</u>	<u>(21,602)</u>	<u>519</u>	2.4%
General revenue				
Allotted appropriations, net of lapses	20,603	18,926	1,677	8.9%
State provided fringe benefits	3,115	2,551	564	22.1%
Total revenues	<u>23,718</u>	<u>21,477</u>	<u>(2,241)</u>	10.4%
Other financing sources				
Transfer out	<u>(1,669)</u>	<u>(5,070)</u>	<u>3,401</u>	-67.1%
Increase in governmental activities net assets	<u>\$ (72)</u>	<u>(5,195)</u>	<u>5,123</u>	-98.6%

### Financial analysis of the Department's Individual Funds

As noted earlier, the Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS – continued**

### Governmental Funds

The focus of the Department's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a Department's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Department's governmental funds reported combined ending fund balances of \$7,284,057, a decrease of \$2,151,126 in comparison with the prior fiscal year. Of these fund balances, \$2,344,306 is reserved to indicate that it is not available for new spending, because it has already been committed to liquidate contracts and purchase orders of the prior period.

### **General Fund Budgetary Highlights**

The General Fund's expenditure budget remained the same from the original to the final budget. The original budget consists of the appropriations as enacted by the 2007 Legislature of the State of Hawaii, Supplemental Appropriation Act of 2008. (Act 158, Session Laws of Hawaii 2008)

### CAPITAL ASSETS

The Department's investment in capital assets for its governmental activities as of June 30, 2009 amounted to \$90,805,139 (net of accumulated depreciation). This investment in capital assets included land and improvements, buildings and improvements, equipment, furniture and fixtures, and motor vehicles.

Additional information on the Department's capital assets can be found in the notes to basic financial statements.

### ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Actual state general fund tax collections decreased by 9.8% in the first eleven months of the fiscal year ended June 30, 2009. The State's General Fund tax growth rate is estimated at 0% in fiscal 2010 and 5.6% in fiscal 2011. Based on these projections, new programs have been continued to be suspended, a 4% restriction on General fund was implemented, allocations were distributed quarterly and every effort to exercise prudence in controlling and reducing government expenditures was made.

### REQUESTS FOR INFORMATION

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Adjutant General, Department of Defense, 3949 Diamond Head Road, Honolulu, Hawaii 96816. General information about the Department can be found at the Department's website, <http://www.dod.state.hi.us>.

**DEPARTMENT OF DEFENSE**  
**STATE OF HAWAII**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2009**

	<u>Governmental Activities</u>
<b>ASSETS</b>	
Cash and short-term cash investments	\$ 18,169,128
Due from Federal Government	4,301,240
Capital assets	
Land, improvements, and construction in progress and other capital assets, net of depreciation	<u>90,805,139</u>
Total assets	<u><u>\$113,275,507</u></u>
<b>LIABILITIES</b>	
Voucher payable	\$ 6,261,582
Accrued liabilities	692,169
Due to State of Hawaii	344,210
Due to subrecipients	2,207,795
Deferred revenues	5,680,555
Long-term liabilities	
Due within one year	599,000
Due in more than one year	<u>1,365,286</u>
Total liabilities	<u>17,150,597</u>
<b>NET ASSETS</b>	
Invested in capital assets	90,805,139
Unrestricted	<u>5,319,771</u>
Total net assets	<u>96,124,910</u>
Total liabilities and net assets	<u><u>\$113,275,507</u></u>

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2009

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in in Net Assets
		Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental activities				
Administration and support service	\$ 7,808,376	275,589	-	(7,532,787)
Air and army national guard service	24,864,526	22,077,806	-	(2,786,720)
Civil defense	40,903,727	33,039,469	-	(7,864,258)
Youth challenge program	3,213,278	1,942,029	-	(1,271,249)
Service to veterans	2,665,661	-	-	(2,665,661)
	<u>\$ 79,455,568</u>	<u>57,334,893</u>	<u>-</u>	<u>(22,120,675)</u>
General revenues				
State allotted appropriations, net of lapses				20,602,636
State provided fringe benefits				<u>3,115,096</u>
Total general revenues				<u>23,717,732</u>
Transfers				<u>(1,669,036)</u>
Change in net assets				(71,979)
Net assets – beginning				<u>96,196,889</u>
Net assets – ending				<u>\$ 96,124,910</u>

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
BALANCE SHEET - GOVERNMENTAL FUNDS  
JUNE 30, 2009**

**ASSETS**

	General Fund	Air & Army National Guard	Disaster Assistance	Domestic Preparedness & Homeland Security Grants	National Guard Civilian Youth Opportunity Programs	Veteran Center/ Cemetery	Regional Training Center	Other Governmental Funds	Total Governmental Funds
Cash and short-term investments	\$ 2,922,384	8,945,124	142,947	730,143	322,025	1,140,218	1,222,450	2,743,837	18,169,128
Due from Federal Government	-	-	488,141	3,813,099	-	-	-	-	4,301,240
Due from other Funds	469,029	6,000	-	-	-	-	-	-	475,029
Total assets	\$ 3,391,413	8,951,124	631,088	4,543,242	322,025	1,140,218	1,222,450	2,743,837	22,945,397

**LIABILITIES AND FUND EQUITY**

**Liabilities**

Vouchers payable	\$ 755,201	2,420,110	165,968	2,720,483	148,236	-	-	51,584	6,261,582
Accrued payroll	347,072	214,477	4,517	69,567	56,536	-	-	-	692,169
Due to State of Hawaii	60,000	283,040	-	-	1,170	-	-	-	344,210
Due to other funds	-	463,389	-	6,000	5,640	-	-	-	475,029
Deferred revenues	-	5,570,108	-	-	110,443	4	-	-	5,680,555
Due to subrecipients	-	-	460,603	1,747,192	-	-	-	-	2,207,795
Total liabilities	1,162,273	8,951,124	631,088	4,543,242	322,025	4	-	51,584	15,661,340

**Fund balances**

Reserved for encumbrances	2,107,183	4,940,882	447,256	2,359,019	61,112	112,152	22,450	1,258,011	11,308,065
Reserved for continuing appropriations	-	-	-	-	-	1,028,062	1,200,000	116,244	2,344,306
Unreserved	121,957	(4,940,882)	(447,256)	(2,359,019)	(61,112)	-	-	1,317,998	(6,368,314)
Total fund balances	2,229,140	-	-	-	-	1,140,214	1,222,450	2,692,253	7,284,057
Total liabilities and fund balances	\$ 3,391,413	8,951,124	631,088	4,543,242	322,025	1,140,218	1,222,450	2,743,837	(1,964,286)

Compensated absences are not due and payable in the current period and therefore are not reported in the funds

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds

Net assets of governmental activities

See accompanying notes.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND  
BALANCES - GOVERNMENTAL FUNDS  
YEAR ENDED JUNE 30, 2009**

	General Fund	Air & Army National Guard	Disaster Assistance	Domestic Preparedness & Homeland Security Grants	National Guard Civilian Youth Opportunity Programs	Veteran Center/ Cemetery	Regional Training Center	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>									
State allotted appropriations	\$ 13,798,080	-	-	4,370,158	-	1,500,000	-	934,398	20,602,636
Intergovernmental	-	22,077,806	7,337,418	25,702,051	1,942,029	-	-	275,589	57,334,893
State provided fringe benefits	3,115,096	-	-	-	-	-	-	-	3,115,096
Total revenues	16,913,176	22,077,806	7,337,418	30,072,209	1,942,029	1,500,000	-	1,209,987	81,052,625
<b>EXPENDITURES</b>									
Administration and support service	4,233,388	-	-	-	-	-	-	147,961	4,381,349
Air and army national guard service	4,477,732	19,965,561	-	-	-	-	-	-	24,443,293
Civil defense	5,661,340	-	7,337,418	26,151,163	-	-	-	1,287,837	40,437,758
Youth challenge program	1,269,292	-	-	-	1,927,394	-	-	-	3,196,686
Service to veterans	1,893,856	-	-	-	-	-	-	-	1,893,856
Capital outlay	63,425	2,112,245	-	221,045	14,635	1,567,209	-	705,414	4,683,973
Total expenditures	17,599,033	22,077,806	7,337,418	26,372,208	1,942,029	1,567,209	-	2,141,212	79,036,915
Excess (deficiency) of revenues over expenditures	(685,857)	-	-	3,700,001	-	(67,209)	-	(931,225)	2,015,710
<b>OTHER FINANCING USES</b>									
Transfer out	(466,835)	-	-	(3,700,001)	-	-	-	-	(4,166,836)
Total other financing uses	(466,835)	-	-	(3,700,001)	-	-	-	-	(4,166,836)
<b>NET CHANGE IN FUND BALANCES</b>	(1,152,692)	-	-	-	-	(67,209)	-	(931,225)	(2,151,126)
Fund balances at July 1, 2008	3,381,832	-	-	-	-	1,207,423	1,222,450	3,623,478	9,435,183
Fund balances at June 30, 2009	\$ 2,229,140	-	-	-	-	1,140,214	1,222,450	2,692,253	7,284,057

See accompanying notes.



**DEPARTMENT OF DEFENSE**

**STATE OF HAWAII**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND  
BALANCES - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2009**

Net change in fund balances – total governmental funds	\$ (2,151,126)
Compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	(158,544)
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	<u>2,237,691</u>
Change in net assets of governmental activities	<u><u>\$ (71,979)</u></u>

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2009**

**NOTE 1 - NATURE OF ORGANIZATION**

The Department of Defense (Department) is a department of the State of Hawaii and provides for the safety, welfare, and defense of the people of Hawaii by maintaining readiness to respond in the event of war or disaster. Its divisions include the Hawaii Army and Air National Guard, State Civil Defense, and Office of Veterans Services.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting entity

The Department's financial statements 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 (State) that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes a comprehensive annual financial report for the State which includes the Department's financial activities.

Basis of presentation

The Department's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). GAAP includes all relevant Governmental Accounting Standards Board (GASB) pronouncements.

Government-wide financial statements

The statement of net assets and the statement of activities display information about the Department as a whole.

Fund financial statements

Fund financial statements of the Department are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column.

Governmental funds

Governmental funds are those through which the acquisition, use and balances of the Department's expendable financial resources and the related liabilities are accounted for. The measurement focus is on the flow of current financial resources. The following are the Department's governmental fund types:

General fund - The general fund is the general operating fund of the Department and is always classified as a major fund. It is used to account for all financial activities except those required to be accounted for in another fund. The general fund presented is a part of the State's general fund and is limited only to those appropriations and obligations of the Department.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

Special revenue funds - Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trust funds) that are legally restricted to expenditures for specified purposes.

Capital projects funds - Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Major funds

The following are the activities of the major funds accounted for in the fund financial statements:

General - See above for description.

Special revenue funds –

National Guard Military Operations & Maintenance - Accounts for revenues and expenditures of providing operations and maintenance projects for the National Guard.

Domestic Preparedness & Homeland Security - Accounts for revenues and expenditures of preventing threats and incidents of terrorism.

Disaster Assistance (FEMA) - Accounts for revenues and expenditures of providing emergency preparedness in the State.

National Guard Civilian Youth Opportunity - Accounts for revenues and expenditures of providing youth programs.

Capital projects funds –

Veteran Center Cemetery - Accounts for financial resources to be used for the acquisition or construction of major capital facilities.

Regional Training Center - Accounts for the financial resources restricted for construction or acquisition of the structures at the training site for veterans.

Basis of accounting

The government-wide financial statements of the Department are presented on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

The fund financial statements, which include governmental funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available, usually when the appropriations are allotted. The Department considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are generally recognized when the related liability is incurred, except for accumulated unpaid vacation and workers compensation benefits, which are recognized as an expenditure when payable from expendable available resources.

In applying the susceptible to accrual concept to federal grant revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. Under most of the Department's federal programs, funds must be expended for a specific purpose or project; therefore, revenue is recognized to the extent that expenditures are recognized.

Cash and short-term cash investments

Cash and short-term cash investments reported in the statement of net assets and the governmental funds balance sheet consist primarily of cash and short-term cash investments in the State Treasury.

The State maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the statement of net assets and the governmental funds balance sheet within cash and short-term cash investments. Those funds are pooled with funds from other State agencies and departments and deposited in approved financial institutions by the State Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State by third party custodians. Interest income from this cash pool is allocated to the various departments and agencies based upon their average cash balance for the period.

The Hawaii Revised Statutes (HRS) authorize the State Director of Finance to invest in obligations of or obligations 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.

Capital assets

Capital assets (primarily land, buildings, improvements, furniture and equipment) on the government-wide financial statements are accounted for as capital assets. All capital assets are recorded at historical cost, or estimated historical cost if actual cost is unavailable. Depreciation on all exhaustible capital assets is recorded as an allocated expense in the statement of activities and accumulated depreciation reflected in the statement of net assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	30 years
Land improvements	15 years
Furniture and equipment	7 years
Motor vehicle	5 years

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued**

Capital assets on the fund financial statements are recorded as capital outlay expenditures of the governmental fund upon acquisition.

Certain parcels of land have been transferred to the Department at no cost or at nominal cost.

Compensated absences

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 liability for these compensated absences is recorded as a long-term liability in the government-wide financial statements. The current portion of this liability is estimated based on historical trends. In fund financial statements, the amounts expected to be liquidated with expendable available financial resources are accrued in the respective funds.

Fund balances

Reserved amounts in fund balances represent amounts that are not appropriable for expenditure or legally segregated for a specific future use. Portions of the fund balances are reserved for the following:

- Encumbrances for outstanding commitments which generally are liquidated in the subsequent fiscal year.
- Continuing appropriations for unencumbered allotment balances representing amounts that have been released and made available for encumbrance or expenditure and are legally segregated for a specific future use.

Appropriations

Appropriations represent an authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital improvement projects.

Employee benefit expenditures

Employee benefit expenditures related to the Department's employees are paid by another state agency and are not reflected in the financial statements unless reimbursed under Federal contracts.

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 DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 3 - BUDGETING AND BUDGETARY CONTROL**

The budget of the Department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected as budgeted revenues are those estimates as compiled by the Department. Budgeted expenditures are derived primarily from a biennial general appropriations act as amended by any supplemental or other specific appropriations acts.

The Department follows these procedures in establishing the budgetary data reflected in the financial statements:

**The Budget** - Not less than 30 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendations of the Governor for each succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress, and an estimate for the succeeding biennium.

**Legislative Review** - The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analyses of programs and finances as would assist in determining the State's program and financial plan and budget.

**Program Execution** - Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

All expenditures of these appropriated funds are made pursuant to the appropriation in the biennial budget as amended by subsequent supplemental appropriations. The final legally adopted budget represents the original appropriations, supplemental appropriations, transfers and other legally authorized legislative and executive changes.

Budgetary control is maintained at the appropriation line item as established in the appropriation acts. The Governor is authorized to transfer appropriations within a State agency; however, transfers of appropriations between State agencies generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the Department.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

NOTE 3 - BUDGETING AND BUDGETARY CONTROL - continued

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

Budgets adopted by the State Legislature for the general and major special revenue funds are presented in the budgetary comparison schedule. The Department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to the encumbrances of purchase order and contract obligations as expenditures for budgetary purpose. These differences represent departures from generally accepted accounting principles (GAAP). A reconciliation between non-GAAP budgetary actual and GAAP actual is as follows:

	<u>General Fund</u>
Sources/inflows of resources:	
Actual amounts (budgetary basis)	
from the budgetary comparison schedule	\$15,747,468
Differences - budget to GAAP:	
Lapsed appropriations	(1,949,388)
State provided fringe benefits	<u>3,115,096</u>
Total revenues (net of lapses) as reported on the statement of revenues, expenditures, and changes in fund balance - governmental funds	<u>\$16,913,176</u>
Use/outflows of resources:	
Actual amounts (budgetary basis)	
from the budgetary comparison schedule	\$14,923,372
Differences - budget to GAAP:	
Expenditures for prior fiscal years' encumbrances	1,795,813
Reserved for encumbrances at fiscal year-end	(2,107,183)
Expenditures accruals for the year not recognized for budgetary purposes, net of prior year accruals	(128,065)
State provided fringe benefits	<u>3,115,096</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balance - governmental funds	<u>\$17,599,033</u>

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

NOTE 3 - BUDGETING AND BUDGETARY CONTROL - continued

	Air & Army National Guard	Disaster Assistance	Domestic Preparedness & Homeland Security Grants	National Guard Civilian Youth Opportunity Programs
Sources/inflows of resources:				
Actual amounts (budgetary basis) from the budgetary comparison schedule	\$ 26,681,730	7,603,311	24,783,799	1,998,718
Differences - budget to GAAP:				
Revenue accruals for the year not recognized for budgetary purposes, net of prior year accruals	(4,603,924)	(265,893)	918,252	(56,689)
Allotment of prior year appropriations	-	-	4,370,158	-
Total revenues (net of lapses) as reported on the statement of revenues expenditures, and changes in fund balance - governmental funds	<u>\$ 22,077,806</u>	<u>7,337,418</u>	<u>30,072,209</u>	<u>1,942,029</u>
Use/outflows of resources:				
Actual amounts (budgetary basis) from the budgetary comparison schedule	\$ 23,287,147	8,206,787	26,587,539	1,982,812
Differences - budget to GAAP:				
Expenditures for prior fiscal years' encumbrances	3,471,556	843,947	2,748,859	25,846
Reversed for encumbrances at fiscal year-end	(4,940,882)	(447,256)	(2,359,019)	(61,112)
Expenditures accruals for the year not recognized for budgetary purposes, net of prior year accrual	<u>259,985</u>	<u>(1,266,060)</u>	<u>(605,171)</u>	<u>(5,517)</u>
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balance - governmental funds	<u>\$ 22,077,806</u>	<u>7,337,418</u>	<u>26,372,208</u>	<u>1,942,029</u>



**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 4 - CASH AND SHORT-TERM INVESTMENTS**

Cash and short-term cash investments includes monies in the State Treasury. The State Treasury maintains an investment pool for all State monies. Hawaii Revised Statutes (HRS) authorize the State Director of Finance to 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.

The State maintains approximately 20 bank accounts for various purposes throughout the State and the nation. Bank accounts are under the custody of the Director of Finance. For financial statement reporting purposes, cash and short-term investments consist of cash, time certificates of deposit, money market accounts, repurchase agreements, and U.S. government securities.

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. Most of the bank balances are covered by federal deposit insurance or by collateral by either the State Treasury or by the State's fiscal agents in the name of the State. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being undercollateralized at various times during the fiscal year. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

At June 30, 2009, the carrying amount, which approximates the bank balance, of the Department's cash and short-term cash investments was \$18,169,128.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

NOTE 5 - CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2009 was as follows:

	Balance July 1, 2008	Increases	Decreases	Balance June 30, 2009
Governmental activities				
Capital assets not being depreciated				
Land	\$ 94,846	-	12,079	82,767
Land improvements	670,256	778,437	-	1,448,693
Works of art	163,089	-	-	163,089
Construction in progress	8,410,340	1,892,208	-	10,302,548
Total capital assets not being depreciated	<u>9,338,531</u>	<u>2,670,645</u>	<u>12,079</u>	<u>11,997,097</u>
Other capital assets				
Land improvements	-	110,973	-	110,973
Buildings	155,843,395	229,275	283,730	155,788,940
Infrastructure	23,892,745	559,871	-	24,452,616
Vehicles	836,423	62,004	80,811	817,616
Equipment	<u>9,073,574</u>	<u>3,629,917</u>	<u>144,050</u>	<u>12,559,441</u>
Total other capital assets	<u>189,646,137</u>	<u>4,592,040</u>	<u>508,591</u>	<u>193,729,586</u>
Less accumulated depreciation				
Land improvements	-	3,699	-	3,699
Buildings	87,904,560	3,537,254	283,729	91,158,085
Infrastructure	14,213,720	571,211	-	14,784,931
Vehicles	679,741	75,708	80,811	674,638
Equipment	<u>7,619,199</u>	<u>788,808</u>	<u>107,816</u>	<u>8,300,191</u>
Total accumulated depreciation	<u>110,417,220</u>	<u>4,976,680</u>	<u>472,356</u>	<u>114,921,544</u>
Governmental activities capital assets, net	\$ <u>88,567,448</u>	<u>2,286,005</u>	<u>48,314</u>	<u>90,805,139</u>

Depreciation expense for the year ended June 30, 2009 was charged to governmental activities as follows:

Administration and support service	\$3,268,907
Army and Air National Guard service	426,549
Civil defense	492,826
Youth challenge program	16,593
Service to veterans	<u>771,805</u>
	<u>\$4,976,680</u>

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

**NOTE 6 - LONG-TERM LIABILITIES**

Long-term liability activity for the year ended June 30, 2009, was as follows:

	Balance <u>July 1, 2008</u>	<u>Increases</u>	<u>Decreases</u>	Balance <u>June 30, 2009</u>
Governmental activities				
Compensated absences	\$ <u>1,805,742</u>	<u>1,074,195</u>	<u>915,651</u>	<u>1,964,286</u>

At June 30, 2009, the amount due within one year was \$599,000.

**NOTE 7 - RETIREMENT PLAN**

All eligible employees of the State and counties are required by HRS Chapter 88 to become members of the ERS, a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits, as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new noncontributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the noncontributory 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 for the contributory and noncontributory options, respectively.

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

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members 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. Most of the new members hired from July 1, 2006 are required to join the hybrid plan.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009

**NOTE 7 - RETIREMENT PLAN - continued**

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

For the years ended June 30, 2009, 2008, and 2007, the actuarially determined contribution requirements for the ERS were as follows:

For year ended June 30,	
2009	\$ 387,748,000
2008	377,475,000
2007	341,896,000

The State contributed 100% of its required contributions for those years, respectively. Covered payroll for the year ended June 30, 2009 was approximately \$2,835,096,000.

**NOTE 8 - POST-RETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS**

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

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

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.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 8 - POST-RETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS - continued**

The State is required to contribute the annual required contribution (ARC) of the employer, an amount that is actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Measurement of the actuarial valuation and the ARC are made for the State as a whole and are not separately computed for the individual state departments and agencies such as the Department. The State has only computed the allocation of the other postemployment benefit (OPEB) costs to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR). Therefore, the OPEB costs for the Department was not available and are not included in the financial statements. The State's CAFR includes the note disclosures and required supplementary information on the State's OPEB plans.

**NOTE 9 - ACCUMULATED SICK LEAVE**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It can 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 sixty days or more of unused sick leave shall be entitled to additional service credit in the Employee's Retirement System. Accumulated sick leave at June 30, 2009, was approximately \$5,224,000.

**NOTE 10 - DEFERRED COMPENSATION PLAN**

The State has established a deferred compensation plan pursuant to Internal Revenue Code Section 457 which enables State employees to defer a portion of their compensation. The State Department of Human Resources Development, has the fiduciary responsibility for administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employees or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant. The assets of the plan and the deferred compensation payable are recorded in the State's Employee Benefits Agency Fund.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO FINANCIAL STATEMENTS - continued  
JUNE 30, 2009**

**NOTE 11 - NONIMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of employees of the Department funded by state appropriations (General Fund) are assumed by the State and are not charged to the Department's operating funds. These costs, totaling \$3,115,096 for the year ended June 30, 2009, have been reported as revenues and expenditures within the Department's general fund.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the Department's special revenue funds.

**NOTE 12 - FUND BALANCE DEFICITS**

The following special revenue funds of the Department have deficits in the unreserved fund balances at June 30, 2009 as shown below.

	Deficit Balance at June 30, 2009
Air & Army National Guard	\$ 4,940,882
Disaster Assistance	447,256
Domestic Preparedness & Homeland Security Grants	2,359,019
National Guard Civilian Youth Opportunity Programs	61,112

Those deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when corresponding funds are measurable and available.

**NOTE 13 - COMMITMENTS AND CONTINGENCIES**

The Department is involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's general fund.

The State maintains certain insurance coverages to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State follows GASB Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" which establishes accounting and financial reporting standards for risk financing and insurance related activities of state governmental entities and requires the recordation of a risk liability for financing and insurance related losses, including those incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. Previously, these losses were recorded on a pay-as-you-go basis. The State retains various risks and insures certain excess layers with commercial insurance companies. The Department's share of workers' compensation losses are appropriated annually in the general fund. Workers compensation expenditures for the year ended June 30, 2009, amounted to approximately \$81,000.

**DEPARTMENT OF DEFENSE**  
**STATE OF HAWAII**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES**  
**(BUDGET AND ACTUAL) - GENERAL FUND**  
**YEAR ENDED JUNE 30, 2009**

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Budgetary fund balance at July 1, 2008	\$ -	-	-	-
Revenues				
State allotted appropriations	16,692,588	15,747,468	15,747,468	-
Expenditures				
Amelioration of physical disasters	13,703,051	12,912,148	12,405,574	506,574
Hawaii National Guard youth challenge academy	1,373,245	1,280,000	1,020,279	259,721
Service to veterans	1,616,292	1,555,320	1,497,519	57,801
	16,692,588	15,747,468	14,923,372	824,096
Excess of revenues over expenditures	-	-	824,096	824,096
Lapsed appropriations	-	-	(824,096)	(824,096)
Budgetary fund balance at June 30, 2009	\$ -	-	-	-

**DEPARTMENT OF DEFENSE**  
**STATE OF HAWAII**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES**  
**(BUDGET AND ACTUAL) - MAJOR SPECIAL REVENUE FUNDS**  
**YEAR ENDED JUNE 30, 2009**

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	Budgetary	Final Budget
			Basis	Positive (Negative)
<b>Air &amp; Army National Guard</b>				
Revenues				
Intergovernmental revenues	\$ 25,825,165	30,587,737	26,681,730	(3,906,007)
Expenditures				
Air and army national guard service	25,825,165	30,587,737	23,287,147	7,300,590
Excess of revenues over expenditures	<u>\$ -</u>	<u>-</u>	<u>3,394,583</u>	<u>3,394,583</u>
<b>Disaster Assistance</b>				
Revenues				
Intergovernmental revenues	\$ 28,084,000	23,734,000	7,603,311	(16,130,689)
Expenditures				
Civil defense	28,084,000	23,734,000	8,206,787	15,527,213
Excess of expenditures over revenues	<u>\$ -</u>	<u>-</u>	<u>(603,476)</u>	<u>(603,476)</u>
<b>Domestic Preparedness &amp; Homeland Security Grants</b>				
Revenues				
Intergovernmental revenues	\$ 32,380,458	32,256,683	24,783,799	(7,472,884)
Expenditures				
Civil defense	32,380,458	32,256,683	26,587,539	5,669,144
Excess of expenditures over revenues	<u>\$ -</u>	<u>-</u>	<u>(1,803,740)</u>	<u>(1,803,740)</u>
<b>National Guard Civilian Youth Opportunity Programs</b>				
Revenues				
Intergovernmental revenues	\$ 2,098,686	2,098,686	1,998,718	(99,968)
Expenditures				
Youth challenge program	2,098,686	2,098,686	1,982,812	115,874
Excess of revenues over expenditures	<u>\$ -</u>	<u>-</u>	<u>15,906</u>	<u>15,906</u>



DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2009

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Federal Expenditures</u>
<u>Department of Defense</u>			
Army National Guard Military Operations and Maintenance Projects			
Real Property	12.401	W912J6-09-2-1001	\$ 3,527,181
		W912J6-08-2-1001	4,914,028
		W912J6-07-2-1001	493,747
Environmental Resources Management	12.401	W912J6-09-2-1002	919,498
		W912J6-08-2-1002	393,614
		W912J6-07-2-1002	15,643
Security Guard Activities	12.401	W912J6-09-2-1003	677,852
		W912J6-08-2-1003	549,531
		W912J6-06-2-1003	411,020
Electronic Surveillance	12.401	W912J6-09-2-1004	187,547
		W912J6-08-2-1004	64,661
Telecommunications	12.401	W912J6-09-2-1005	52,060
		W912J6-08-2-1005	47,674
Integrated Training Area Management	12.401	W912J6-09-2-1007	142,126
		W912J6-08-2-1007	98,151
Anti-Terrorism Program Management	12.401	W912J6-09-2-1010	95,645
		W912J6-08-2-1010	8,297
Distance Learning	12.401	W912J6-09-2-1040	65,388
		W912J6-08-2-1040	111,716
			<u>12,775,379</u>
National Guard Civilian Youth Opportunities	12.404	W912J6-09-2-4002	29,593
		W912J6-08-2-4002	1,743,871
		W912J6-07-2-4002	170,415
			<u>1,943,879</u>
National Guard Bureau, Athletics & Youth Development Starbase Hawaii (Hickam AFB)	None	Letter of Agreement	<u>225,305</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - continued  
YEAR ENDED JUNE 30, 2009

<u>Federal Grantor/Pass-through</u> <u>Grantor/Program Title</u>	<u>Federal</u> <u>CFDA</u> <u>Number</u>	<u>Grant</u> <u>Number</u>	<u>Federal</u> <u>Expenditures</u>
<u>Department of Defense - continued</u>			
Air National Guard Military Operations and Maintenance Projects			
Facilities Activities	12.401	W912J6-09-2-1021 W912J6-08-2-1021	\$ 1,662,093 727,696
Security Guard Activities	12.401	W912J6-08-2-1023	4,943
			<u>2,394,732</u>
<u>Department of Homeland Security -</u> <u>Federal Emergency Management Agency</u> <u>Cooperative Agreement</u>			
Emergency Operations Center Grants	97.052	EMF-2003-GR-0383	<u>896,661</u>
Pre-Disaster Mitigation	97.017	EMF-2005-PC-0004	<u>262,175</u>
Emergency Preparedness Management Grants	97.042	2007-EM-E7-0062 2008-EM-E8-0039 2009-EP-E9-0032	366,857 1,857,014 4,740
			<u>2,228,610</u>
<u>Disaster Programs</u>			
Crisis Counseling - Dec 2008 Flood	97.032	FEMA-1814-DR-HI	<u>240,648</u>
<u>Public Assistance Grants</u>			
Nov 2000 Flood	97.036	FEMA-1348-DR-HI	36,243
Oct 2004 Flood		FEMA-1575-DR-HI	1,127,325
Mar 2006 Flood		FEMA-1640-DR-HI	2,036,680
Kiholo Bay Earthquake		FEMA-1664-DR-HI	3,189,503
Dec 2007 Storm Damages		FEMA-1743-DR-HI	797,655
Dec 2008 Flood		FEMA-1814-DR-HI	39,898
			<u>7,227,305</u>
<u>Hazard Mitigation Grants</u>			
Oahu 2004 Flood	97.039	FEMA-1575-DR-HI	56,245
Mar 2006 Flood		FEMA-1640-DR-HI	51,359
Kiholo Bay Earthquake		FEMA-1644-DR-HI	186,121
			<u>293,726</u>
Fire Management Grants	97.046	FEMA-2576-2740	<u>933,571</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - continued  
YEAR ENDED JUNE 30, 2009

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Federal Expenditures</u>
<u>Department of Homeland Security</u>			
FY2004 Homeland Security Grant	97.004	2005-GE-T4-0042	\$ 827,621
FY2008 Task Force Emergency Readiness	97.007	2008-TH-T8-K008	4,662
FY2007 UASI Non-Profit	97.008	2007-TU-XM-0013	100,000
FY2008 Interoperable Emergency Communications Grant	97.055	2008-IO-T8-0013	4,137
FY2008 Port Security Grant	97.056	2008-GB-T8-K069	1,380
FY2006 Transit Planning Grant	97.057	2006-RL-T6-0009	15,949
FY2007 Transit Planning Grant		2007-RL-T7-0016	61,612
FY2007 Transit Planning Grant Supp		2007-RL-T7-0106	145,940
FY2008 Transit Planning Grant		2008-RL-T8-0023	55,370
			278,871
FY2005 Office of State and Local Government Coordination	97.067	2006-GE-T5-0034	10,559,777
FY2006 Office of State and Local Government Coordination		2006-GE-T6-0033	7,761,203
FY2007 Office of State and Local Government Coordination		2007-GE-T7-0013	993,391
FY2008 Homeland Security Grant		2008-GE-T8-0022	144,507
			19,458,878
FY2005 Transit Security Grant	97.075	2005-GB-T5-0007	656,822
FY2008 Regional Catastrophic Preparedness	97.111	2008-CP-T8-0020	42,362

See accompanying notes to Schedule of Expenditures of Federal Awards.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - continued  
YEAR ENDED JUNE 30, 2009

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Federal Expenditures</u>
<u>Department of Health</u>			
Enforcing Underage Drinking Law (HPUD)	16.727	ASO Log No. 07-183	\$ 102,671
Enforcing Underage Drinking Laws Discretionary (DRED)		ASO Log No. 07-210	256,805
			<u>359,475</u>
<u>Department of Human Services</u>			
About Face Family of Programs (TANF/JUMP)	93.558	DHS-05-BESSD-4079	2,252,641
		DHS-07-BESSD-2233	1,295,615
Forward March (FMAR)		DHS-06-BESSD-3127	768,093
Healthy Lifestyles in Our Community (LIFE)		DHS-05-BESSD-2203	1,617,602
TANF - UAD Multi-Media Social Marketing Campaign		DHS-08-BESSD-5175	96,272
			<u>6,030,223</u>
<u>Department of Transportation</u>			
HMEP Assistance	20.703	HME HI7004150	83,101
		HME HI8004160	65,871
			<u>148,972</u>
<u>Department of Commerce</u>	Not available	None	<u>466,788</u>
<u>Department of Labor and Industrial Relations</u>			
Youth Program - Workforce Investment Act	17.259	WIA-08-YP-K	52,425
		WIA-07-YP-K	31,365
			<u>83,790</u>
			<u>\$ 57,885,973</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED JUNE 30, 2009

**NOTE 1 - BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A - 133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**NOTE 2 - SUBRECIPIENTS**

Of the federal expenditures presented in the schedule, the Department of Defense provided federal awards to subrecipients as follows:

<u>Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Federal Expenditures</u>
<u>Federal Emergency Management Agency</u>			
Emergency Operation Center Grants	97.052	EMF-2003-GR-0383	\$ 896,661
Pre-Disaster Mitigation	97.017	EMF-2005-PC-0004	135,000
Crisis Counseling - Dec 2008 Flood	97.032	FEMA-1814-DR-HI	240,648
Public Assistance Grants			
Nov 2000 Flood	97.036	FEMA-1348-DR-HI	36,243
October 2004 Flood	97.036	FEMA-1575-DR-HI	811,385
March 2006 Flood	97.036	FEMA-1640-DR-HI	1,395,162
Kiholo Bay Earthquake	97.036	FEMA-1664-DR-HI	2,911,605
Dec 2007 Storm Damages	97.036	FEMA-1743-DR-HI	779,139
Dec 2008 Flood	97.036	FEMA-1814-DR-HI	39,898
Fire Management Grants	97.046	FEMA-2576-2740	928,677
<u>Department of Transportation</u>			
HMEP Assistance	20.703	HME HI7004150	50,101
HMEP Assistance	20.703	HME HI8004160	28,662

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - continued  
YEAR ENDED JUNE 30, 2009

NOTE 2 - SUBRECIPIENTS - continued

<u>Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Federal Expenditures</u>
<u>Department of Homeland Security</u>			
FY2004 Homeland Security	97.004	2004-GE-T4-0042	\$ 659,003
FY2008 Interoperable Emergency Communications Grant	97.055	2008-IO-T8-0013	4,137
FY2008 Port Security Grant	97.056	2008-GB-T8-K069	1,380
FY2006 Transit Planning Grant	97.057	2006-RL-T6-0009	15,949
FY2007 Transit Planning Grant	97.057	2007-RL-T7-0016	48,490
FY2007 Transit Planning Grant Supp	97.057	2007-RL-T7-0106	145,940
FY2008 Transit Planning Grant	97.057	2008-RL-T8-0023	55,370
FY2005 Office of State and Local Government Coordination	97.067	2006-GE-T5-0034	9,580,333
FY2006 Office of State and Local Government Coordination	97.067	2006-GE-T6-0033	6,863,713
FY2007 Office of State and Local Government Coordination	97.067	2007-GE-T7-0013	746,790
FY2008 Homeland Security Grant	97.067	2008-GE-T8-0022	120,885
FY2005 Transit Security Grant	97.075	2005-GB-T5-0007	656,822
FY2008 Regional Catastrophic Preparedness	97.111	2008-CP-T8-0020	42,242

**CHOO, OSADA & LEE, CPAs, INC.**

CERTIFIED PUBLIC ACCOUNTANTS

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**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***

To the Auditor  
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and aggregate remaining fund information of the Department of Defense of the State of Hawaii (Department), as of and for the year ended June 30, 2009, and have issued our report thereon dated August 31, 2012. 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 Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

*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.

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

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted a matter that we reported to management of the Department in a separate letter dated August 31, 2012.

The Department's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management of the State of Hawaii Department of Defense, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Choo, Osada & Lu, CPAs, Inc.*

Honolulu, Hawaii  
August 31, 2012



**CHOO, OSADA & LEE, CPAs, INC.**

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Auditor  
State of Hawaii

Compliance

We have audited the compliance of the Department of Defense State of Hawaii (Department) with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2009. 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. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the 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. Our audit does not provide a legal determination on the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2009. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 09-1 to 09-4.

### Internal Control Over Compliance

Management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

*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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 09-5 to be a material weakness.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 09-6 to 09-10 to be significant deficiencies.

The Department's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Department's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management of the State of Hawaii Department of Defense, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Choo, Osada & Lu, CPAs, Inc.*

Honolulu, Hawaii  
August 31, 2012

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2009

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: unqualified

Internal control over financial reporting:

Material weaknesses identified? \_\_\_\_\_yes X no

Significant internal control deficiencies identified  
not considered to be material weaknesses? \_\_\_\_\_yes X none reported

Noncompliance material to financial statements noted? \_\_\_\_\_yes X no

Federal Awards

Internal control over major programs:

Material weaknesses identified? X yes \_\_\_\_\_no

Significant deficiencies identified  
not considered to be material weaknesses? X yes \_\_\_\_\_no

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

Any audit findings disclosed that are required to be  
reported in accordance with Circular A-133,  
Section .510(a)? X yes \_\_\_\_\_no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
97.036	<b>Federal Emergency Management Agency</b> Disaster Programs
97.004	<b>Department of Homeland Security</b> State Homeland Security Grant Program
97.067	Office of State & Local Government Coordination
93.558	<b>Department of Human Services</b> About Face Family of Programs Forward March Program Healthy Lifestyles in Our Community

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009

**Section I - Summary of Auditor's Results - continued**

Dollar threshold used to distinguish between  
Type A and Type B programs:

\$ 1,736,579

Auditee qualified as low-risk auditee?

\_\_\_\_\_yes X no

**Section II - Financial Statement Findings**

No matters were reported.

**Section III - Federal Award Findings and Questioned Costs**

**Finding No. 09-1**

**Questioned Costs: None**

**Significant deficiency**

Background

The Department was required, as part of an audit performed in accordance with OMB Circular A-133, to submit to its auditors a schedule of expenditures of federal awards.

Condition

In the schedule of expenditures of federal awards submitted by the Department, there were discrepancies between expenditures reported for several federal programs, and the related amounts in the Department's accounting records. This finding was also noted in the prior year.

Recommendation

The Department should review procedures related to the preparation of the schedule of federal awards so that there is an adequate reconciliation to supporting departmental accounting records.

Response of Department

In preparation of participating in the State of Hawaii single audit report, the appropriate departmental staff has been trained to prepare the State Expenditure of Federal Awards (SEFA). Inter-departmental procedures will be prepared to ensure that the reconciliation to FAMIS and Data Mart will support departmental accounting records.

**Finding No. 09-2**

**Questioned Costs: None**

**Significant deficiency**

Condition

The Department's Single Audit was not completed within nine months of the end of the fiscal year as specified by Office of Management and Budget Circular A-133. This finding was also noted in the prior year.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009**

Recommendation

The Department should make staffing and contracting arrangements for the completion of the audit within the specified deadline; if the audit cannot be completed within that time frame, the Department should request an extension of time to submit the audit report package to its federal oversight agency.

Response of Department

The Department did not have adequate funding to contract for the preparation of the financial statement for the Department. This requirement has been completed and the reports for FY 2008, 2009, and 2010 has been completed. The department has opted to participant in the State of Hawaii's combined Single Audit report beginning from FY 2010. With the additional staff services from the Department of Accounting and General Services and the execution of a contract to perform the Statewide Single Audit, timely completion of the Single Audit reports should be resolved.

**Finding No. 09-3 State Homeland Security Grant Program; CFDA NO.: 97.004**

**Questioned Costs: None**

**Significant deficiency**

Condition

The Department was required to submit a final report of expenditures to the federal awarding agency 90 days after the expiration or the termination of the grant. The grant was extended to May 2009. However, the Department prepared and submitted the final report on July 2008. Total expenditures reported to the federal awarding agency included estimated expenditures instead of actual expenditures. The Department did not submit an amended report to the federal awarding agency.

We noted that there was no documentation of review by an appropriated level of management for the financial reports prepared by a grant administrator prior to the submission. This finding was also noted in the prior year.

Recommendation

The expenditures reported to the federal awarding agencies should be based on actual expenditures. Additionally, documentation of the financial reports should be reviewed to ensure the accurate reports submitted.

Response of Department

The Department has received authorization to hire a program analyst type of employee and an additional accountant that will both report to the Business Management Officer (BMO). All future grants received by the Department will be monitored by these individuals to ensure that requirements of grants are being met including the review of all correspondences and financial reports. There will also be developed within the ASO a log system of all due outs by grant requirements.

The State DOD ASO and the grant program manager will determine the Federal grant program and ASO staffs' level of understanding with regard to the grant compliance requirements and final expenditure reporting. Based on the recommendation of this finding, training will be conducted to address the level of understanding deficiencies. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures and compliance requirements.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009**

**Finding No. 09-4 State Homeland Security Grant Program; CFDA NO.: 97.004**  
**Questioned Costs: None**

Condition

In accordance with the grant terms, expenditures should be incurred only during the grant period and all obligations must be liquidated no later than 90 days after the end of the grant period. We noted that two expenditures processed on December 29, 2008 were charged to the grant that ended on June 30, 2008. Department personnel could not locate a copy of the approved extension request. Instead, the Department provided an alternative form of support to substantiate the extension of the grant to a later date.

Recommendation

The Department should file and maintain records related to the extension requests.

Response of Department

The Department has received authorization to hire a program analyst type of employee and an additional accountant that will both report to the Business Management Officer (BMO). All future grants received by the Department will be monitored by these individuals to ensure that requirements of grants are being met. A copy of all grant documents and correspondence will be made a part of a checklist that should be kept in the grant files. The State DOD ASO and the grant program manager will determine the Federal grant program and ASO staffs' level of understanding with regard to the grant compliance requirements and final expenditure reporting. Based on the recommendation of this finding, training will be conducted to address the level of understanding deficiencies. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures and compliance requirements.

**Finding No. 09-5 State Homeland Security Grant Program; CFDA NO.: 97.067**  
**Questioned Costs: None**  
**Material weakness**

Background

Expenditures are reconciled from reports generated using the State's accounting software (FAMIS), to reports generated using the Department's accounting software (Foxpro). The Department's financial statements and schedule of federal awards are generated FAMIS reports, while financial status reports submitted to federal awarding agencies are generated from Foxpro reports.

Finding

The activity code changes which were reflected to change expenditures on the schedule of expenditures of federal award were made to the Foxpro database, but these revisions were not documented on the original documents such as the requisition and purchase order form (Form C-3). This finding was also noted in the prior year.

Recommendation

The Department should consider reminding individual responsible for reviewing expenditure activity codes that such changes should be consistently made in both accounting systems as well as documented on the related purchase orders. Management should also consider the feasibility of applying the changes to activity codes after the close of the fiscal year by utilizing journal vouchers to document the changes.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009**

Response of Department

The Department has received authorization to hire a program analyst type of employee and an additional accountant that will both report to the BMO. All future grants received by the Department will be monitored by these individuals to ensure that requirements of grants are being met. If there are any changes required by the grants, instructions will be initiated by the ASO. The instructions will include the type of documentation that should be generated to ensure an audit trail. The State DOD ASO and the grant program manager will determine the Federal grant program and ASO staffs' level of understanding with regard to the grant compliance requirements and final expenditure reporting. Based on the recommendation of this finding, training will be conducted to address the level of understanding deficiencies. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures and compliance requirements.

**Finding No. 09-6 State Homeland Security Grant Program; CFDA NO.: 97.067**

**Questioned Costs: \$299,524**

**Significant deficiency**

Condition

During our review of the audited financial statements of Department subrecipients, we noted \$299,524 was reported on one of the subrecipients' Schedule of Expenditures of Federal Awards, but Department personnel could not locate the related program expenditure on its records, nor could they locate documentation to support that a follow-up for this discrepancy had been made.

Recommendation

The Department should take a more active role in monitoring the subrecipients' compliance with federal requirements and perform monitoring activities on a timely basis.

Response of Department

The Department has received authorization to hire a program analyst type of employee and an additional accountant that will both report to the BMO. All future grants received by the Department will be monitored by these individuals to ensure that requirements of grants are being met. If there are any changes required by the grants, instructions will be initiated by the ASO. The instructions will include the type of documentation that should be generated to ensure an audit trail. The State DOD ASO and the grant program manager will determine the Federal grant program and ASO staffs' level of understanding with regard to the grant compliance requirements and final expenditure reporting. Based on the recommendation of this finding, training will be conducted to address the level of understanding deficiencies. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures and compliance requirements.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009**

**Finding No. 09-7 Disaster Program; CFDA NO.: 97.036  
Questioned Costs: \$27,965**

Condition

A finding was included in the audited financial statements of one of the Department's subrecipients related to an overstatement of the federal share of eligible costs. The Department is required to monitor its subrecipients to ensure that they administer federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements. We were unable to determine whether the Department did a follow up with the subrecipient regarding the finding.

Recommendation

The Department should follow up with the subrecipient to determine whether corrective actions have been identified and implemented. The Department should also consider establishing guidelines and procedures for monitoring subrecipients.

Response of Department

The Department has received authorization to hire a program analyst type of employee and an additional accountant that will both report to the BMO. All future grants received by the Department will be monitored by these individuals to ensure that requirements of grants are being met, i.e., monitoring of sub recipients. Any corrective actions required by the sub recipients will be brought to the attention of the program manager. If there are any changes required by the grants, instructions will be initiated by the ASO. The instructions will include the action that must be taken and the type of documentation that should be generated to ensure an audit trail. The State DOD ASO and the grant program manager will determine the Federal grant program and ASO staffs' level of understanding with regard to the grant compliance requirements and final expenditure reporting. Based on the recommendation of this finding, training will be conducted to address the level of understanding deficiencies. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures and compliance requirements.

**Finding No. 09-8 About Face Family of Programs: CFDA NO.: 93.558  
Questioned Costs: Unknown  
Significant deficiency**

Condition

The Department entered into an agreement with a vendor related to a federal grant received through the State Department of Human Services (DHS). However, in accordance with the terms of the contract, all equipment, furniture and supplies purchased belonged to the DHS. Under the contract, the vendor was responsible for providing an inventory listing of all items purchased within the period covered. A complete inventory listing of such items purchased during the current year was not provided by the vendor. Furthermore, the Department did not provide a list of capital assets purchased to DHS during the year. This finding was also noted in the prior year.

Recommendation

The Department should review procedures related to the monitoring of contracts to help ensure that a proper accounting of capital asset purchases is provided to the DHS.



**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009**

Response of Department

The State DOD ASO and the grant program manager will reconcile equipment purchases on a monthly basis and also on the final report to determine that all equipment and disbursements are in accordance with the Memorandum of Agreements. Sub recipients records will be monitored quarterly and discrepancies or variances to instructions (instructions were given to lease all equipment) discovered will be immediately transmitted to DOD ASO for appropriate action. All new staff will be trained to address the level of understanding deficiencies and findings to prevent future deficiency transactions. Once trained, supervisory or independent reviews will be strengthened to ensure that staffs are responsible in processing and administering Federal grant expenditures.

**Finding No. 09-9 About Face Family of Programs: CFDA NO.: 93.558**

**Questioned Costs: None**

**Significant deficiency**

Condition

The Department was a subrecipient of a federal grant through the State Department of Human Services (DHS). The program accountant prepared a schedule of payroll expenses allocated to six separate programs of the grant, which was then used to prepare a monthly report to the DHS. We noted that the sum of the allocation reported was \$220,683 more than the total payroll expense recorded to that grant for that period. This finding was also noted in the prior year.

Recommendation

The allocation reports prepared by the program accountant should be reconciled to the Department's books on a regular basis.

Response of Department

DOD has implemented controls over all Personal Services Contracts (PSC) and has instructed all personnel involved to adhere to all requirements issued by the Governor in his current Budget Execution Memorandum, the State Procurement Office, the State Department of Human Resources and Development and the Department of the Attorney General prior to the execution of any PSC. In order to clarify and instruct departmental staff, a departmental policy directive was developed for the execution of PSC.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
YEAR ENDED JUNE 30, 2009

**Federal Award Findings and Questioned Costs**

**Section II - Financial Statement Findings**

**Finding No. 08-1**

Condition

Total expenditures reported in the Department's financials were overstated by \$50,000 because an expenditure was recorded twice. However, there was no effect on the Department's cash balance because the corresponding credit was recorded to revenues.

Recommendation

The Department should consider reconciling its cash receipts and disbursement records to the Department's Status of Appropriation Account Balances (MBP430-B) reports on a monthly basis.

Status

This finding was not noted in the current year.

**Section III - Federal Award Findings and Questioned Costs**

**Finding No. 08-2**

Background

The Department was required, as part of an audit performed in accordance with OMB Circular A-133, to submit to its auditors a schedule of federal awards summarizing its expenditures under federally funded programs.

Condition

In the schedule of federal awards submitted by the Department, there were discrepancies between expenditures reported for several federal programs, and the related amounts in the Department's accounting records. This finding was also noted in the prior year.

Recommendation

The Department should review procedures related to the preparation of the schedule of federal awards so that there is an adequate reconciliation to supporting departmental accounting records.

Status

This finding has been repeated in the current year as finding no. 09-01.

**Finding No. 08-3**

Condition

The Department's Single Audit was not completed within nine months of the end of the fiscal year as specified by Office of Management and Budget Circular A-133.

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009

Recommendation

The Department should make staffing and contracting arrangements for the completion of the audit within the specified deadline; if the audit cannot be completed within that time frame, the Department should request an extension of time to submit the audit report package to its federal oversight agency.

Status

This finding has been repeated in the current year as finding no. 09-02.

**Finding No. 08-4 State Homeland Security Grant Program; CFDA NO.: 97.004 and 97.067**

Condition

The Department was required to submit a final report of expenditures to the federal awarding agency 90 days after the expiration or the termination of the grant. The grant was extended to May 2009. However, the Department prepared and submitted the final report on July 2008. Total expenditures reported to the federal awarding agency included estimated expenditures instead of actual expenditures, and excluded an unobligated balance of federal funds of approximately \$38,000. Furthermore, the Department did not submit an amended report to the federal awarding agency.

We also noted that for other financial reports submitted by the Department, total unliquidated obligations were overstated by approximately \$170,000 on one report and \$619,000 on another report. The Department was not able to provide support for the amount of unliquidated obligations reported.

We also noted that there was no documentation for review by an appropriate level of management for the financial reports prepared by a grant administrator prior to the submission.

Recommendation

The Department should consider if modifications are necessary to ensure that reporting requirements are followed. The expenditures reported to the federal awarding agencies should be based on actual expenditures and supporting documentation for the reported expenditures should be maintained. Additionally, financial reports should be reviewed prior to submission and such reviews should be documented.

Status

This finding has been repeated in the current year as finding no. 09-03.

**Finding No. 08-5 State Homeland Security Grant Program; CFDA NO.: 97.067**

Background

Expenditure reporting utilizes reports generated using the State's accounting software (FAMIS) and reports generated using the Department's accounting software (Foxpro). The Department's financial statements and schedule of federal awards are generated from FAMIS reports, while financial status reports submitted to federal awarding agencies are generated from Foxpro reports.

Finding

The activity code changes which were reflected to change expenditures on the schedule of expenditures of federal award were made to the Foxpro database, but these revisions were not documented on the original documents such as the requisition and purchase order form (Form C-3).

DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009

Recommendation

The Department should consider reminding individuals responsible for reviewing expenditure activity codes that revisions should be consistently made in both accounting systems as well as documented on the related purchase orders. Management should also consider the feasibility of applying the changes to activity codes after the close of the fiscal year by utilizing journal vouchers to document the changes.

Status

This finding has been repeated in the current year as finding no. 09-01.

**Finding No. 08-6 State Homeland Security Grant Program; CFDA NO.: 97.004 and 97.067**

Finding

We noted that an activity code change that was not made in one of the Department's two financial reporting systems resulted in the overstatement of a federal grant award expenditure and the understatement of another federal grant award expenditure by \$282,331.

Recommendation

The Department should establish policies and procedures for assignment of expenditure activity codes to ensure the accuracy of data in both the Status of Appropriation Account Balances and the schedule of expenditures of federal awards.

Status

This finding was not noted in the current year.

**Finding No. 08-7 State Homeland Security Grant Program; CFDA NO.: 97.004**

Condition

Expenditure and payroll records related to the Homeland Security grant award were deleted in April 2008. Records from March 2006 to April 2008 were backed up onto tapes, but recovery of the data was not successful. The Department provided alternative records of support to substantiate the reconciliation of the schedule of expenditures of federal awards.

Recommendation

The Department should review and monitor internal controls related to the backup and recovery system.

Status

This finding was not noted in the current year.

**Finding No. 08-8 About Face Family of Programs; CFDA NO.: 93.558**

Condition

Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, require the Department to properly record expenditures as allowed for by the laws, regulations, and the provisions of contract or grant agreements. We noted that expenditures of \$12,819 related to the National Guard Civilian Youth Opportunities program were miscoded to the About Face Family of Programs.

DEPARTMENT OF DEFENSE  
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SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS - continued  
YEAR ENDED JUNE 30, 2009

Recommendation

The Department should consider if modifications are necessary to its procedures to ensure that expenditures are charged to the appropriate programs.

Status

This finding was not noted in the current year.

**Finding No. 08-9 About Face Family of Programs: CFDA NO.: 93.558**

Condition

The Department entered into an agreement with a vendor related to a federal grant passed through from the State Department of Human Services (DHS). Under the terms of the contract, all equipment, furniture and supplies purchased belonged to the DHS. Additionally, the vendor was responsible for providing an inventory listing of all items purchased within the period covered. A complete inventory listing of such items purchased during the current year was not provided by the vendor. Furthermore, the Department did not provide a list of capital assets purchased during the year to DHS.

Recommendation

The Department should review procedures related to the monitoring of contracts to help ensure that a proper accounting of capital asset purchases is provided to the DHS.

Status

This finding has been repeated in the current year as finding no. 09-08.

**Finding No. 08-10 About Face Family of Programs: CFDA NO.: 93.558**

Condition

The Department was a subrecipient of a federal grant through the State Department of Human Services (DHS). The program accountant prepared a schedule of payroll expenses allocated to six separate programs of the grant, which was then used to prepare a monthly report to the DHS. We noted that the sum of the allocation reported was \$6,266 less than the total payroll expense recorded to that grant for that period.

Recommendation

The allocation reports prepared by the program accountant should be reconciled to the Department's books on a regular basis.

Status

This finding has been repeated in the current year as finding no. 09-09.

**Finding No. 08-11 National Guard Civilian Youth Opportunities Program: CFDA NO.: 12.404**  
**Questioned Costs: \$20,064**

Condition

State of Hawaii procurement procedures required that goods or services of contracts meeting small purchase requests criteria to be awarded utilizing the Hawaii Electronic Procurement System (HePS). We found that although one contract met these criteria, it was not awarded through HePS.

**DEPARTMENT OF DEFENSE  
STATE OF HAWAII  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS - continued  
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Recommendation

We recommend that the Department review its procurement procedures to help ensure that purchases comply with the State procurement requirements. All exceptions to Hawaii Revised Statutes (HRS) 103D-305 and applicable Hawaii Administrative Rules (HAR) Chapter 3-122, Subchapter 8 should be clearly noted on the purchase orders.

Status

This finding was not noted in the current year.