

State of Hawaii
Department of Health
Financial and Compliance Audit
June 30, 2010

Submitted by
The Auditor
State of Hawaii

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Department of Health
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Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department") which collectively comprises the Department's basic financial statements as listed in the index. 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 1, the basic financial statements of the Department are intended to present the financial position and the changes in the financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2010, or the changes in its financial position and cash flows, where applicable, thereof for the year 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, the business-type activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2010, and the respective changes in financial position and, where applicable, cash flows 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 March 31, 2011 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the 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 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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 (the "Schedule") 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. As described in Note 1 to the Schedule, the accompanying Schedule was prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare 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 on the basis of accounting described in Note 1 to the Schedule, in relation to the basic financial statements as a whole.

Accuity LLP

Honolulu, Hawaii
March 31, 2011

State of Hawaii
Department of Health
Management's Discussion and Analysis (Unaudited)
June 30, 2010

This Management Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities and performance of the State of Hawaii, Department of Health (the "Department") during the fiscal year that ended on June 30, 2010. Please read it in conjunction with the Department's Financial Statements including its related notes (which follow this section) as well as the subsequent Schedule of Expenditures of Federal Awards ("SEFA"). The following is a brief description of the contents of those three sections:

Overview of the Financial Statements

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements; (2) fund financial statements; and (3) notes to the basic financial statements.

Department-wide Financial Statements

The department-wide financial statements provide information about the Department's overall financial position and results of operations. These statements, which are presented on an accrual basis of accounting, consist of the Statement of Net Assets and the Statement of Activities.

The department-wide statements report information about the Department as a whole using accounting methods similar to those used by private sector companies. The statement of net assets provides both short-term and long-term information about the Department's financial position, which assists in assessing the Department's economic condition at the end of the fiscal year. All of the current year revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid. The department-wide financial statements include two statements:

- The *Statement of Net Assets* presents all of the Department's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases and decreases in the Department's 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.

The department-wide financial statements of the Department are further divided into two categories:

- *Governmental activities* –The activities in this section are primarily supported by State of Hawaii appropriations, funds from the tobacco settlement, beverage container deposit administrative fees, federal grants, and fees.
- *Business-type activities* –These functions normally are intended to recover all or a significant portion of their costs through user's fees and charges to external users. These activities include the Department's two revolving loan funds.

Fund Financial Statements

The fund financial statements include the Department's: (1) governmental funds, for which activities are funded primarily from appropriations from the State of Hawaii, by revenues from the tobacco settlement agreement, beverage container deposit program and federal grants; (2) proprietary funds, which consist of revolving loan funds and are reported similar to business activities; and (3) fiduciary funds. The governmental funds are presented on the modified accrual basis of accounting. The proprietary and the fiduciary funds are presented on the accrual basis of accounting.

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The fund financial statements provide more detailed information about the Department's most significant funds and not the Department as a whole. In these statements, the financial activities of the Department are recorded in individual funds. 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. Funds are reported as a major fund or a non-major (other) fund. The Governmental Accounting Standards Board ("GASB") issued Statement 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments*, which sets forth the minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

The fund financial statements also include the budgetary comparison statements, which include reconciliations for the general fund, tobacco settlement fund, and deposit beverage container fund, comparing the excess of revenues over expenditures presented on a budgetary basis to the excess (deficiency) of revenues over expenditures presented in conformity with generally accepted accounting principles ("GAAP") as presented in the governmental fund financial statements.

To reiterate, the Department has three types of funds:

- *Governmental funds* – Governmental funds are used to account for essentially the same functions reported in the governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, governmental financial statements focus on near-term inflows and outflows of expendable resources as well as on the balances of expendable resources available at the end of the fiscal year.

Because the focus of governmental funds is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. Both the governmental fund balance sheet and statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate comparison between governmental funds and governmental activities in the department-wide financial statements.

- *Proprietary funds* – Proprietary funds are used to report activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the department-wide financial statements. The Department uses enterprise funds to account for the operations of its two revolving loan funds each of which are considered to be major funds of the Department.
- *Fiduciary funds* – The fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

Notes to Financial Statements

The *Notes to Financial Statements* section provides additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements follow the basic financial statements.

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Schedule of Expenditures of Federal Awards

Other information consists of the Schedule of Expenditures of Federal Awards and the Notes to the Schedule of Expenditures of Federal Awards. The SEFA reports federal awards to the Department expended on the cash basis of accounting for the year ended June 30, 2010.

Financial Highlights

- The Department's total net assets increased from \$625.6 million as of June 30, 2009 to \$707.0 million as of June 30, 2010, or by approximately \$81.4 million. The total increase in net assets was attributed to an increase in the Department's business type activities' net assets of \$62.4 million and an increase in governmental activities' net assets of \$19.0 million during the year.
- The Department's governmental funds reported an aggregate increase in fund balance of approximately \$28.5 million during the year totaling \$146.9 million at June 30, 2010. Note that this is based on the fund balance at June 30, 2009 of \$118.4 million.
- The Department's proprietary funds, consisting of two revolving loan funds, reported an increase in net assets of \$62.4 million for FY 2010. Total net assets were \$519.5 million at June 30, 2010 compared to the FY 2009 year end total of \$457.1 million.

Department-Wide Financial Analysis

This section includes condensed Department-wide financial information and analysis.

Statement of Net Assets
June 30, 2010
(\$000)

	Governmental Activities		Business-Type Activities		Total	
	2010	2009	2010	2009	2010	2009
Current assets	\$ 262,645	\$ 262,115	\$ 157,351	\$ 172,610	\$ 419,996	\$ 434,725
Capital assets	60,452	64,144	203	272	60,655	64,416
ARRA advances	-	-	23,693	-	23,693	-
Loans receivable, noncurrent	-	-	339,295	285,151	339,295	285,151
Total assets	\$ 323,097	\$ 326,259	\$ 520,542	\$ 458,033	\$ 843,639	\$ 784,292
Current liabilities	\$ 118,368	\$ 140,118	\$ 262	\$ 305	\$ 118,630	\$ 140,423
Long term liabilities	17,271	17,628	760	599	18,031	18,227
Total liabilities	135,639	157,746	1,022	904	136,661	158,650
Net assets						
Invested in capital assets	60,452	64,144	204	272	60,656	64,416
Restricted	124,714	123,714	519,316	456,857	644,030	580,571
Unrestricted	2,292	(19,345)	-	-	2,292	(19,345)
Total net assets	187,458	168,513	519,520	457,129	706,978	625,642
Total liabilities and net assets	\$ 323,097	\$ 326,259	\$ 520,542	\$ 458,033	\$ 843,639	\$ 784,292

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As noted earlier, changes in net assets may serve over time as a useful indicator of the Department's financial position. As of June 30, 2010, the Department's total net assets were approximately \$707.0 million.

At June 30, 2010, in addition to cash in the state treasury approximating \$281.7 million, the Department had total loans receivable from county governments in the amount of \$368.6 million arising from its two revolving loan funds. The Department had total liabilities of \$136.7 million at June 30, 2010 of which \$9.9 million relates to accrued wages and employee benefits payable. Approximately \$48.2 million in liabilities relate to vouchers and contracts payable. At June 30, 2010, restricted net assets were \$644.0 million. The restrictions arise from legal and contractual agreements.

Statement of Activities
June 30, 2010
(\$000)

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Revenue						
Program revenues						
Charges for services	\$ 43,670	\$ 54,458	\$ 7,323	\$ 6,936	\$ 50,993	\$ 61,394
Operating grants and contributions	107,682	81,235	54,964	16,134	162,646	97,369
General revenues						
State appropriated funds	382,031	441,046	-	-	382,031	441,046
Non imposed fringe benefits	45,689	53,273	-	-	45,689	53,273
Tobacco settlement funds	50,925	60,008	-	-	50,925	60,008
Environmental fees and taxes	38,331	29,293	-	-	38,331	29,293
Total revenues	<u>668,328</u>	<u>719,313</u>	<u>62,287</u>	<u>23,070</u>	<u>730,615</u>	<u>742,383</u>
Expenses						
General administration	34,594	32,461	-	-	34,594	32,461
Environmental health	66,007	72,848	2,572	3,126	68,579	75,974
Behavior health	213,745	276,063	-	-	213,745	276,063
Health resources	280,521	309,477	-	-	280,521	309,477
Total expenses	<u>594,867</u>	<u>690,849</u>	<u>2,572</u>	<u>3,126</u>	<u>597,439</u>	<u>693,975</u>
Excess before transfers	73,461	28,464	59,715	19,944	133,176	48,408
Transfers	<u>(54,516)</u>	<u>(39,242)</u>	<u>2,675</u>	<u>3,326</u>	<u>(51,841)</u>	<u>(35,916)</u>
Change in net assets	18,945	(10,778)	62,390	23,270	81,335	12,492
Net assets						
Beginning of year, as restated	<u>168,513</u>	<u>179,291</u>	<u>457,129</u>	<u>433,859</u>	<u>625,642</u>	<u>613,150</u>
End of year	<u>\$ 187,458</u>	<u>\$ 168,513</u>	<u>\$ 519,519</u>	<u>\$ 457,129</u>	<u>\$ 706,977</u>	<u>\$ 625,642</u>

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Governmental activities increased the Department's net assets by \$18.9 million in FY 2010. There was a decrease in the State appropriated funds of \$59.0 million from FY 2009 to FY 2010. The decrease was due in part to the implementation of a two-day per month furlough for all state workers effective October 2009 (\$17.4 million), a reduction of the purchase of services contracts for the Healthy Start program (\$11.3 million), and an overall increase in the Federal Medical Assistance Percentage "FMAP" which resulted in a corresponding decrease in the state fund match (\$23.2 million). The FMAP was 56.50% at the beginning of FY 2009 and decreased to 55.11% effective October 1, 2008. However, under the American Recovery and Reinvestment Act, the FMAP was increased to 66.13% effective October 1, 2008 through March 31, 2009, then increased to 67.35% for the period April 1, 2009 to December 31, 2010.

Revenues of the Department's business-type activities, which increased by \$39.2 million from 2009, consist of the Department's environmental loan programs — one for water pollution control and the other for drinking water treatment — were generated from charges for services, program investment income, and federal assistance program funds as well as state matching funds. Charges for services consist primarily of administration loan fees and interest income on loans related to the Department's two revolving loan programs. The majority of the programs investment income is from the Department's participation in the State Treasury Investment Pool System.

For the fiscal year ended June 30, 2010, business-type activities increased the Department's net assets by \$62.4 million to \$519.5 million as of June 30, 2010.

Total Department-wide expenses for FY 2010 were \$597.4 million of which \$594.9 million was for governmental activities. As compared to FY 2009, total Department-wide expenses were \$694.0 million of which \$690.8 million was for governmental activities. A portion of the decrease in expenses is also due to the Reduction-in-Force ("RIF") that was implemented in mid-FY 2010 in which the Department lost 314.88 full-time equivalent positions. Overall, the Department is organized into four major administrations.

The Behavioral Health Services Administration expended a significant 35.8% or \$213.7 million of departmental funds with a decrease of \$62.3 million over FY 2009. This administration is responsible for providing available and coordinated mental health and substance abuse treatment and prevention programs. Programs within this administration are:

- Adult Mental Health Division ("AMHD") that includes the Hawaii State Hospital and Community Mental Health Center Branches;
- Child and Adolescent Mental Health Division ("CAMHD") which includes seven Family Guidance Centers and the Family Court Liaison Branches; and
- Alcohol and Drug Abuse Division ("ADAD") which plans for and purchases substance abuse prevention and treatment services for adolescents and adults.

A portion of the decrease in expenditures is attributed to a decrease in the AMHD's client count as well as the implementation of a 14-unit cap in January 2009 on service authorizations per client per month for community-based case management services. The decrease in client count resulted from the change in eligibility criteria and the movement of consumers back to their commercial insurance plans. In FY 2010, AMHD serviced 14,633 clients as compared to the 15,722 clients serviced in FY 2009. AMHD's Access Line continues to provide the community with a resource site for information as well as a referral point for possible clients. CAMHD continues to respond to the ongoing requirements of the settled Felix case, while ADAD is still responsible for implementing the "Ice" (nickname for methamphetamine) initiative.

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The Health Resources Administration expended approximately 47.2% of all expenses. FY 2010 expenditures for this Administration decreased \$29.0 million over FY 2009. Major programs included in this administration include:

- Developmental Disabilities Division (“DDD”) that services disabled clients in Hawaii while addressing the conditions of the Makin Settlement;
- Family Health Services Division (“FHSD”) that administers the State’s Early Intervention program for children zero to three in compliance with the Federal Individual with Disabilities Education Act, Part C as well as serving children, youth and families through its three branches, namely, Children with Special Health Needs, Maternal and Child Health, and Women Infants and Children;
- Community Health Division (“CHD”) that provides Public Health Nursing Services, which in concert with the two programs of the FHSD continues to provide services necessary to meet the requirements of the settled Felix lawsuit, and the chronic disease management and control program;
- Emergency Medical Services and Injury Prevention System Branch that includes the State’s mandated Emergency Medical Services, which operates the State’s emergency ambulance service in the four major counties, and the injury prevention program;
- Tobacco Settlement Project/Healthy Hawaii Initiative (“TSP/HHI”) program which seeks to prevent chronic diseases such as heart disease, cancer and diabetes utilizing tobacco settlement funds for programs that work to decrease tobacco use, improve nutrition and promote physical activities;
- Communicable Disease Division which provides tuberculosis control, Hansen’s disease control programs in the community and at Kalaupapa, and STD/AIDS prevention services;
- Disease Outbreak Control Division which provides immunization and disease investigation services as well as provides emergency response to disease outbreaks and potential acts of bioterrorism;
- Dental Health Division (“DHD”) which is the smallest division in this administration and implements a dental hygiene program in the public schools and provides public health dental services to the State’s disabled clientele.

This administration provides a wide array of public health services in addition to meeting the court settlement conditions, which results in the expenditure of a high percentage of departmental funds. The decrease in expenditures in FY 2010 as compared to FY 2009 resulted primarily from the furlough savings reduction and the fiscal impact of the RIF.

It is noted that as a result of the RIF, the CHD was abolished and its two branches, namely the Public Health Nursing Branch (“PHNB”) and the Chronic Disease Management and Control Branch (“CDMCB”) were transferred to other programs within the Department. PHNB was transferred to the DHD and CDMCB was transferred to the TSP/HHI. The Department is currently working on a reorganization proposal to formally reflect these organizational changes.

The Environmental Health Administration is responsible for the management of the clean air, clean water, solid and hazardous waste, public health sanitation, vector control, and purity of food and drugs. It expended approximately 11.5% of the departmental funds with a decrease of \$7.4 million expended over FY 2009. This decrease in expenditures is mainly due to the public’s decreasing participation in the Deposit Beverage Container Program. This decrease is reflected in the slowdown of redemption rates for recycling beverage containers. In FY 2010, the redemption rate decreased to 76.1% with 686,392,140

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beverage containers redeemed as compared to a 78.7% redemption rate in FY 2009, with 705,156,511 beverage containers redeemed. Other programs in this administration are heavily federally funded through the Environmental Protection Agency. This administration also manages both the Water Pollution Control Revolving and the Drinking Water Treatment Revolving Loan Funds.

Finally, General Administration provides the overall leadership and oversight for the Department. It includes administrative support staff, three district health offices, and five administratively attached agencies. This administration expends approximately 5.8% of the departmental funds.

The following table presents revenues and expenditures of the governmental funds for FY 2010 and FY 2009 (\$000):

	2010	2009
Revenues		
State general fund allotments	\$ 382,030	\$ 441,046
Nonimposed fringe benefits	45,689	53,273
Tobacco settlement funds	50,925	60,109
Deposit beverage container program	18,027	17,789
Intergovernmental	130,034	123,579
Taxes, fees, fines and other	33,782	28,255
Investment income (loss)	9,219	(5,592)
Total revenues	669,706	718,459
Expenditures		
General administration	32,910	31,893
Environmental health	66,236	71,205
Behavioral health	211,548	298,491
Health resources	282,151	283,881
Total expenditures	592,845	685,470
Excess of revenues over expenditures before transfers	\$ 76,861	\$ 32,989

The governmental funds revenue consist of the Department's general fund, tobacco settlement funds, deposit beverage container funds, intergovernmental (federal) funds, taxes, fees, fines and investment income.

During the fiscal year ended June 30, 2010, general fund revenues were \$423.6 million, including \$45.5 million for fringe benefits paid directly from the State general fund. General fund expenditures were \$393.9 million, including the \$45.5 million for fringe benefits discussed above.

For FY 2010, the tobacco settlement fund earned revenues of \$53.7 million, including investment income of \$2.7 million. \$42.0 million was transferred to other State departments and agencies of which \$6.9 million was for the State's Emergency and Budget Reserve Fund (a.k.a. Rainy Day Fund), \$12.9 million was for the University of Hawaii to pay debt service on revenue bonds to support construction of a new health and wellness center, to include a new medical school and bioresearch center in Kakaako, and \$12.5 million was required to be transferred to the State's General Fund in accordance with Act 79/90.

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In FY 2010, the deposit beverage container fund earned \$18.0 million in beverage container deposit administrative fees and unredeemed containers. Of this amount received, \$25.0 million was paid to recycling centers, or utilized to fund the program. The bottle bill fund collected \$49.1 million in deposits from distributors and repaid \$36.3 million in deposits to consumers during FY 2010.

The proprietary funds consist of two funds: Water Pollution Control Revolving Fund and Drinking Water Treatment Revolving Loan Fund and are reported in the statement of net assets and statement of activities as business-type activities.

The Water Pollution Control Revolving Fund accounts for federal and state funds used to provide loans to county governments for the construction of wastewater treatment facilities and the repayment of principal, interest and fees from such loans and investment of such monies. During FY 2010, this fund received \$4.6 million and \$1.0 million of federal and state funds, respectively. The fund also disbursed \$66.6 million in loan proceeds and collected \$22.0 million in principal repayments in 2010. As compared to 2009, the fund collected \$12.1 million and \$1.7 million in federal and state contributions, and disbursed \$76.0 million in loan proceeds and collected \$21.0 million in principal payments.

The Drinking Water Treatment Revolving Loan Fund accounts for federal and state match funds used to provide loans and other types of financial assistance to public water systems for drinking water infrastructure and the repayment of principal interest and fees from such loans and the investment of such monies. During FY 2010, this fund received \$15.3 million and \$1.6 million of federal and state funds, respectively. The fund also disbursed \$18.3 million in loan proceeds and collected \$3.7 million in principal repayments in 2010. As compared to 2009, the fund disbursed \$10.0 million in loan proceeds and collected \$3.1 million in principal payments.

The Department accounts for funds held as an agent and/or trustee for certain individuals in the fiduciary funds.

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Budgetary Analysis

The following budget information relates to the general fund, tobacco settlement fund, and deposit beverage container fund for 2010:

	Budgeted Amounts (\$000)		Actual on a Budgetary Basis (\$000)
	Original	Final	
General fund			
Revenues	\$ 408,217	\$ 408,217	\$ 382,379
Expenditures			
General administration	18,304	18,372	16,952
Environmental health	20,202	20,202	17,058
Behavioral health	195,278	195,278	185,445
Health resources	174,433	174,365	162,925
Tobacco settlement fund			
Revenues	49,016	49,016	51,376
Expenditures	49,016	49,016	41,403
Deposit beverage container fund			
Revenues	71,121	71,121	54,332
Expenditures	71,121	71,121	68,011

The differences between the original budgeted appropriation and actual expenditures for the general fund were due mainly to the furlough savings reductions imposed upon the Department in FY 2010 and the fiscal impact of the RIF.

For the tobacco settlement fund, the actual expenditures of \$41.4 million in FY 2010 were \$10.0 million less than the actual revenues received.

The deposit beverage container program recognized revenues from the program's beverage container deposit administrative fees and unredeemed deposits of \$18.0 million, which is based on the actual number of containers sold. In fiscal year 2009, there were 895,737,097 containers sold. The amount of containers sold increased to 901,861,628 in fiscal year 2010.

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Capital Assets

As of June 30, 2010, the Department's governmental activities had invested approximately \$60.5 million (net of accumulated depreciation) in a broad range of capital assets. See Note 4 to the Department's financial statements for a description of capital assets activities for the fiscal year ended June 30, 2010.

Capital Assets
Governmental Activities
June 30, 2010
(\$000)

	2010	2009
Land	\$ 1,018	\$ 1,018
Land and building improvements	138,828	138,312
Furniture and equipment	<u>22,646</u>	<u>22,272</u>
Total	162,492	161,602
Accumulated depreciation	<u>102,040</u>	<u>97,458</u>
Total capital assets, net	<u>\$ 60,452</u>	<u>\$ 64,144</u>

Currently Known Facts, Decisions, or Conditions

The effects of the slowdown in the State's economy compounded the Department's challenge to continue to provide needed services to ensure the overall health and safety of the people of our state, especially in the areas of mental health and developmental disabilities.

The Department has continued to evaluate and monitor the statewide service delivery system of the adult mental health program in order to improve service delivery and to contain operational costs.

In the developmental disabilities program, the number of clients decreased by 96 clients in FY 2010. In FY 2010, the program served 2,485 clients in the home and community-based waiver program as compared to 2,581 clients served in FY 2009. Further, the Federal Medical Assistance Percentage ("FMAP") decreased from 56.50% to 55.11% effective October 1, 2008. The FMAP was later amended to 66.13% retroactively for the period October 1, 2008 through March 31, 2009. For the period April 1, 2009 through December 31, 2010, the FMAP was increased to 67.35%. The FY 2010 year-end Average Cost per Client ("APC") increased to \$43,267 as compared to the FY 2009 year-end APC of \$41,527. Although the number of clients decreased, the APC increased. Therefore, program management continues to reevaluate the program and its services to achieve operational efficiencies.

And lastly, the Water Pollution Control Revolving Fund ("WPCRF") and the Drinking Water Treatment Revolving Loan Fund ("DWTRLF") executed a total of three loan agreements in the amount of \$20.2 million and three loan agreements for \$11.1 million, respectively, during FY 2010. Also, in FY 2010, the WPCRF executed seven American Recovery and Reinvestment Act ("ARRA") loan agreements in the amount of \$29.8 million and the DWTRLF executed nine loan agreements for \$19.5 million. Further, the WPCRF expects to execute a total of three loan agreements in the amount of \$30.1 million while the DWTRLF expects to execute a total of eight loan agreements for \$12.3 million in FY 2011.

State of Hawaii
Department of Health
Department-wide – Statement of Net Assets
June 30, 2010

	Governmental Activities	Business-Type Activities	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 157,169,188	\$ 124,533,060	\$ 281,702,248
Receivables			
Due from State Treasury	62,882,484	-	62,882,484
Due from other State agencies	5,651,000	-	5,651,000
Accrued interest and loan fees	605,528	3,393,430	3,998,958
Accounts receivable	5,004,091	-	5,004,091
Due from Federal government	4,432,840	80,852	4,513,692
Tobacco settlement receivable	26,900,000	-	26,900,000
Loans maturities of loans receivable	-	29,343,263	29,343,263
	<u>105,475,943</u>	<u>32,817,545</u>	<u>138,293,488</u>
Total current assets	262,645,131	157,350,605	419,995,736
ARRA advances	-	23,692,588	23,692,588
Loans receivable, net of current maturities	-	339,295,109	339,295,109
Capital assets, net of accumulated depreciation	60,452,337	203,247	60,655,584
Total assets	<u>\$ 323,097,468</u>	<u>\$ 520,541,549</u>	<u>\$ 843,639,017</u>
Liabilities and Net Assets			
Current liabilities			
Vouchers and contracts payable	\$ 48,136,984	\$ 80,109	\$ 48,217,093
Accrued wages and employee benefits payable	9,748,250	103,370	9,851,620
Accrued vacation, current portion	9,780,012	78,345	9,858,357
Workers' compensation liability	389,905	-	389,905
Deferred income	413,640	-	413,640
Due to other State agencies	27,219,203	-	27,219,203
Beverage container deposits	22,680,452	-	22,680,452
Total current liabilities	<u>118,368,446</u>	<u>261,824</u>	<u>118,630,270</u>
Accrued vacation, net of current portion	17,270,732	255,236	17,525,968
Other postemployment benefits	-	505,097	505,097
Total liabilities	<u>135,639,178</u>	<u>1,022,157</u>	<u>136,661,335</u>
Commitments and contingencies			
Net assets			
Investment in capital assets	60,452,337	203,247	60,655,584
Restricted for			
Loans	-	519,316,145	519,316,145
Tobacco prevention and control	27,378,596	-	27,378,596
Capital projects	8,225,307	-	8,225,307
Other purposes	89,109,909	-	89,109,909
Unrestricted	<u>2,292,141</u>	<u>-</u>	<u>2,292,141</u>
Total net assets	<u>187,458,290</u>	<u>519,519,392</u>	<u>706,977,682</u>
Total liabilities and net assets	<u>\$ 323,097,468</u>	<u>\$ 520,541,549</u>	<u>\$ 843,639,017</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Department-wide – Statement of Activities
Year Ended June 30, 2010

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Primary government						
Governmental activities						
General administration	\$ 34,594,104	\$ 266,600	\$ 11,569,870	\$ (22,757,634)	-	\$ (22,757,634)
Environmental health administration	66,006,693	3,536,919	13,985,730	(48,484,044)	-	(48,484,044)
Behavioral health services administration	213,744,613	23,042,557	20,580,112	(170,121,944)	-	(170,121,944)
Health resources administration	280,521,370	16,824,338	61,546,374	(202,150,658)	-	(202,150,658)
Total governmental activities	594,866,780	43,670,414	107,682,086	(443,514,280)	-	(443,514,280)
Business-type activities						
Environmental health loan programs	2,572,345	7,323,173	54,964,212	-	59,715,040	59,715,040
Total business-type activities	2,572,345	7,323,173	54,964,212	-	59,715,040	59,715,040
Total primary government	\$ 597,439,125	\$ 50,993,587	\$ 162,646,298	(443,514,280)	59,715,040	(383,799,240)
General revenues						
State general fund allotments, net				382,030,576	-	382,030,576
Nonimposed employee fringe benefits				45,688,592	-	45,688,592
Environmental response tax				1,569,541	-	1,569,541
Deposit beverage container fee				18,027,423	-	18,027,423
Advance glass disposal fee				701,607	-	701,607
Tobacco tax				18,032,282	-	18,032,282
Tobacco settlement funds				50,924,814	-	50,924,814
Transfers				(54,515,948)	2,675,000	(51,840,948)
Total general revenues and transfers				462,458,887	2,675,000	465,133,887
Change in net assets				18,944,607	62,390,040	81,334,647
Net assets at July 1, 2009				168,513,683	457,129,352	625,643,035
Net assets at June 30, 2010				\$ 187,458,290	\$ 519,519,392	\$ 706,977,682

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Governmental Funds – Balance Sheet
June 30, 2010

	General	Tobacco Settlement	Deposit Beverage Container	Other Funds	Total Governmental
Assets					
Equity in cash and cash equivalents and investments in State Treasury	\$ -	\$ 38,554,619	\$ 31,978,605	\$ 86,635,964	\$ 157,169,188
Due from State Treasury	54,657,177	-	-	8,225,307	62,882,484
Due from other State agencies	-	-	-	2,553,000	2,553,000
Internal balances	-	-	-	-	-
Accrued interest receivable	-	-	-	155,243	155,243
Accounts receivable	-	-	5,004,091	-	5,004,091
Due from Federal government	-	-	-	4,432,840	4,432,840
Total assets	<u>\$ 54,657,177</u>	<u>\$ 38,554,619</u>	<u>\$ 36,982,696</u>	<u>\$ 102,002,354</u>	<u>\$ 232,196,846</u>
Liabilities and Fund Balances					
Liabilities					
Vouchers and contracts payable	\$ 22,332,483	\$ 3,971,922	\$ 8,166,950	\$ 11,917,129	\$ 46,388,484
Accrued wages and employee benefits	7,268,285	133,539	35,978	2,310,448	9,748,250
Deferred income	-	-	-	413,640	413,640
Due to State of Hawaii	-	-	-	-	-
Due to other State agencies	1,722,141	4,380,562	-	-	6,102,703
Beverage container deposits	-	-	22,680,452	-	22,680,452
Total liabilities	<u>31,322,909</u>	<u>8,486,023</u>	<u>30,883,380</u>	<u>14,641,217</u>	<u>85,333,529</u>
Fund balance (deficit)					
Reserved for encumbrances	35,193,156	8,214,360	11,253,848	50,496,319	105,157,683
Unreserved, reported in					
General fund	(11,858,888)	-	-	-	(11,858,888)
Tobacco settlement fund	-	21,854,236	-	-	21,854,236
Deposit beverage container fund	-	-	(5,154,532)	-	(5,154,532)
Special revenue funds	-	-	-	36,864,818	36,864,818
Total fund balance	<u>23,334,268</u>	<u>30,068,596</u>	<u>6,099,316</u>	<u>87,361,137</u>	<u>146,863,317</u>
Total liabilities and fund balance	<u>\$ 54,657,177</u>	<u>\$ 38,554,619</u>	<u>\$ 36,982,696</u>	<u>\$ 102,002,354</u>	<u>\$ 232,196,846</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Reconciliation of the Governmental Funds' Fund Balance to the
Governmental Activities' Net Assets
June 30, 2010

Total fund balance – governmental funds	\$ 146,863,317
Amounts reported for governmental activities in the statement of net assets are different because	
Tobacco settlement receivable (net of vouchers payable and Due to State of Hawaii amounts) is not available for current financial resources and therefore is not reported as an asset in the governmental funds.	4,035,000
Capital assets used in governmental activities are not financial resources and therefore not reported as an asset in the governmental funds.	60,452,337
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds.	(27,050,744)
Workers' compensation liability reported in the statement of net assets does not require the use of current financial resources and therefore is not reported as a liability in the governmental funds.	(389,905)
Receivables from other State agencies are not available to pay for current-period expenditures and therefore are not reported as an asset in the governmental funds.	3,548,285
Net assets of governmental activities	<u>\$ 187,458,290</u>

The accompanying notes are an integral part of this statement.

**State of Hawaii
Department of Health
Governmental Funds – Statement of Revenues, Expenditures and Changes in Fund Balance
Year Ended June 30, 2010**

	General	Tobacco Settlement	Deposit Beverage Container	Other Funds	Total
Revenues					
State allotment, net	\$ 378,105,576	\$ -	\$ -	\$ 3,925,000	\$ 382,030,576
Intergovernmental	-	-	-	130,034,000	130,034,000
Tobacco settlement	-	50,924,814	-	-	50,924,814
Deposit beverage container program	-	-	18,027,423	-	18,027,423
Nonimposed employee fringe benefits	45,521,327	-	-	167,265	45,688,592
Taxes, fees, fines and other	-	-	-	33,781,985	33,781,985
Investment income	-	2,731,858	2,302,092	4,185,085	9,219,035
Total revenues	423,626,903	53,656,672	20,329,515	172,093,335	669,706,425
Expenditures					
General administration	20,187,937	-	-	12,722,511	32,910,448
Environmental health	21,498,273	-	25,019,502	19,717,864	66,235,639
Behavioral health services	189,279,939	-	-	22,268,220	211,548,159
Health resources	162,971,668	12,484,045	-	106,695,680	282,151,393
Total expenditures	393,937,817	12,484,045	25,019,502	161,404,275	592,845,639
Excess (deficiency) of revenues over expenditures	29,689,086	41,172,627	(4,689,987)	10,689,060	76,860,786
Other financing sources (uses)					
Transfers in	1,755,142	58,800	-	24,438,630	26,252,572
Transfers out	(10,665,434)	(42,065,553)	-	(21,888,330)	(74,619,317)
Total other financing sources (uses)	(8,910,292)	(42,006,753)	-	2,550,300	(48,366,745)
Net change in fund balance	20,778,794	(834,126)	(4,689,987)	13,239,360	28,494,041
Fund balance at July 1, 2009	2,555,474	30,902,722	10,789,303	74,121,777	118,369,276
Fund balance at June 30, 2010	\$ 23,334,268	\$ 30,068,596	\$ 6,099,316	\$ 87,361,137	\$ 146,863,317

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Reconciliation of the Governmental Funds' Changes in Fund Balance to the
Governmental Activities' Change in Net Assets
Year Ended June 30, 2010

Net change in fund balance – total governmental funds	\$ 28,494,041
Amounts reported for governmental activities in the statement of activities are different because	
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays for the year.	(3,691,378)
Increase in compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds.	(30,394)
Decrease in the noncurrent portion of workers' compensation liability reported in the statement of activities do not require the use of current financials resources and therefore is not reported as an expenditure in the governmental funds.	13,853
Tobacco settlement fund portion of the receivable to be allocated to different agencies	(2,690,000)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the governmental funds.	<u>(3,151,515)</u>
Change in net assets of governmental activities	<u>\$ 18,944,607</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
General Fund – Budgetary Comparison Statement
Year Ended June 30, 2010

	Budgeted Amounts		Actual Amounts (Budgetary Basis)
	Original	Final	
Revenues			
Current-year appropriations	\$ 408,217,068	\$ 408,217,068	\$ 382,379,279
Total revenues	408,217,068	408,217,068	382,379,279
Expenditures			
General administration	18,303,691	18,372,140	16,951,895
Environmental health administration	20,202,376	20,202,376	17,057,762
Behavioral health services administration	195,277,543	195,277,543	185,445,052
Health resources administration	174,433,458	174,365,009	162,924,570
Total expenditures	408,217,068	408,217,068	382,379,279
Excess of revenues over expenditures	\$ -	\$ -	\$ -

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Tobacco Settlement Fund – Budgetary Comparison Statement
Year Ended June 30, 2010

	Budgeted Amounts		Actual Amounts (Budgetary Basis)
	Original	Final	
Revenues			
Current-year funds	\$ 49,016,207	\$ 49,016,207	\$ 51,375,915
Total revenues	49,016,207	49,016,207	51,375,915
Expenditures			
Health resources administration	49,016,207	49,016,207	41,403,253
Total expenditures	49,016,207	49,016,207	41,403,253
Excess of revenues over expenditures	\$ -	\$ -	\$ 9,972,662

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Deposit Beverage Container Fund – Budgetary Comparison Statement
Year Ended June 30, 2010

	<u>Budgeted Amounts</u>		<u>Actual Amounts (Budgetary Basis)</u>
	<u>Original</u>	<u>Final</u>	
Revenues			
Current-year funds	<u>\$ 71,120,933</u>	<u>\$ 71,120,933</u>	<u>\$ 54,331,933</u>
Total revenues	<u>71,120,933</u>	<u>71,120,933</u>	<u>54,331,933</u>
Expenditures			
Environmental health administration	<u>71,120,933</u>	<u>71,120,933</u>	<u>68,011,226</u>
Total expenditures	<u>71,120,933</u>	<u>71,120,933</u>	<u>68,011,226</u>
Excess of expenditures over revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (13,679,293)</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Proprietary Funds – Statement of Net Assets
June 30, 2010

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 94,642,007	\$ 29,891,053	\$ 124,533,060
Loan fees receivable	420,309	659,922	1,080,231
Accrued interest receivable	738,920	69,986	808,906
Other accrued interest	1,227,258	277,035	1,504,293
Due from federal government	-	80,852	80,852
Current portion of loans receivable	24,937,628	4,405,635	29,343,263
Total current assets	121,966,122	35,384,483	157,350,605
ARRA advances	12,776,428	10,916,160	23,692,588
Loans receivable, net of current portion	272,590,066	66,705,043	339,295,109
Capital assets, net of accumulated depreciation, at cost	-	203,247	203,247
Total assets	<u>\$ 407,332,616</u>	<u>\$ 113,208,933</u>	<u>\$ 520,541,549</u>
Liabilities			
Current liabilities			
Accounts payable and other accrued liabilities	\$ 124,562	\$ 137,262	\$ 261,824
Total current liabilities	124,562	137,262	261,824
Accrued vacation, net of current portion	213,577	41,659	255,236
Other postemployment benefits	391,882	113,215	505,097
Total liabilities	730,021	292,136	1,022,157
Net Assets			
Invested in capital assets	-	203,247	203,247
Restricted – expendable	406,602,595	112,713,550	519,316,145
Total net assets	<u>406,602,595</u>	<u>112,916,797</u>	<u>519,519,392</u>
Total liabilities and net assets	<u>\$ 407,332,616</u>	<u>\$ 113,208,933</u>	<u>\$ 520,541,549</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Proprietary Funds – Statement of Revenues, Expenses and
Changes in Fund Net Assets
Year Ended June 30, 2010

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Operating revenues			
Interest income from loans	\$ 3,204,496	\$ 261,896	\$ 3,466,392
Administrative loan fee	1,761,314	2,095,467	3,856,781
Total revenues	4,965,810	2,357,363	7,323,173
Expenses			
Administrative	1,553,573	431,954	1,985,527
State program management	-	273,631	273,631
Water protection	-	102,958	102,958
Small systems	-	210,229	210,229
Total expenses	1,553,573	1,018,772	2,572,345
Operating income	3,412,237	1,338,591	4,750,828
Nonoperating revenues and expenses			
State contributions	1,045,000	1,630,000	2,675,000
Federal contributions	4,587,187	15,324,872	19,912,059
Federal ARRA contributions	12,867,564	10,916,160	23,783,724
Other interest income	9,761,618	1,506,811	11,268,429
Total nonoperating revenues and expenses	28,261,369	29,377,843	57,639,212
Change in net assets	31,673,606	30,716,434	62,390,040
Net assets			
Beginning of year	374,928,989	82,200,363	457,129,352
End of year	\$ 406,602,595	\$ 112,916,797	\$ 519,519,392

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Proprietary Funds – Statement of Cash Flows
Year Ended June 30, 2010

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Cash flows from operating activities			
Interest income from loans	\$ 3,230,084	\$ 248,275	\$ 3,478,359
Administrative loan fees	1,741,163	1,966,200	3,707,363
Principal repayments on loans	21,999,439	3,746,720	25,746,159
Disbursement of loan proceeds	(66,569,189)	(18,338,015)	(84,907,204)
Payments to employees	(1,328,020)	(396,939)	(1,724,959)
Payments rendered by other State agencies	-	(40,990)	(40,990)
Payments to vendors	(117,258)	(501,098)	(618,356)
Net cash used in operating activities	(41,043,781)	(13,315,847)	(54,359,628)
Cash flows from noncapital financing activities			
State contributions	1,045,000	1,630,000	2,675,000
Federal contributions	4,587,187	15,264,698	19,851,885
Federal ARRA contributions	12,867,564	10,916,160	23,783,724
Disbursement of ARRA advances	(12,776,428)	(10,916,160)	(23,692,588)
Net cash provided by noncapital financing activities	5,723,323	16,894,698	22,618,021
Cash flows from investing activities			
Other interest income	9,794,718	1,449,677	11,244,395
Net cash provided by investing activities	9,794,718	1,449,677	11,244,395
Net increase (decrease) in cash	(25,525,740)	5,028,528	(20,497,212)
Equity in cash and cash equivalents and investments in State Treasury			
Beginning of year	120,167,747	24,862,525	145,030,272
End of year	\$ 94,642,007	\$ 29,891,053	\$ 124,533,060

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Proprietary Funds – Statement of Cash Flows
Year Ended June 30, 2010

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Reconciliation of operating income to net cash used in operating activities			
Operating income	\$ 3,412,237	\$ 1,338,591	\$ 4,750,828
Adjustments to reconcile operating income to net cash used in operating activities			
Depreciation expense	-	69,119	69,119
Change in assets and liabilities			
Loan fees receivable	(20,150)	(129,267)	(149,417)
Accrued interest on loans receivables	25,588	(13,620)	11,968
Loans receivable	(44,569,750)	(14,591,295)	(59,161,045)
Accounts payable and other accrued liabilities	8,189	(18,329)	(10,140)
Other postemployment benefits	100,105	28,954	129,059
	<u>100,105</u>	<u>28,954</u>	<u>129,059</u>
Net cash used in operating activities	<u>\$ (41,043,781)</u>	<u>\$ (13,315,847)</u>	<u>\$ (54,359,628)</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Fiduciary Funds – Statement of Fiduciary Net Assets
June 30, 2010

	Agency Funds
Assets	
Cash and cash equivalents	\$ 449,390
Total assets	<u>\$ 449,390</u>
Liabilities	
Due to others	\$ 449,390
Total liabilities	<u>\$ 449,390</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Health
Notes to Financial Statements
June 30, 2010

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawaii, Department of Health (the "Department"), administers and oversees statewide personal health services, health promotion and disease prevention, mental health programs, monitoring of the environment, and the enforcement of environmental health laws. Federal grants received to support the State's health services and programs are administered by the Department.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") prescribed by the Governmental Accounting Standards Board ("GASB").

The Department is part of the executive branch of the State of Hawaii (the "State"). The financial statements of the Department are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2010, and the changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America. The State Comptroller maintains the central accounts for all State funds and publishes a comprehensive annual financial report for the State annually, which includes the Department's financial activities.

Act 262, Session Laws of Hawaii of 1996, established the Hawaii Health Systems Corporation ("HHSC") as a public body corporate and politic and an instrumentality and agency of the State. HHSC consists of the state hospitals and was created to provide quality health care for all of the people in the state. HHSC commenced operations on July 1, 1996 and is administratively attached to the Department. However, HHSC is a component unit of the State and not the Department. HHSC's stand-alone financial statements are included in the State's comprehensive annual financial report but are not included in the Department's basic financial statements.

Department-wide Financial Statements

The Department-wide statements of net assets and activities are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Certain eliminations have been made as prescribed by GASB Statement No. 34 related to interfund activities, receivables, and payables. All internal balances have been eliminated except those representing balances between governmental and business-type activities, which are presented as internal balances and eliminated in the total department column when applicable. In the statement of activities, those transactions between governmental and business-type activities have not been eliminated. In addition, the fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

State of Hawaii
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Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments are recorded only when payment is due.

The proprietary and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the department-wide financial statements described above.

The Department has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, to elect to apply all Financial Accounting Standards Board ("FASB") pronouncements issued after November 30, 1989, unless the FASB statements conflict with GASB pronouncements. The Department's enterprise funds have elected not to apply FASB statements after the applicable date.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

A description of the funds administered by the Department is as follows:

Governmental Funds (Governmental Activities):

- *General Fund* – The General Fund is the general operating fund of the Department. It is used to account for all financial resources 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 to only those appropriations and obligations of the Department.
- *Special Revenue Funds* – Special revenue funds are used to account for the proceeds of specific revenue sources (other than major capital projects) 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 (other than those financed by proprietary fund type) and are included in Other Funds in the fund financial statements.

Proprietary Funds (Business-Type Activities):

- *Enterprise Funds* – Enterprise funds are used to account for the activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to customers, or where sound financial management dictates that periodic determination of results of operations are appropriate.

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Fiduciary Funds:

- *Agency Funds* – Agency funds are used to account for cash collected and disbursed by the Department in a custodial capacity.

Equity in Cash and Cash Equivalents and Investments in State Treasury

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

The State requires that depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("Statement No. 40"), requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit, and custodial risk assumed by the Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit, and custodial risks are not determinable at the department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") which may be obtained from the Department of Accounting and General Services' ("DAGS") website:
<http://hawaii.gov/dags/rpts>.

In March 2011, DAGS issued guidance informing State agencies participating in the State Treasury Investment Pool that the change in the fair value of the auction rate securities resulted in a gain for the year ended June 30, 2010 and that each participating State agency would be allocated a portion of the gain. The Department's total allocated gain for fiscal 2010 amounted to \$16,901,186.

Due from State Treasury

The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as Due from State Treasury in the accompanying fund and department-wide financial statements.

Due from Other State Agencies

Receivables due from other State agencies consist of reimbursements from the Department of Human Services ("DHS") for Medicaid payments that the Department makes to providers of health services. The Department is responsible to pay the State portion of the Medicaid claims, and DHS reimburses the Department for the Federal portion of the claims. The receivable of \$5.8 million is comprised of various Medicaid rehabilitation option claims.

Payments made to providers and received from DHS for the Federal portion of the Medicaid claims are classified as transfers out and transfers in, respectively, for financial statement purposes.

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Tobacco Settlement

In November 1998, the State settled its tobacco lawsuit as part of a nationwide settlement involving 46 other states and various tobacco industry defendants. Under the settlement, those tobacco companies that have joined in the Master Settlement Agreement will pay the State approximately \$1.3 billion over a 25-year period. The Department is responsible for administering the Hawaii Tobacco Settlement Special Fund. The Department receives all tobacco settlement monies and then allocates and appropriates 85% of the funds to other State agencies and other entities in accordance with Hawaii Revised Statutes (“HRS”) 328L-2. The Department receives annual payments on April 15 of each year for tobacco settlements earned for the preceding calendar year.

The Department received approximately \$50,900,000 in tobacco settlement proceeds during the year ended June 30, 2010 for the calendar year ended December 31, 2010. In accordance with GASB Technical Bulletin No. 04-01, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, the Department has recorded a tobacco settlement receivable for \$26,900,000 in the statement of net assets representing tobacco settlements earned for the period January 1, 2010 through June 30, 2010.

ARRA Advances

The proprietary funds received American Recovery and Reinvestment Act (“ARRA”) stimulus money that was used to provide construction grants with no interest or loan fees and 100% principal forgiveness upon completion of approved projects. The proprietary funds are allowed to use a portion of the ARRA funds for specified purposes as set forth in the grant. ARRA funds provided to counties have been classified as “ARRA Advances” on the Statement of Net Assets upon disbursement. The ARRA advances will be completely forgiven and expensed once all the conditions and compliance requirements have been satisfied by the counties. If conditions and compliance requirements are not met, the grants will convert to loans, requiring repayment of principal, interest and loan fees.

Loans Receivable

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

Administrative Loan Fees

The Department has implemented an administrative loan fee program to pay for the proprietary fund’s administration, including employee salaries and benefits. The proprietary funds apply an administrative fee to all loans as provided for in Chapter 11-65 of the Hawaii Administrative Rules.

Capital Assets

Capital assets, which include buildings, furniture, and equipment, are reported in the applicable governmental or business-type activities in the department-wide financial statements and in the proprietary funds’ financial statements. Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

Land	All capitalized
Land improvements	\$100,000
Building and building improvements	\$100,000
Furniture and equipment	\$5,000

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Such assets are recorded at historical cost if purchased or constructed. Donated assets are recorded at estimated fair value at the time received. Depreciation expense is recorded in the department-wide financial statements using the straight-line method over the estimated useful lives of the assets. Generally, the useful lives are as follows:

	Governmental- Type Activities	Business- Type Activities
Land improvements	15	Not applicable
Building and building improvements	30	Not applicable
Furniture and equipment	5–7	5–7

Deferred Income

Deferred income at the fund level and department-wide level arise when the Department receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the Department has a legal claim to the resources, the liability for deferred income is removed from the statement of net assets and balance sheet, and revenue is recognized. Deferred income at June 30, 2010 consisted primarily of Federal grant funds for which all eligibility requirements had not yet been met.

Due to Other State Agencies

Payables to other State agencies consist of reimbursements to DHS for the State portion of the Medicaid claims for the Developmental Disabilities program and 85% of funds allocated to other State agencies in accordance with the Hawaii Tobacco Settlement Special Fund. The State portion of the Medicaid claims for the Development Disabilities program is \$2.0 million and the amount allocated to other funds in accordance with the Hawaii Tobacco Settlement Special Fund is \$24.7 million.

Beverage Container Deposits

Deposits of \$0.05 are made by distributors to the deposit beverage container fund for each qualifying container. The deposit beverage container fund maintains all deposits until the recycling centers claim reimbursement for the deposits that they pay out to the consumers. The deposit beverage container fund maintains the deposits that are expected to be redeemed.

Amounts paid out to the consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e., aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management estimates, based on past collections and success of recycling in other states, that 80% of the containers will be recycled every year. The remaining 20% of the containers are expected to be unredeemed; therefore, 20% of the deposits collected are recognized into revenue each year.

Accrued Vacation

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet.

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Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the State's Employees' Retirement System ("ERS"). At June 30, 2010, accumulated sick leave was approximately \$66,800,000.

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 are recorded as operating transfers in the basic financial statements.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reserved for Encumbrances

Encumbrance accounting, under which purchase orders and contractual commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed in the governmental funds. Although appropriations generally lapse at year end, open encumbrances are reported as reservations of fund balances because the commitments will be honored when the goods or services are received. Encumbrances do not constitute expenditures or liabilities.

Use of Restricted and Unrestricted Net Assets

When an expense is incurred for which both restricted and unrestricted net assets are available, the Department's policy is to apply restricted net assets first.

New Accounting Pronouncements

In March 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement provides clearer fund balance classifications that can be more consistently applied and clarifies the existing governmental fund type definitions. This Statement also establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds and provides for additional classifications such as restricted, committed, assigned, and unassigned fund balance. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2010. Management does not expect this Statement to have a material effect on the Department's financial statements.

In January 2011, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management does not expect that this Statement will have a material effect on the Fund's financial statements.

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2. Budgeting and Budgetary Control

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

- *The Budget* – Not less than 20 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 recommendation of the Governor for the 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 analysis of programs and finances as will 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.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

Budgets are adopted for the General Fund of the Department and are prepared on the basis of cash receipts and amounts disbursed, which is a basis of accounting other than GAAP.

The major differences between the budgetary and GAAP basis are that: (1) the budget is prepared on the basis of cash receipts and amounts disbursed; and (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis.

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Since budgetary basis differs from GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures on a budgetary basis at June 30, 2010, to revenues in excess of (less than) expenditures presented in conformity with GAAP follows:

	General Fund	Tobacco Settlement Fund	Deposit Beverage Container Fund
Excess of revenues over expenditures (expenditures over revenues) – actual on a budgetary basis	\$ -	\$ 9,972,662	\$ (13,679,293)
Reserve for encumbrances at year end	35,193,156	8,214,360	11,253,848
Expenditures for liquidation of prior year's encumbrances	(37,895,698)	(13,706,805)	(8,654,076)
Accruals and other adjustments	<u>32,391,628</u>	<u>36,692,410</u>	<u>6,389,534</u>
Excess of revenues over expenditures (expenditures over revenues) – GAAP basis	<u>\$ 29,689,086</u>	<u>\$ 41,172,627</u>	<u>\$ (4,689,987)</u>

3. Loans Receivable

At June 30, 2010, the proprietary funds loans receivable consisted of loans to county governmental units for the water pollution control and drinking water treatment programs. The loans require annual, semi-annual or quarterly payments, including interest at 0.00% to 3.02%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion. Accrued interest receivable on the loans amounted to approximately \$809,000 at June 30, 2010.

The following is a schedule of principal payments due on loans for projects completed or in progress as of June 30, 2010:

Year ending June 30,	
2011	\$ 29,343,263
2012	29,844,991
2013	30,251,865
2014	27,773,351
2015	24,084,950
Thereafter	<u>227,339,952</u>
	<u>\$ 368,638,372</u>

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4. Capital Assets

Capital asset activity for the year ended June 30, 2010 was as follows:

	Beginning Balance	Additions	Dispositions	Ending Balance
Governmental activities				
Capital assets, not being depreciated				
Land	\$ 1,018,080	\$ -	\$ -	\$ 1,018,080
Total capital assets not being depreciated	1,018,080	-	-	1,018,080
Capital assets, being depreciated				
Land improvements	1,862,927	-	-	1,862,927
Building and building improvements	136,448,787	516,445	-	136,965,232
Furniture and equipment	22,272,417	1,427,155	(1,053,420)	22,646,152
Total capital assets being depreciated	160,584,131	1,943,600	(1,053,420)	161,474,311
Less: Accumulated depreciation				
Land improvements	1,858,757	4,170	-	1,862,927
Building and building improvements	80,550,663	4,107,129	-	84,657,792
Furniture and equipment	15,049,076	1,512,152	(1,041,893)	15,519,335
Total accumulated depreciation	97,458,496	5,623,451	(1,041,893)	102,040,054
Governmental activities capital assets, net	<u>\$ 64,143,715</u>	<u>\$ (3,679,851)</u>	<u>\$ (11,527)</u>	<u>\$ 60,452,337</u>
Business-type activities				
Capital assets being depreciated				
Furniture and equipment	\$ 1,157,304	\$ -	\$ (23,554)	\$ 1,133,750
Total capital assets being depreciated	1,157,304	-	(23,554)	1,133,750
Less: Accumulated depreciation for equipment	884,938	69,119	(23,554)	930,503
Total accumulated depreciation	884,938	69,119	(23,554)	930,503
Business-type activities capital assets, net	<u>\$ 272,366</u>	<u>\$ (69,119)</u>	<u>\$ -</u>	<u>\$ 203,247</u>

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Current period depreciation expense was charged to functions as follows:

Governmental activities	
General administration	\$ 635,082
Environmental health	596,613
Behavioral health	1,739,811
Health resources	2,651,945
Total depreciation expense – governmental activities	<u>\$ 5,623,451</u>
 Business-type activities	
Environmental health	\$ 69,119
Total depreciation expense – business-type activities	<u>\$ 69,119</u>

5. Accrued Vacation

The changes to the accrued vacation liability during 2010 were as follows:

	Governmental Activities	Business-Type Activities
Balance at July 1, 2010	\$ 27,306,754	\$ 286,404
Increase	13,060,787	137,615
Decrease	<u>(13,316,797)</u>	<u>(90,438)</u>
Balance at June 30, 2010	27,050,744	333,581
Less: Current portion	<u>9,780,012</u>	<u>78,345</u>
Noncurrent portion	<u>\$ 17,270,732</u>	<u>\$ 255,236</u>

6. Beverage Container Deposits

The changes to the beverage container deposit liability during 2010 were as follows:

Balance at July 1, 2009	\$ 19,685,339
Increase: Deposits received from distributor	49,185,256
Decrease: Payments made to recycling centers, net of refunds	(36,353,092)
Decrease: Unredeemed deposits recognized as revenues	<u>(9,837,051)</u>
Balance at June 30, 2010	<u>\$ 22,680,452</u>

7. Non-Imposed Employee Fringe Benefits

Non-imposed employee fringe benefits related to general and State special fund salaries are funded by the State. These costs, totaling approximately \$45,700,000 for the fiscal year ended June 30, 2010, have been reported as revenues and expenditures of the Department's general and State special revenue fund.

Payroll fringe benefit costs related to Federally-funded salaries are not funded by the State and are recorded as expenditures in the Federal special revenue fund.

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8. Employee Benefit Plans

Substantially all employees of the Fund participate in the State's various employee benefit plans, including the ERS, post-employment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans, refer to the State ERS' CAFR. The State's CAFR can be found on the DAGS website. The ERS CAFR can be found at the ERS website: <http://www4.hawaii.gov/ers/default.htm>.

Employees' Retirement System

The ERS is a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

Post-Employment Healthcare and Life Insurance Benefits

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

State Policy

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

Annual OPEB Cost

The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the Department's two proprietary funds. The following table shows the allocated annual OPEB cost that has been allocated to the two proprietary funds of the Department for the year ended June 30, 2010:

	Water Pollution Control Revolving Fund	Drinking Water Treatment Revolving Loan Fund	Total
Annual OPEB cost	\$ 164,561	\$ 47,597	\$ 212,158
Less: contributions made	<u>(64,456)</u>	<u>(18,643)</u>	<u>(83,099)</u>
Increase in net OPEB obligation	100,105	28,954	129,059
Net OPEB obligation, beginning of year	<u>291,777</u>	<u>84,261</u>	<u>376,038</u>
Net OPEB obligation, end of year	<u>\$ 391,882</u>	<u>\$ 113,215</u>	<u>\$ 505,097</u>

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years June 30, 2010, 2009, and 2008 were approximately \$2,330,000, \$2,751,000, and \$2,915,000.

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Required Supplementary Information and Disclosures

The State's CAFR includes the required footnote disclosures and supplementary information on the State's OPEB plan.

Deferred Compensation Plan

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

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

9. Commitments and Contingencies

Operating Leases

The Department leases various office facilities and equipment through fiscal year 2016 on a long-term basis as provided for in the lease agreements. The following is a schedule of minimum future rent payments on noncancelable operating leases at June 30, 2010:

Year ending June 30,	
2011	\$ 640,100
2012	273,000
2013	130,700
2014	128,900
2015	67,900
Thereafter	51,000
	<hr/>
	\$ 1,291,600

Rent expenditures for the fiscal year ended June 30, 2010 approximated \$2,400,000.

Insurance Coverage

The State maintains certain insurance coverage 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 records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2010, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation expense for the year ended June 30, 2010 was approximately \$274,000

Litigation

The Department is a party to various legal proceedings, 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.

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Ceded Lands

The Office of Hawaiian Affairs (“OHA”) and the State are involved in litigation regarding the State’s alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands. The ultimate outcome of this matter is still unknown. Full discussion of this matter and other legal matters between OHA and the State are disclosed in the State’s CAFR.

**Schedule of
Expenditures of Federal Awards**

State of Hawaii
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Schedule of Expenditures of Federal Awards
Year Ended June 30, 2010

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
U.S. Department of Health and Human Services ("DHHS")				
Direct Programs				
Special Programs for Aging – Title VII Chapter 3	468	93.041	\$ 40,121	\$ -
Special Programs for Aging – Title VII Chapter 2	468	93.042	114,272	-
Special Programs for Aging – Title III Part D	401	93.043	83,587	83,587
Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers	401	93.044	1,802,451	1,783,775
Special Programs for Aging – Title III Part C – Nutrition Services	401	93.045	2,937,981	2,561,102
Nutrition Services Incentive Program	406	93.053	395,460	395,460
ARRA – Aging Home-Delivered Nutrition Services for States	586	93.705	92,396	92,396
ARRA – Aging Congregate Nutrition Services for States	489	93.707	186,677	186,677
Subtotal Aging Cluster			5,414,965	5,019,410 *
Special Programs for Aging – Title IV and Title II – Discretionary Projects	various	93.048	460,238	307,534
National Family Caregiver Support, Title III, Part E	401	93.052	710,260	710,260
Public Health Emergency Preparedness	various	93.069	13,674,219	4,783,715
Environmental Public Health and Emergency Response	444, 472	93.070	333,711	233,886
Emergency System for Advance Registration of Volunteer Health Professionals	588	93.089	3,500	-
Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances ("SED")	229, 589	93.104	437,803	-
Maternal and Child Health Federal Consolidated Programs	various	93.110	517,868	300,564
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	247	93.116	721,517	-
Emergency Medical Services for Children	388	93.127	41,455	-
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	298	93.130	138,700	36,704
Injury Prevention and Control Research and State and Community Based Programs	343, 278	93.136	279,505	84,072
Projects for Assistance in Transition from Homelessness ("PATH")	various	93.150	353,683	195,022
Hansen's Disease National Ambulatory Care Program	264	93.215	667,617	-
Family Planning – Services	239	93.217	2,727,140	2,226,977
Traumatic Brain Injury State Demonstration Grant Program	434	93.234	96,000	-
Abstinence Education Program	273	93.235	112,043	109,900
State Rural Hospital Flexibility Program	410, 415	93.241	2,006,283	-
Substance Abuse and Mental Health Services – Projects of Regional and National Significance	various	93.243	3,716,325	1,882,046 *
Universal Newborn Hearing Screening	416	93.251	172,910	15,188
State Health Access Program	437	93.256	71,342	-
Immunization Grants	457	93.268	13,665,306	10,638,932
ARRA – Immunization	579	93.712	279,935	-
Subtotal Immunization Cluster			13,945,241	10,638,932 *
Substance Abuse and Mental Health Services – Access to Recovery Centers for Disease Control and Prevention – Investigations and Technical Assistance	various	93.283	2,763,152	618,611
Small Rural Hospital Improvement Grant Program	454	93.301	49,698	49,698
Community-Based Child Abuse Prevention Grants	270	93.590	336,771	258,756
Development Disabilities Basic Support and Advocacy Grants	240	93.630	360,358	-
Child Abuse and Neglect Discretionary Activities	274	93.670	137,290	7,682
ARRA – Preventing Healthcare – Associated Infections	582	93.717	18,892	-
ARRA – Prevention and Wellness – State, Territories and Pacific Islands	594	93.723	1,292	-
ARRA – Prevention and Wellness – Communities Putting Prevention to Work				
Funding Opportunities Announcement ("FOA")	595	93.724	12,481	-
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	various	93.777	1,608,900	-
Centers for Medicare and Medicaid Services Research, Demonstrations and Evaluations	403, 590	93.779	224,233	10,956
National Bioterrorism Hospital Preparedness Program	435, 564	93.889	3,976,788	2,760,652 *
Grants to States for Operation of Offices of Rural Health	299	93.913	123,617	-
HIV Care Formula Grants	293	93.917	3,291,135	- *
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Early Detection Programs	448	93.919	1,094,825	1,007,437

* Denotes Major Federal Program

**State of Hawaii
Department of Health
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2010**

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
Healthy Start Initiative	286	93.926	972,768	754,176
Special Projects of National Significance	269	93.928	55,000	-
HIV Prevention Activities – Health Department Based	266	93.940	2,011,507	-
HIV / AIDS Surveillance	272	93.944	187,182	-
Cooperative Agreements to Support State-Based Safe Motherhood and Infant Health Initiative Programs	319	93.946	162,585	-
Block Grants for Community Mental Health Services	various	93.958	1,810,730	875,782
Substance Abuse Prevention and Treatment Block Grants	various	93.959	7,141,606	5,944,518 *
Preventive Health Services – Sexually Transmitted Diseases Control Grants	268	93.977	341,750	-
Mental Health Disaster Assistance and Emergency Mental Health	358, 390	93.982	99,930	87,953
Preventive Health and Health Services Block Grant	various	93.991	702,715	-
Maternal and Child Health Services Block Grant	various	93.994	2,130,945	45,602
Vital Statistics Cooperative Program	285	93.200-2000-07211	211,393	-
Subtotal Direct Programs			80,432,239	42,516,190
Pass-through from the State Department of Human Services				
Temporary Assistance for Needy Families	various	93.558	2,047,960	2,039,960
Child Care and Development Block Grant	various	93.575	234,253	215,013
Child Abuse and Neglect State Grants	various	93.669	61,268	-
Subtotal Pass-through Programs			2,343,481	2,254,973
Total Department of Health and Human Services			82,775,720	44,771,163
U.S. Department of Agriculture				
Direct Program				
Food Safety Cooperative Agreements	203, 580	10.479	510,040	-
Special Supplemental Nutrition Program for Women, Infants, and Children	275, 295	10.557	32,178,424	2,592,469 *
Subtotal Direct Programs			32,688,464	2,592,469
Pass-through from the State Department of Human Services				
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	various	10.561	721,503	-
Subtotal Pass-through Programs			721,503	-
Total Department of Agriculture			33,409,967	2,592,469
Environmental Protection Agency ("EPA")				
Direct Program				
Air Pollution Control Program Support	233	66.001	540,416	4,011
Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	294	66.034	139,795	-
Water Pollution Control State, Interstate, and Tribal Program Support	231, 237	66.419	2,120,952	360,599
State Public Water System Supervision	232	66.432	422,776	-
Water Quality Management Program	14284-16284	66.454	5,983	-
ARRA – Water Quality Management Program	485	66.454	68,603	-
Capitalization Grants for Clean Water State Revolving Funds	15206-20206	66.458	4,587,187	4,587,187 *
ARRA – Capitalization Grants for Clean Water State Revolving Funds	483	66.458	12,867,564	12,776,428 *
Nonpoint Source Implementation Grants	various	66.460	1,088,497	500,432
Water Quality Cooperative Agreements	256	66.463	111,340	-
Capitalization Grants for Drinking Water State Revolving Funds	3207-9207	66.468	15,325,617	14,385,842 *
ARRA – Capitalization Grants for Drinking Water State Revolving Funds	482	66.468	10,916,160	10,916,160 *
Operator Certification Expense Grant	310	66.471	-	-
Beach Monitoring and Notification Program	8291	66.472	264,071	35,006
Water Protection Coordination	449	66.474	122,385	-
Environmental Information Exchange Grant Program	various	66.608	490,196	357,028
Toxic Substances Compliance Monitoring Cooperative Agreements	243	66.701	138,434	-
TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	330	66.707	113,928	-
Multi-Media Capacity Building Grants for States and Tribes	373	66.709	8,015	-
Hazardous Waste Management State Program Support	230	66.801	496,388	3,912
Superfund State Site Specific Cooperative Agreements	394	66.802	265,838	-
State Underground Storage Tanks Program ("UST" Program)	339	66.804	176,957	-
Leaking Underground Storage Tank Trust Fund Corrective Action Program	258	66.805	479,770	-
ARRA – Leaking Underground Storage Tank Trust Fund Corrective Action Program	487	66.805	35,058	-
State and Tribal Response Program Grants	360	66.817	1,144,517	-
Total Environmental Protection Agency			51,930,447	43,926,605

* Denotes Major Federal Program

**State of Hawaii
Department of Health
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2010**

Federal Grantor/Pass-Through Grantor/Program Title	Project Number	CFDA Contract, Award or Assistance ID Number	Federal Expenditures	Amount Provided to Subrecipient
U.S. Department of Education				
Direct Program				
Special Education – Grants for Infants and Families	213	84.181A	2,378,754	816,004
ARRA – Early Intervention Services	488	84.393A	1,123,003	1,122,618
Early Intervention Services Cluster			<u>3,501,757</u>	<u>1,938,622</u> *
Subtotal Direct Programs			<u>3,501,757</u>	<u>1,938,622</u>
Pass-through from the State Department of Education				
Special Education – State Personnel Development	481	84.323	23,325	3,240
Special Parent Information Network	322	84	185,392	-
Subtotal Pass-through Programs			<u>208,717</u>	<u>3,240</u>
Total Department of Education			<u>3,710,474</u>	<u>1,941,862</u>
U.S. Department of Defense				
Direct Program				
State Memorandum of Agreement Program for the Reimbursement of Technical Services	245	12.113	251,297	-
Total Department of Defense			<u>251,297</u>	<u>-</u>
U.S. Department of Justice				
Direct Program				
Enforcing Underage Drinking Laws Program	458, 480	16.727	599,559	555,351
Total Department of Justice			<u>599,559</u>	<u>555,351</u>
U.S. Department of Homeland Security				
Direct Program				
Crisis Counseling	390	97.032	13,887	-
Pass-through from the State Department of Homeland Security				
Homeland Security Grant Program	various	97.067	145,504	-
Total Department of Homeland Security			<u>159,391</u>	<u>-</u>
U.S. Department of Labor				
Pass-through from the State Department of Labor and Industrial Relations				
WIA Pilots, Demonstrations, and Research Projects	various	17.261	208,536	92,908
Total Department of Labor			<u>208,536</u>	<u>92,908</u>
U.S. Department of Transportation				
Pass through from the State Department of Transportation				
State and Community Highway Safety	various	20.600	54,383	-
Total Department of Homeland Security			<u>54,383</u>	<u>-</u>
Total Expenditures of Federal Awards			<u>\$ 173,099,774</u>	<u>\$ 93,880,358</u>

* Denotes Major Federal Program

State of Hawaii
Department of Health
Notes to the Schedule of Expenditures of Federal Awards
Year Ended June 30, 2010

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the State of Hawaii, Department of Health (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.

2. Loans Outstanding

The Department had the following loan balances outstanding at June 30, 2010. Loans made during the year are included in the federal expenditures presented in the schedule of expenditures of federal awards.

Program Title	Federal CFDA Number	Amount Outstanding
Capitalization Grants for Clean Water State Revolving Funds	66.458	\$ 48,772,539
Capitalization Grants for Drinking Water State Revolving Funds	66.468	39,520,023

3. Noncash Awards

The Department also receives noncash awards for the Immunization Grants and Public Health Emergency Preparedness program. The Department expended approximately \$10,639,000 and \$4,784,000 for the Immunization Grants and Public Health Emergency Preparedness program respectively, in vaccines for the fiscal year ended June 30, 2010.

PART II
Government Auditing Standards



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Health (the "Department") as of and for the year ended June 30, 2010, which collectively comprise the Department's basic financial statements and have issued our report thereon dated March 31, 2011. 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting 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 described in the accompanying schedule of findings and questioned costs, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiency described in the accompanying schedule of findings and questioned costs as Finding No. 10-01 to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as Finding Nos. 10-02 and 10-03 to be significant deficiencies.

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, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we will report to the State Auditor and management of the Department in a separate letter.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor, the Department's management, and 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.

Accuity LLP

Honolulu, Hawaii
March 31, 2011

PART III
OMB Circular A-133



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

Compliance

We have audited the compliance of the State of Hawaii, Department of Health (the "Department") with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2010. 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. 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 of 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, 2010. 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 Finding Nos. 10-04 through 10-09.

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.

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.

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

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor, the Department's management, and 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.

Accuity LLP

Honolulu, Hawaii
March 31, 2011

PART IV

Schedule of Findings and Questioned Costs

**State of Hawaii
 Department of Health
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	Yes
Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major programs:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	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 Section 510(a) of Circular A-133?	Yes

**State of Hawaii
 Department of Health
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster	
	U.S. Department of Health & Human Services	
	Aging Cluster	
93.044	Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers	
93.045	Special Programs for Aging – Title III Part C – Nutrition Services	
93.053	Nutrition Services Incentive Program	
93.705	ARRA – Aging Home-Delivered Nutrition Services for States	
93.707	ARRA – Aging Congregate Nutrition Services for States	
93.243	Substance Abuse and Mental Health Services – Projects of Regional and National Significance	
	Immunization Cluster	
93.268	Immunization Grants	
93.712	ARRA – Immunization Grants	
93.275	Substance Abuse and Mental Health Services – Access to Recovery	
93.889	National Bioterrorism Hospital Preparedness Program	
93.917	HIV Care Formula Grants	
93.959	Substance Abuse Prevention and Treatment Block Grants	
	U.S. Department of Agriculture	
10.557	Special Supplemental Nutrition Program for Women, Infants & Children	
	U.S. Environmental Protection Agency	
66.458	Capitalization Grants for Clean Water State Revolving Funds	
66.458	ARRA – Capitalization Grants for Clean Water State Revolving Funds	
66.468	Capitalization Grants for Drinking Water State Revolving Funds	
66.468	ARRA – Capitalization Grants for Drinking Water State Revolving Funds	
	U.S. Department of Education	
	Early Intervention Services Cluster	
84.181A	Special Education – Grants for Infants and Families	
84.393A	ARRA – Special Education – Grants for Infants and Families	
	Dollar threshold used to distinguish between type A and type B programs:	\$3,000,000
	Auditee qualified as low-risk auditee?	No

**State of Hawaii
 Department of Health
 Financial Statement Findings
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

II. Financial Statement Findings

		Questioned Cost
Finding No. 10-01:	Department of Human Services Transactions (Material Weakness)	\$ _____ -
Federal Agency:	Finding is not specific to a Federal Agency.	
CFDA Number and Title:	Finding is not specific to a Federal Agency.	
Award Number and Award Year:	Not applicable	Not applicable

Finding and Cause and Effect

The Department has difficulty determining the amounts due to or from the State of Hawaii, Department of Human Services (“DHS”) related to services provided by the Department’s Adult Mental Health Division (“AMHD”) program to Medicaid eligible patients under contracts between the Department and DHS.

Due to the decentralized manner in which DHS contracts are structured and managed, and the fact that DHS does not regularly reconcile payments to the Department, the Department continually struggles with DHS to accurately determine the settlement of Medicaid related transactions for financial reporting purposes, which could lead to material misstatement of the Department’s financial statements.

Criteria

In accordance with GASB 34, paragraph 12e, the Department is required to:

“Measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains, and losses using the economic resources measurement focus and accrual basis of accounting.”

In order to report on the accrual basis of accounting, the Department needs to assess all amounts due to and from other State Agencies for services that were provided throughout the year.

In addition, the Department’s management makes the following representation to us before we issue the financial statements:

We understand that as part of your audit, you prepared the adjusting journal entries necessary to convert our cash basis records to the accrual basis of accounting and acknowledge that we have reviewed and approved those entries and accepted responsibility for them.

**State of Hawaii
Department of Health
Financial Statement Findings
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010**

Recommendation

We recommend that the Department work toward developing Medicaid services contracts with DHS that contain consistent terms and conditions. The Department should develop policies to ensure that appropriate documentation is maintained to support billings to DHS and hold DHS accountable for reconciliation of Medicaid payments and timely communication of over or underpayments. Finally, the Department should ensure that adequate funds are available in the event that overpayments need to be returned to DHS.

**State of Hawaii
 Department of Health
 Financial Statement Findings
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-02:	Compensated Absences (Significant Deficiency)	\$ <u> </u> -
Federal Agency:	Finding is not specific to a Federal Agency.	
CFDA Number and Title:	Finding is not specific to a Federal Agency.	
Award Number and Award Year:	Not applicable	Not applicable

Finding and Cause and Effect

The Department's process for tracking compensated absences is decentralized. Each program is responsible for maintaining and tracking its own vacation, sick and compensatory time records. On an annual basis, the programs report their compensated absence information to the Department's Administrative Service Office ("ASO") for purposes of preparation of the year-end financial statements and submission to the Department of Accounting and General Services ("DAGS"). We noted the following matters during our prior year audits:

- Each division maintains its own vacation and sick leave records and submits year-end totals to the fiscal office in the form of detailed division schedules. However, we noted that not all programs used the proper version of the G-1 system developed by the Health Information Systems Office to track compensated absences either because they were unaware of the system's existence or program personnel lacked formal training on how to properly use the system. This resulted in inconsistent and/or inaccurate information being provided to the ASO.
- Although the Department's internal policies and procedures state that time keepers may not maintain their own personal records for compensated absences, we noted an instance where a time keeper and another employee both entered the time keeper's compensatory absence earned which resulted in an overstatement of the time keeper's balance.
- Although employees are entitled to payment for their residual balances of accrued vacation and compensatory time upon termination of their employment, we noted that there are no Department-wide policies or procedures for programs to follow to ensure that terminated employees are paid out for their vested compensated absence balances in a timely manner.
- We noted issues with the G-1 tracking system. We continued to note discrepancies in the amount of vacation/sick/comp hours between the "Annual Vacation and Sick Leave Accrual Report" and the DPS-7, Employee Leave Record forms.
- We also noted several instances where the individual entries were summed improperly, resulting in incorrect totals.
- We noted that the majority of programs did not use the system-wide G-1 report "Annual Vacation and Sick Leave Accrual Report" summary to report their vacation balances.

**State of Hawaii
Department of Health
Financial Statement Findings
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010**

Criteria

In accordance with GASB 34, paragraph 12e, the Department is required to:

“Measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains, and losses using the economic resources measurement focus and accrual basis of accounting.”

In order to report on the accrual basis of accounting, the Department needs to accurately calculate their accrued vacation balance.

In addition, the Department’s management makes the following representation to us before we issue the financial statements:

We understand that as part of your audit, you prepared the adjusting journal entries necessary to convert our cash basis records to the accrual basis of accounting and acknowledge that we have reviewed and approved those entries and accepted responsibility for them.

Recommendation

We recommend the following:

- Personnel responsible for maintenance, tracking and reporting of compensated absence information should receive formal training on how to properly use the G-1 tracking system and understand the purpose for tracking such information. The Department should establish a standardized format for reporting vacation, sick and compensatory time balances to ensure consistency across programs. Furthermore, someone in the ASO familiar with governmental accounting principles should review the Department-wide compensated absence reports for accuracy and completeness.
- The Department should maintain a listing of all time keepers and ensure that time keepers are not maintaining their own compensated absence balances.
- The Department should develop, implement and communicate Department-wide procedures over the payment of accrued vacation and compensatory time balances to terminated employees in a timely manner.

**State of Hawaii
 Department of Health
 Financial Statement Findings
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-03:	Equipment Management (Significant Deficiency)	\$ _____ --
Federal Agency:	Department of Health and Human Services ("DHHS")	
CFDA Number and Title:	93.243 – Substance Abuse and Mental Health Services - Projects of Regional and National Significance	
	93.889 – National Bioterrorism Hospital Preparedness Program	
Award Number and Award Year:	5U79SM057457-03	09/30/08 – 09/29/09
	5U79SM057457-04	09/30/09 – 09/29/10
	4 U3RHS007592-01-04	09/01/06 – 08/31/09
	4 U3REP070015-01-03	09/01/07 – 08/08/09
	6 U3REP080073-01-02	08/09/08 – 08/08/10
	6 U3REP090225-01-01	08/09/09 – 06/30/10
	1 U3REP090209-01-00	07/31/09 – 07/30/10

Finding and Cause and Effect

The Department adheres to the State’s policies and procedures contained in the DAGS – State Procurement Office (“SPO”) – Inventory Management Branch Training Manual (“State Inventory Manual”) for capital asset accounting, financial reporting, and compliance with equipment management in accordance with OMB Circular A-133. In addition, the Department requires property custodians to reconcile quarterly equipment acquisitions in Financial Accounting and Management Information System (“FAMIS”) to the DAGS computerized inventory reports (“MDB reports”) from the State’s Fixed Asset Inventory System (“FAIS”).

During our audit, we noted the following matters that resulted in either audit adjustments or noncompliance with federal requirements:

- Quarterly reconciliations were not performed consistently and discrepancies identified went unresolved.
- Construction projects administered by another State agency on behalf of the Department were improperly recorded in FAIS.
- The Mental Health Transformation State Incentive Grant (“MHT SIG”) and National Bioterrorism Hospital Preparedness (“HPP”) programs reported capital asset purchases to SPO for inclusion in FAIS in an untimely manner and failed to use decals on capital asset additions for physical tracking purposes.
- The HPP program purchased equipment and transferred it to the State Department of Civil Defense; however the asset was never reported to the SPO or reflected in FAIS.

State of Hawaii
Department of Health
Financial Statement Findings
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010

The matters identified were primarily caused by competing priorities of program personnel, the lack of a compliance monitoring function to ensure that all programs adhere to policies and procedures, and the lack of enforcement by senior Department administration.

Criteria

40 CFR 31.32 states that a state will use, manage, and dispose of equipment acquired in accordance with the state's laws and procedures. Per the SPO State Inventory Manual:

- Chapter 3 – “Record keeping of property which includes accounting for all acquired state property by reconciling financial expenditures for property with property recorded in the FAIS; conducting of physical inventory; updating the master inventory listing; maintaining an accurate audit trail; and conducting internal audits.”
- Chapter 3 – “Safekeeping of property which includes affixing of property identification or decal (maintaining a decal number log, assignment of decal numbers to items and ensuring each item is properly tagged or identified); documentation for authorized loan, movement from location, and transfer to another agency; guidelines pertaining to property declared excess, surplus, obsolete, beyond economical repair, lost, or stolen; guidelines for sale of property.”
- Chapter 9 – “At the end of each quarter, but no later than the 15th of the following month, the designated property custodian submits AGS Form 17-A (Detail Inventory of Property) to the Inventory Management Office, reporting all property acquisition and changes to their master inventory balances.”
- Chapter 10 – “After the fourth quarter, before September 16 of each year, each designated property custodian must submit to the SPO, Inventory Management Office Form AGS 17-B, Annual Inventory Report.”

Recommendation

We recommend that the Department adhere to State and internal policies and procedures over capital asset management. The State's and Department's policies are designed to achieve appropriate accounting, financial reporting and compliance. Department administration must hold programs accountable for adhering to policies and procedures through regular monitoring and application of consequences for noncompliance.

**State of Hawaii
 Department of Health
 Immunization Cluster
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

Section III. Federal Award Findings and Questioned Costs

		Questioned Cost
Finding No. 10-04:	Certification of Federally Funded Employees	\$ <u> -</u>
Federal Agency:	DHHS	
CFDA Number and Title:	Immunization Cluster 93.268 – Immunization Grants 93.712 – ARRA – Immunization	
Award Number and Award Year:	5H23IP922518-07 01/01/09 – 12/31/09 5H23IP922518-08 01/01/10 – 12/31/10 3H23IP922518-07S1 09/01/09 – 12/31/11	

Finding and Cause and Effect

During our testing of the allowability compliance requirement for the Immunization Cluster, we noted that the programs had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or (per requirement stated below) their supervisors, confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 (“Circular”) guidelines for payroll.

Although proper controls are in place to ensure that only employees that spend time on grant-related activities actually charged time to the program’s appropriation, there is no documentation maintained to confirm that this control was in place and that the time allocated to the program for these employees were periodically reviewed by the employees or their supervisors.

Criteria

In accordance with the Circular, compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular. In accordance with the Circular, where employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first-hand knowledge of the work performed by the employee.

**State of Hawaii
Department of Health
Immunization Cluster
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010**

Recommendation

We recommend that the Immunization Cluster obtain semi-annual certifications from all employees that spend 100% of their time on federally funded grants, confirming that they worked solely on grant related activities. The certification should be signed by either the employees or their supervisors.

**State of Hawaii
 Department of Health
 HIV Care Formula Grants
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-05:	Eligibility	\$ _____ -
Federal Agency:	DHHS	
CFDA Number and Title:	93.917 – HIV Care Formula Grants	
Award Number and Award Year:	X07HA00050-19-00 4/1/09 – 3/31/10 X07HA00050-20-00 4/1/10 – 3/31/11	

Finding and Cause and Effect

We noted that for one out of the 38 AIDS Drug Assistance Program (“ADAP”) patient records tested, the participant continued to receive services without being recertified within six months.

Criteria

Title 42, Section 300ff-26(b) of the U.S. Code requires that the Department ensure that eligible individuals receive assistance. In order to qualify for assistance, an individual must have a medical diagnosis of HIV disease and be a low-income individual, as defined by the State.

The Notice of Grant Award to the ADAP, the Health Resources and Services Administration (“HRSA”) of DHHS expects all Title II grantees to implement an ADAP recertification process to ensure that individuals remain eligible to receive assistance. At a minimum, an individual is required to be recertified every six months to ensure that the program only services eligible clients.

Recommendation

We recommend that the HIV program continue to conduct initial eligibility certification and semi-annual eligibility recertification of all participants as required by federal and State program guidelines in a timely manner.

We also recommend that the HIV program request that the recertification requirement be extended because it is difficult to get patients to recertify when their prescriptions are longer than six months. In addition, we recognize that while the program requires that participants complete six month recertification of eligibility, the program is reluctant to discharge clients at the six month point solely on the basis of failure to meet this requirement. Interrupting participants’ access to medications could have serious medical implications and is inconsistent with the program’s effort to maintain individuals in medical care, the program continues to provide medications beyond the six month eligibility period concurrent with efforts to obtain updated documentation from participants.

**State of Hawaii
 Department of Health
 Aging Cluster
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-06:	Allowable Costs/Cost Principles	\$ _____ -
Federal Agency:	DHHS	
CFDA Number and Title:	Aging Cluster 93.044 – Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers 93.045 – Special Programs for the Aging – Title III Part C – Nutrition Services. 93.053 – Nutrition Services Incentive Program 93.705 – ARRA – Aging Home-Delivered Nutrition Services for States 93.707 – ARRA – Aging Congregate Nutrition Services for States	
Award Number and Award Year:	09AAHIT3SP 10/01/08 – 09/30/09 10AAHIT3SP 10/01/09 – 09/30/10 09AAHINSIP 10/01/08 – 09/30/09 10AAHINSIP 10/01/09 – 09/30/10 09AAHIC2RR 03/18/09 – 09/30/10 09AAHIC1RR 03/07/09 – 09/30/10	

Finding and Cause and Effect

During our testing of the allowable costs/cost principles compliance requirement for the Aging Cluster, we noted that the Cluster did not maintain adequate supporting documentation for the time charged by an employee to the grant in accordance with OMB Circular A-87 (“Circular”) guidelines for payroll.

Criteria

In accordance with the Circular, compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular. In accordance with the Circular, where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation unless a statistical sampling system or other substitute system has been approved by the cognizant Federal agency. These reports must reflect an after-the-fact distribution of the actual

**State of Hawaii
Department of Health
Aging Cluster
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010**

activity of each employee, account for the total activity for which each employee is compensated, be prepared at least monthly and coincide with one or more pay periods, and must be signed by the employee.

Recommendation

We recommend that the program implement a procedure to obtain monthly time and effort sheets from all employees who perform work on federal grants, ensuring that expenses charged to federal grants is for actual time spent on the respective grant. The time records should be prepared monthly and signed by the employee.

**State of Hawaii
 Department of Health
 Aging Cluster
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-07:	Reporting	\$ _____ -
Federal Agency:	DHHS	
CFDA Number and Title:	Aging Cluster 93.044 – Special Programs for Aging – Title III Part B – Grants for Supportive Services and Senior Centers 93.045 – Special Programs for the Aging – Title III Part C – Nutrition Services. 93.053 – Nutrition Services Incentive Program 93.705 – ARRA – Aging Home-Delivered Nutrition Services for States 93.707 – ARRA – Aging Congregate Nutrition Services for States	
Award Number and Award Year:	09AAHIT3SP 10/01/08 – 09/30/09 10AAHIT3SP 10/01/09 – 09/30/10 09AAHINSIP 10/01/08 – 09/30/09 10AAHINSIP 10/01/09 – 09/30/10 09AAHIC2RR 03/18/09 – 09/30/10 09AAHIC1RR 03/07/09 – 09/30/10	

Finding and Cause and Effect

During our current year audit, we noted that the program reported an incorrect amount of federal expenditures on the Annual Financial Status Report, Standard Form (“SF”)-269, and the Administration on Aging (“AoA”) Supplemental Form (OMB No. 0985-0004). We noted the total expenditures for the Title III grant were misstated by \$76,536.

Criteria

Part IV of the June 2010 Compliance Supplement and the grant agreement state that the SF-269 and AoA Supplemental Form (OMB No.0985-0004) is required semi-annually. Failure to comply with the reporting requirements may result in deferral or additional restrictions of future funding decisions.

State of Hawaii
Department of Health
Aging Cluster
Schedule of Findings and Questioned Costs
Year Ended June 30, 2010

Recommendation

We recommend that the ASO and program personnel develop and implement procedures to ensure that accurate and complete financial reports are submitted to federal awarding agencies. Supporting documentation should be maintained to support the accuracy of data reported.

**State of Hawaii
 Department of Health
 Special Supplemental Nutrition Program for
 Women, Infants, and Children
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-08:	Eligibility	\$ <u> -</u>
Federal Agency:	Department of Agriculture	
CFDA Number and Title:	10.557 – Special Supplemental Nutrition Program for Women, Infants, and Children (“WIC”)	
Award Number and Award Year:	7HI700HI7	10/1/08 - 9/30/09
	7HI700HI7	10/1/09 - 9/30/10

Finding and Cause and Effect

We noted the following instances of noncompliance with eligibility requirements for the WIC program:

- For 6 out of 60 participant records tested, the program was unable to provide written documentation to evidence the eligibility of the participants.
- For 3 out of 60 participants records tested, the program was unable to provide written documentation that the signor of the food instrument was authorized to use the food instrument.

The lack of written support was largely due to human resource constraints at the WIC client site (local agency) level.

Criteria

Applicants for WIC program benefits are screened at WIC clinic sites to determine eligibility. In order to be certified eligible, a participant must meet categorical and income requirements, be able to show proof of residency, and have a nutritional risk.

The State Plan sets the guidelines for the requirements of the State’s WIC program. It specifies that a participant’s nutritional risk must be certified by a Competent Professional Authority as defined in 7 CFR Section 246.2. In addition, the participant’s categorical, income, and residency eligibility must be certified by a WIC Nutrition Aid. The State Plan requires written documentation for eligibility and the authorized representative’s signature.

Recommendation

We recommend that the WIC program maintain written documentation to evidence the eligibility of all WIC participants.

**State of Hawaii
 Department of Health
 Early Intervention Services Cluster
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2010**

		Questioned Cost
Finding No. 10-09:	Subrecipient Monitoring	\$ _____ -
Federal Agency:	Department of Education	
CFDA Number and Title:	Early Intervention Services Cluster 84.181A – Special Education – Grants for Infants and Families 84.393A – ARRA - Special Education – Grants for Infants and Families Recovery Act	
Award Number and Award Year:	H181A080091	07/01/08 – 09/30/09
	H181A080091	07/01/09 – 09/30/10
	H393A090091A	02/17/09 – 09/30/10

Finding and Cause and Effect

We noted that subawards to subrecipients for the Early Intervention Services (“IDEA”) Cluster did not contain the federal award number, CFDA number, or the amount of American Recovery and Reinvestment Act (“ARRA”) funds awarded. The subawards also did not require subrecipients to specifically identify ARRA funds in their Schedules of Expenditures of Federal Awards (“SEFA”) and Data Collection Forms (“SF-SAC”). This was an oversight by all parties involved in the subaward process, including the ASO, Attorney General and program personnel.

Criteria

In accordance with 2 CFR Section 176.210:

- (c) Recipients agree to separately identify to each subrecipient, and document at the time of subaward and at the time of disbursement of funds, the Federal award number, CFDA number, and amount of ARRA funds. When a recipient awards ARRA funds for an existing program, the information furnished to subrecipients shall distinguish the subawards of incremental ARRA funds from regular subawards under the existing program.
- (d) Recipients agree to require their subrecipients to include on their SEFA information to specifically identify ARRA funding similar to the requirements for the recipient SEFA described above. This information is needed to allow the recipient to properly monitor subrecipient expenditure of ARRA funds as well as oversight by the Federal awarding agencies, Offices of Inspector General and the Government Accountability Office.

Recommendation

We recommend that the Department incorporate ARRA specific requirements into its subawards to subrecipients.

PART V

Prior Year Findings and Questioned Costs

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

**State of Hawaii
Department of Health
Financial Statement Findings
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010**

Finding No. 09-01: Restatement of Beginning Fund Balance/Net Assets (Material Weakness)

During our prior year financial statement audit of the Department's deposit beverage container fund, we identified an accounting error that resulted in the understatement of liabilities as of June 30, 2008 and overstatement of revenues for the year ended June 30, 2008. The error resulted from the lack of oversight by fiscal management over the accrual of liabilities and reconciliation of differences between the deposit beverage container fund's accounting system ("Quickbooks") and FAMIS. FAMIS is maintained on the cash basis of accounting and Quickbooks is maintained on the accrual basis. Therefore, the differences were not properly reflected in the Department's financial statements.

We recommended that the Department restate the beginning balances in its basic financial statements for the year ended June 30, 2008 to correct the error identified. We also recommended that fiscal management of the Department provide greater oversight to ensure that the basic financial statements are prepared and presented in accordance with generally accepted accounting principles ("GAAP").

Status

Resolved. In the current year, there were no instances of restatement related to the prior year's fund balance.

Finding No. 09-02: Capital Assets (Material Weakness)

In prior year audits (starting with the fiscal year 2004 audit), we noted that the Department was not adhering to State policies and procedures over capital asset management and reporting.

We recommended that the Department report capital assets to the SPO in a timely manner in accordance with the State Inventory Manual and ensure that programs reconcile capital asset activity on a quarterly basis to minimize material misstatement of the financial statements.

Status

Unresolved. While financial statement misstatements have been reduced, we continued to note instances where Department programs expending federal funds are still not adhering to State policies. Since the Department continues to address our recommendations in this finding in connection with our recommendations in current year Finding No.10-03, this finding will not carry forward.

Finding No. 09-03: Department of Human Services Transactions (Material Weakness)

In prior year audits, it was noted that the Department had difficulty determining the amounts due to and due from the DHS related to the Medicaid funds.

We recommended that the Department develop a policy for establishing contracts and maintaining records and balances due to and from DHS for the programs that are eligible to receive Medicaid reimbursement. A consistent policy will assist in ensuring that the data that is recorded is appropriate. In addition, if the Department is aware that DHS has to reconcile the data at the end of the year, which might result in the Department owing or receiving more Medicaid funds, the Department should ensure that the programs are following up with DHS on the status of the reconciliations. If the Department needs to cut current year costs to repay the prior years' shortfalls, they should ensure that they are aware of

**State of Hawaii
Department of Health
Financial Statement Findings
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010**

these shortfalls and can include them in the budget that is approved. On the other hand, any additional money that the Department could receive would help to alleviate other funding sources that are required to provide the required services.

Status

Unresolved. The Department continues to struggle with accurately accounting for and reporting Medicaid services transactions with DHS. Since the Department continues to address our recommendations in this finding in connection with our recommendations in current year Finding No.10-01, this finding will not carry forward.

**State of Hawaii
Department of Health
Drinking Water Treatment Revolving Loan Fund
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010**

Finding No. 09-04: Allowability (Set-Asides used for Grants)

During our prior year audit of for the Capitalization Grants for Drinking Water State Revolving Funds (“DWSRF”) program (CFDA 66.468) administered by the Drinking Water Treatment Revolving Loan Fund (“DWTRLF”), we noted three grants aggregating \$75,000 that were disbursed from the program’s set-aside funds (2% set-aside for Small Systems Technical Assistance and 15% for Technical or Financial Assistance to PWS’s). Contradictory language in the intent of the State statutes led us to question whether or not grants are allowed to be made from the DWTRLF program.

We recommended that the program seek an opinion from the Attorney General on whether grants from the program’s set-aside funds are an allowable activity to ensure that the program is in compliance with State and Federal guidelines.

Status

Resolved. In the current year, the program obtained approval from the Attorney General to make grants from the DWTRLF’s set-aside funds. Therefore, it appears that grants made from the program’s set-aside funds are an allowable activity and the program is in compliance with State and Federal guidelines.

**State of Hawaii
Department of Health
Substance Abuse and Mental Health Services –
Projects of Regional and National Significance
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010**

Finding No. 09-05: Equipment Management

During our prior year audit, we noted that the Mental Health Transformation State Incentive Grant (“MHT SIG”) program did not follow State policies and procedures over capital asset management.

We recommended that the program follow the SPO manual and monitor its equipment, especially properly recording, safekeeping and reporting all additions and disposals of equipment acquired during the year. We also recommended that the program adhere to the State’s established policies and procedures over equipment management in order to comply with Federal and State regulations.

Status

Unresolved. During our current audit, we continued to note similar instances where the program did not adhere to State policies over capital asset management. Since the program continues to address our recommendations in this finding in connection with our recommendations in current year Finding No.10-03, this finding will not carry forward.

**State of Hawaii
Department of Health
Substance Abuse Prevention & Treatment Block Grants
Substance Abuse and Mental Health Services – Access to Recovery
Status of Prior Year of Findings and Questioned Costs
Year Ended June 30, 2010**

Finding No. 09-06: Certification for Federally Funded Employees

During our prior year testing of the allowability compliance requirement for the Substance Abuse Prevention & Treatment Block Grant and the Access To Recovery Voucher Grant, we noted that both programs had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or (per requirement stated below) their supervisors, confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 guidelines for payroll.

We recommended that the programs implement a procedure to obtain semi-annual certifications from all employees that spend 100% of their time on the grants, confirming that they actually worked solely on grant related activities. The certification should be signed by either the employee or their supervisor.

Status

Resolved. In the current year audit, there were no instances of noncompliance.

**State of Hawaii
Department of Health
Public Health Emergency Preparedness
HIV Care Formula Grants
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010**

Finding No. 09-07: Allowable Cost/Cost Principles

During our prior year testing of the allowable costs/cost principles compliance requirement for the HIV Care grant, we noted that the program did not maintain adequate supporting documentation for the time charged by an employee to the grant in accordance with OMB Circular A-87 guidelines for payroll.

We recommended that the program implement a procedure to obtain monthly time and effort sheets from all employees who perform work on federal grants, ensuring that expenses charged to federal grants is for actual time spent on the respective grant. The time records should be prepared monthly and signed by the employee.

Status

Resolved. In the current year audit, there were no instances of noncompliance.

State of Hawaii
Department of Health
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2010

Finding No. 06-08: Cash Management

During our prior year review of the Department's cash management procedures, we noted that we could not verify whether DAGS disbursed funds from federal sources within three business days after the Department drew down the funds which is in accordance with the Cash Management Improvement Act Regulations & Guidance 31 CFR 205 (Final Rule). We also noted that the Department was not calculating or remitting any interest earnings attributable to these untimely disbursements. The delays were caused by the State's payment process that requires payments by all State departments to be processed through DAGS resulting in processing delays.

We recommended that the Department work with DAGS to ensure timely disbursement of federal funds. In addition, we recommended that the Department calculate and remit any interest liability to the federal government, if necessary, in accordance with federal regulations.

Status

Unresolved. We continued to find the Department is not calculating interest on the funds drawn down in advance.

We were also still unable to verify whether the Department and DAGS complied with the Cash Management Improvement Act's requirement to minimize the time between the transfer of funds from the U.S. Treasury and disbursement by the Department.

Corrective Action Plan

NEIL ABERCROMBIE
GOVERNOR OF HAWAII



LORETTA J. FUDDY, A.C.S.W., M.P.H.
INTERIM DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P. O. BOX 3378
HONOLULU, HI 96801-3378

In reply, please refer to:
File:

ASO-F/11-1028

March 22, 2011

Office of the Auditor
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear State Auditor:

Attached are the Department of Health's Corrective Action Plan for the findings on the audit report for fiscal year 2010 and comments regarding a prior year finding.

We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Loretta J. Fuddy", is written over a circular stamp or watermark.

Loretta J. Fuddy, A.C.S.W., M.P.H.
Interim Director of Health

Attachment

II. Financial Statement Findings

Finding No. 10-01: Department of Human Services Transactions (Material Weakness)

Finding and Cause and Effect

The Department has difficulty determining the amounts due to or from the State of Hawaii, Department of Human Services ("DHS") related to services provided by the Department's Adult Mental Health Division ("AMHD") program to Medicaid eligible patients under contracts between the Department and DHS.

Due to the decentralized manner in which DHS contracts are structured and managed, and the fact that DHS does not regularly reconcile payments to the Department, the Department continually struggles with DHS to accurately determine the settlement of Medicaid related transactions for financial reporting purposes, which could lead to material misstatement of the Department's financial statements.

Corrective Action Plan

The Department is in the process of centralizing the development of Medicaid services contracts with DHS to ensure consistent terms and conditions and the development of policies to ensure that appropriate documentation is maintained to support billings to DHS. The Department will also confer with DHS on the reconciliation of Medicaid payments and timely communication of over or underpayments. Unless funds are transferred out of the control of the Department, AMHD has funds available in the event that overpayments to AMHD need to be returned to DHS.

Person Responsible

Deputy Director for Behavioral Health

Anticipated Date of Completion

December 1, 2011

Finding No. 10-02: Compensated Absences (Significant Deficiency)

Finding and Cause and Effect

The Department's process for tracking compensated absences is decentralized. Each program is responsible for maintaining and tracking its own vacation, sick and compensatory time records. On an annual basis, the programs report their compensated absence information to the Department's Administrative Services Office ("ASO") for purposes of preparation of the year-end financial statements and submission to the Department of Accounting and General Services ("DAGS").

Corrective Action Plan

The Department's Health Information Systems Office (HISO) is currently developing a new G-1 Leave Tracking System. This system is customizable, reliable, and uses a human resource compensated absences management software that manages all types of employee absenteeism. It automatically tracks balances for vacations, sick leave, and compensatory time earned by each employee, as well as prints the G-1 leave form and FORM 7 that shows a detailed breakout of all leave taken during a calendar year.

This new system will streamline the Department's reporting. Currently, all leave forms are manually prepared and they are posted to the old G-1 system after approval. This new system will be the sole system to print all the G-1 forms upon the request of an employee. Under the new program, leave records will be automatically updated as soon as the forms are generated. This will prevent under recording and inaccurate leave information.

Under the new policy, segregation of duty is defined for the time keeper. The time keeper's supervisor will maintain and keep track of the time keeper's leave forms.

The new G-1 System has a central data base that will be able to generate reports such as accrued vacation and sick leave and leave balances on a program level as well as on the Department level. This will prevent any errors resulting from the manual transfer of inaccurate data from the G-1 leave summary forms into an electronic soft consolidated file.

This new system will be implemented on June 1, 2011 by the HISO. A pilot program will be underway in late March 2011. Thereafter, a conversion of transferred data from the old system to the new system will occur. The Department will continue to work to improve the system so that the leave data is accurate.

Person Responsible

ASO Fiscal Officer and Health Information Systems Office Chief

Anticipated Date of Completion

June 1, 2011

Finding No. 10-03: Equipment Management (Significant Deficiency)

Finding and Cause and Effect

The Department adheres to the State's policies and procedures contained in the DAGS – State Procurement Office ("SPO") – Inventory Management Branch Training Manual ("State Inventory Manual") for capital asset accounting, financial reporting, and compliance with equipment management in accordance with OMB Circular A-133. In addition, the Department requires property custodians to reconcile quarterly equipment acquisitions in Financial Accounting and

Management Information System (“FAMIS”) to the DAGS computerized inventory reports (“MDB reports”) from the State’s Fixed Asset Inventory System (“FAIS”).

During our audit, we noted the following matters that resulted in either audit adjustments or noncompliance with federal requirements:

- Quarterly reconciliations were not performed consistently and discrepancies identified went unresolved.
- Construction projects administered by another State agency on behalf of the Department were improperly recorded in FAIS.
- The Mental Health Transformation State Incentive Grant (“MHT SIG”) and National Bioterrorism Hospital Preparedness (“HPP”) programs reported capital asset purchases to SPO for inclusion in FAIS in a untimely manner and failed to use decals on capital asset additions for physical tracking purposes.
- The HPP program purchased equipment and transferred it to the State Department of Civil Defense; however the asset was never reported to the SPO or reflected in FAIS.

Corrective Action Plan

The Department will continue to strive to adhere to State and internal policies and procedures for capital asset management. Programs, especially those funded by federal grants, will be reminded to report capital asset purchases to SPO for inclusion in FAIS in a timely manner and to promptly affix the decals on capital asset additions for physical tracking purposes.

The Administrative Services Office (ASO) will work with the programs to ensure that they designate staff responsible for equipment management and will monitor programs for equipment inventory compliance.

Person Responsible

ASO Procurement and Supply Specialist and Public Health Administrative Officer or Program Chief for each program

Anticipated Date of Completion

June 30, 2011

Section III. Federal Award Findings and Questioned Costs

Finding No. 10-04: Certification of Federally Funded Employees

Finding and Cause and Effect

During our testing of the allowability compliance requirement for the Immunization Cluster, we noted that the programs had employees that spent 100% of their time on the grant but did not obtain semi-annual certifications signed by the employees or (per requirement stated below) their supervisors, confirming that they worked solely on grant related activities in accordance with OMB Circular A-87 ("Circular") guidelines for payroll.

Although proper controls are in place to ensure that only employees that spend time on grant-related activities actually charged time to the program's appropriation, there is no documentation maintained to confirm that this control was in place and that the time allocated to the program for these employees were periodically reviewed by the employees or their supervisors.

Corrective Action Plan

The Immunization Branch implemented procedures to obtain semi-annual certifications beginning January 1, 2011 from all employees who spend 100 percent of their time on activities funded by and related to the Immunization and Vaccines for Children Grant. The certifications are signed by either the employee or their supervisor.

Person Responsible:

Immunization Branch Chief

Anticipated Date of Completion

January 1, 2011

Finding No. 10-05: Eligibility

Finding and Cause and Effect

We noted that for one out of the 38 AIDS Drug Assistance Program ("ADAP") patient records tested, the participant continued to receive services without being recertified within six months.

Corrective Action Plan

The STD/AIDS Prevention Branch (SAPB) has revised the way in which recertification of eligibility is conducted. Beginning July 1, 2010, the SAPB HIV Drug Assistance Program (HDAP) staff has real-time access to client eligibility information in e2Hawaii, a new data system used by HIV case management providers. E2Hawaii provides documentation of dates on which

eligibility information is updated and certified by the case manager. It is expected that the streamlined process will provide for more frequent recertification of eligibility and will reduce the likelihood that an individual will continue in the program without recertification of eligibility at least every six months.

Person Responsible

Program Specialist V

Anticipated Date of Completion

June 30, 2011

Finding No. 10-06: Allowable Costs/Cost Principles

Finding and Cause and Effect

During our testing of the allowable costs/cost principles compliance requirement for the Aging Cluster, we noted that the Cluster did not maintain adequate supporting documentation for the time charged by an employee to the grant in accordance with OMB Circular A-87 ("Circular") guidelines for payroll.

Corrective Action Plan

The Executive Office on Aging (EOA) will develop procedures for tracking staff time spent on federal grants by federal fiscal year (FFY) to ensure that expenses charged to federal grants represent the actual time spent on the respective grant. EOA will have all federally funded or partially federally funded employees track the amount of time that they spend on each federal grant. EOA employees will submit their monthly time and effort sheets to the Accountant/or designated authority by the 5th day following the close of the month after they have signed the sheet. The EOA Accountant/or designated authority will compile the data into a master worksheet by grant title, number and month. Following the close of the FFY, the Accountant will have on file all time spent by grant name and grant number for the FFY.

Person Responsible

EOA Accountant

Anticipated Date of Completion

June 30, 2011

Finding No. 10-07: Reporting

Finding and Cause and Effect

During our current year audit, we noted that the program reported an incorrect amount of federal expenditures on the Annual Financial Status Report, Standard Form ("SF")-269, and the

Administration on Aging ("AoA") Supplemental Form (OMB No. 0985-0004). We noted the total expenditures for the Title III grant were misstated by \$76,536.

Corrective Action Plan

EOA is in the process of filling its vacant Accountant position. The Accountant will be responsible for implementing policies and procedures to require that all financial reports and forms are reviewed and monitored by more than one member of the financial staff to ensure accuracy and correctness.

EOA will work with the Administrative Services Office to submit the necessary revised Annual Financial Status Reports, SF-269s to the AoA. EOA will also maintain appropriate documentation to support the financial data reported for all their financial reports.

Person Responsible

EOA Accountant

Anticipated Date of Completion

June 30, 2011

Finding No. 10-08: Eligibility

Finding and Cause and Effect

We noted the following instances of noncompliance with eligibility requirements for the WIC program:

- For 6 out of 60 participant records tested, the program was unable to provide written documentation to evidence the eligibility of the participants.
- For 3 out of 60 participant records tested, the program was unable to provide written documentation that the signor of the food instrument was authorized to use the food instrument.

The lack of written support was largely due to human resource constraints at the WIC client site (local agency) level.

Corrective Action Plan

State audit findings of the WIC Program's inadequate written documentation on (1) the eligibility of the participants and (2) authorization for signor of the food instrument to use the food instrument were reviewed with Local Agency Coordinators (LACs) along with suggestions for improvement at the October 14, 2010 state-wide WIC nutritionists' meeting. LACs were advised to in-service train their staff on these findings and recommendations. All six affected LACs have in-serviced trained their staff. The WIC program will maintain written documentation to provide evidence of the eligibility of their participants.

Person Responsible

WIC Branch Chief

Anticipated Date of Completion

December 30, 2010

Finding No. 10-09: Subrecipient Monitoring

Finding and Cause and Effect

We noted that subawards to subrecipients for the Early Intervention Services ("IDEA") Cluster did not contain the federal award number, CFDA number, or the amount of American Recovery and Reinvestment Act ("ARRA") funds awarded. The subawards also did not require subrecipients to specifically identify ARRA funds in their Schedules of Expenditures of Federal Awards ("SEFA") and Data Collection Forms ("SF-SAC"). This was an oversight by all parties involved in the subaward process, including the ASO, Attorney General and program personnel.

Corrective Action Plan

The Early Intervention Section ("EIS") has already informed all those subrecipients of ARRA funds of the CFDA number, the contract number, and the amount of ARRA funds awarded to correct the error identified. It is not anticipated that the Department will be receiving any additional ARRA funds.

Person Responsible

EIS Public Health Administrative Officer

Anticipated Date of Completion

All subrecipients of ARRA funds were notified by e-mail on January 5 and 6, 2011, of the CFDA number, the contract number, and the amount of ARRA funds awarded to correct the error identified.

Finding No. 06-08: Cash Management

During our prior year review of the Department's cash management procedures, we noted that we could not verify whether DAGS disbursed funds from federal sources within three business days after the Department drew down the funds which is in accordance with the Cash Management Improvement Act Regulations & Guidance 31 CFR 205 (Final Rule). We also noted that the Department was not calculating or remitting any interest earnings attributable to these untimely disbursements. The delays were caused by the State's payment process that requires payments by all State departments to be processed through DAGS resulting in processing delays.

Corrective Action Plan

The Department of Health is part of the Executive Branch of the State of Hawaii. As such, the Department must follow the accounting guidelines and procedures provided by the State Department of Accounting and General Services (DAGS). DAGS requires that all cash receipts and disbursements must be recorded in the State's Financial Accounting Management and Information System (FAMIS).

The Department is one of the largest agencies in the Hawaii State Executive Branch. We have more than 150 federal grants with multiple grant years. Each program is responsible for managing their grant, reviewing invoices, and certifying invoices for payment. Our ASO Audit Unit of the Procurement and Audit Section reviews the submitted invoices and inputs payment data to the State Accounting System. The ASO Accounting Section prepares the daily cash management requirement spreadsheets based on FAMIS reports and performs daily cash draws as needed. Because we are using the State System, we may not be able to meet the requirements of the federal government's three-day drawdown rule which results in payment delays.

Person Responsible

Administrative Services Officer and Fiscal Officer

Anticipated Date of Completion

Not applicable.