

State of Hawaii Drinking Water Treatment Revolving Loan Fund

Financial Statements

June 30, 2012

**Submitted by
The Auditor
State of Hawaii**

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Drinking Water Treatment Revolving Loan Fund
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June 30, 2012

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Report of Independent Auditors

The Auditor
State of Hawaii

We have audited the accompanying statement of net assets of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2012, and the related statements of revenues, expenses and change in net assets, and cash flows for the year then ended, which collectively comprise the Fund's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2012, and the changes in its financial position and its cash flows 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 December 5, 2012 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Fund's financial statements as a whole. The supplementary information on pages 14 through 17 is presented for purposes of additional analysis and is not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relate 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 in relation to the financial statements as a whole.

Accuity LLP

Honolulu, Hawaii
December 5, 2012

Financial Statements

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Net Assets
June 30, 2012

Assets

Current assets	
Equity in cash and cash equivalents and investments in State Treasury	\$ 45,683,845
Loan fees receivable	683,964
Accrued interest on loans	65,792
Other accrued interest	24,373
Due from federal government	239,601
Current maturities of loans receivable	<u>5,053,880</u>
Total current assets	51,751,455
ARRA advances	5,843,387
Loans receivable, net of current maturities	69,102,707
Capital assets, net of accumulated depreciation	<u>268,654</u>
Total assets	<u>\$ 126,966,203</u>

Liabilities and Net Assets

Current liabilities	
Accounts payable and other accrued liabilities	<u>\$ 234,612</u>
Total current liabilities	234,612
Accrued vacation, net of current portion	99,311
Other postemployment benefits	<u>327,501</u>
Total liabilities	661,424
Commitments and contingencies	
Net assets	
Invested in capital assets	268,654
Restricted – expendable	<u>126,036,125</u>
Total net assets	<u>126,304,779</u>
Total liabilities and net assets	<u>\$ 126,966,203</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2012

Operating revenues	
Interest income from loans	\$ 275,163
Administrative loan fees	2,421,462
Total operating revenues	<u>2,696,625</u>
Operating expenses	
Administrative	550,713
State program management	1,165,596
Water protection	1,188,539
Small systems	12,576
Total operating expenses	<u>2,917,424</u>
Operating loss	(220,799)
Nonoperating revenues and expenses	
State contributions	2,715,000
Federal contributions	4,852,116
Federal ARRA contributions	789,257
Principal forgiveness for ARRA	(13,288,800)
Other interest income	146,800
Total nonoperating revenues and expenses	<u>(4,785,627)</u>
Change in net assets	(5,006,426)
Net assets	
Beginning of year	<u>131,311,205</u>
End of year	<u>\$ 126,304,779</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Statement of Cash Flows
Year Ended June 30, 2012

Cash flows from operating activities	
Interest income from loans	\$ 283,909
Administrative loan fees	2,491,353
Principal repayments on loans	5,074,627
Disbursement of loan proceeds	(3,353,292)
Payments to employees	(826,065)
Payments to vendors	(2,048,414)
	<u>1,622,118</u>
Net cash provided by operating activities	<u>1,622,118</u>
Cash flows from noncapital financing activities	
State contributions	2,715,000
Federal contributions	4,755,322
Federal ARRA contributions	789,257
Disbursement of ARRA advances	(789,257)
	<u>7,470,322</u>
Net cash provided by noncapital financing activities	<u>7,470,322</u>
Cash flows from capital and related financing activities	
Purchase equipment	(32,304)
	<u>(32,304)</u>
Net cash used in capital and related financing activities	<u>(32,304)</u>
Cash flows from investing activities	
Other interest income	161,022
	<u>161,022</u>
Net cash provided by investing activities	<u>161,022</u>
Net increase in cash	9,221,158
Equity in cash and cash equivalents and investments in State Treasury	
Beginning of year	<u>36,462,687</u>
End of year	<u>\$ 45,683,845</u>
Reconciliation of operating loss to net cash provided by operating activities	
Operating loss	\$ (220,799)
Adjustments to reconcile operating loss to net cash provided by operating activities	
Depreciation expense	96,932
Change in assets and liabilities	
Loans receivable	1,721,335
Accrued interest on loans	8,745
Loan fees receivable	69,891
Accounts payable and other accrued liabilities	(180,611)
Other postemployment benefits	126,625
	<u>1,622,118</u>
Net cash provided by operating activities	<u>\$ 1,622,118</u>

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

1. Establishment and Purpose of the Fund

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

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

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

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

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates, among others, include the allowances for uncollectible accounts, depreciable lives of capital assets, fair value of equity in cash and cash equivalents and investments in State Treasury, and other postemployment benefits ("OPEB") liability.

Equity in Cash and Cash Equivalents and Investments in State Treasury

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

At June 30, 2012, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

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 loss for the year ended June 30, 2012 and that each participating State agency would be allocated a portion of the loss. The Fund's allocated loss for 2012 amounted to \$51,761.

ARRA Advances

The Fund received American Recovery and Reinvestment Act ("ARRA") stimulus money that was used to provide construction grants with no interest or loan fees and 100 percent principal forgiveness upon completion of approved projects. The Fund is allowed to use up to 4 percent of the ARRA funds for administrative costs, up to 2 percent for technical assistance to small systems and up to 10 percent for State program management, however has elected not to do so. 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 of 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 the counties are funded by federal capitalization grants, State matching funds, repayments and investment interest income. Loan funds are disbursed to local agencies as they expend for the purposes of the loan, and request reimbursement from the Fund. Interest is calculated from the date that loan funds are disbursed, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and interest accrued during the project period.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

Administrative Loan Fees

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

Capital Assets

Capital assets are defined by the Department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than \$5,000. Such assets consist principally of equipment, and are recorded at cost or, if donated, at appraised value at the date of donation. Depreciation of capital assets is provided for on a straight-line basis over the estimated useful lives (5-7 years) of the respective assets.

Accrued Vacation

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

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in ERS. At June 30, 2012, accumulated sick leave was approximately \$279,000.

Net Assets

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

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

Administrative Costs

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

Fund Accounts

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

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

Expenses

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

New Accounting Pronouncements

In December 2010, 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.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources and governmental entity's net position. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to reclassify assets and liabilities as deferred outflows of resources and deferred inflow of resources for consistency in financial reporting. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 66, *Technical Corrections*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The objective of this Statement is to establish accounting and financial reporting requirements for pensions of governments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

3. Loans Receivable

At June 30, 2012, loans receivable from government entities were as follows:

Nine loans receivable from the City & County of Honolulu, Board of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 0.36%, 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.	\$ 20,872,675
Ten loans receivable from the County of Hawaii, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.12% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	13,406,406
Eight loans receivable from the County of Maui, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.55%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	14,707,408
Thirteen loans receivable from the County of Kauai, Department of Water due in semi-annual payments, including interest ranging from 0.16% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	<u>25,170,098</u>
	74,156,587
Less: Current portion	<u>5,053,880</u>
Noncurrent portion	<u>\$ 69,102,707</u>

Loans are expected to mature at various dates through 2031. The scheduled principal payments on loans maturing in subsequent years are as follows:

2013	\$ 5,053,880
2014	5,182,049
2015	5,205,235
2016	5,228,460
2017	5,252,439
Thereafter	<u>48,234,524</u>
	<u>\$ 74,156,587</u>

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

In fiscal year 2012, \$13,289,000 ARRA advances were forgiven. All advances forgiven were in accordance with the required conditions.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

At June 30, 2012, \$24,152,000, \$6,619,000, and \$18,592,000 were committed to be loaned out to the County of Hawaii, County of Kauai, and County of Maui Departments of Water Supply, respectively, under existing loan agreements.

4. Contributed Capital

The Fund is capitalized by grants from the EPA and matching funds from the State. The following summarizes the EPA capitalization grants and ARRA funds awarded, amounts drawn on each grant, and the balances available for future loans at June 30, 2012:

Budget Period	Amount	Total Draws at June 30, 2011	Total 2012 Cash Draws	Funds Available
04/01/04 – 06/30/11	\$ 8,004,100	\$ 7,596,203	\$ 407,897	\$ -
10/01/05 – 06/30/13	8,303,100	6,869,348	1,252,745	181,007
09/01/06 – 06/30/16	8,285,500	6,764,769	210,900	1,309,831
07/01/07 – 06/30/17	8,229,300	6,053,578	300,000	1,875,722
03/01/08 – 06/30/17	8,229,000	5,419,973	1,387,555	1,421,472
10/01/08 – 06/30/13 (ARRA)	19,500,000	18,342,930	789,257	367,813
03/01/09 – 06/30/18	8,146,000	-	585,778	7,560,222
01/01/10 – 06/30/19	8,146,000	-	178	8,145,822
04/01/11 – 06/30/17	13,573,000	-	380,148	13,192,852
09/30/11 – 06/30/18	9,268,000	-	230,121	9,037,879
	<u>\$ 99,684,000</u>	<u>\$ 51,046,801</u>	<u>\$ 5,544,579</u>	<u>\$ 43,092,620</u>

The State is required to match 20 percent of the estimated amount of the grant from the EPA and does so in the year that the capitalization grant is awarded. The State is not required to match funds for ARRA awards. Through June 30, 2012, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2012 approximated \$26.2 million, of which approximately \$18.7 million has been utilized and \$7.5 million was available to be loaned out at June 30, 2012.

ARRA funds available have been committed to counties in the form of grant agreements and will be disbursed upon request for reimbursement.

5. Capital Assets

Summary of capital assets at June 30, 2012 is as follows:

	Balance at July 1, 2011	Additions	Retirements/ Transfers	Balance at June 30, 2012
Equipment	\$ 1,208,197	\$ 32,304	\$ (3,512)	\$ 1,236,989
Accumulated depreciation	(874,915)	(96,932)	3,512	(968,335)
	<u>\$ 333,282</u>	<u>\$ (64,628)</u>	<u>\$ -</u>	<u>\$ 268,654</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

6. Accrued Vacation

At June 30, 2012, long-term obligations included accrued vacation as follows:

Balance at July 1, 2011	\$ 140,378
Increase	41,630
Decrease	<u>(48,418)</u>
Balance at June 30, 2012	133,590
Less: Current portion	<u>34,279</u>
Noncurrent portion	<u>\$ 99,311</u>

7. Employee Benefit Plans

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

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.

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.

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.

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Notes to Financial Statements
June 30, 2012

The basis for the allocation is the proportionate share of contributions made by each component unit or proprietary fund for retiree health benefits.

Annual OPEB Cost

The components of the allocated annual OPEB cost (annual required contribution, interest on net OPEB obligation, and adjustment to annual required contribution) are insignificant to the Fund's financial statements. The following table shows the allocated annual OPEB cost for the year ended June 30, 2012:

Annual OPEB cost	\$ 173,371
Less: contributions made	<u>(46,746)</u>
Increase in net OPEB obligation	126,625
Net OPEB obligation	
Beginning of year	<u>200,876</u>
End of year	<u>\$ 327,501</u>

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Fund's contributions for the years ended June 30, 2012, 2011, and 2010 approximated \$47,000, \$29,000, and \$19,000, respectively.

Required Supplementary Information and Disclosures

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

8. Insurance Coverage

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

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

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

Supplementary Information

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Cash Receipts, Disbursements and Cash Balance
Year Ended June 30, 2012

Receipts

Principal repayments on loans	\$ 5,074,627
Interest income from loans	283,909
State contributions	2,715,000
Federal contributions	4,755,322
Federal ARRA contributions	789,257
Administrative loan fees	2,491,353
Investment interest	<u>161,022</u>
Total receipts	16,270,490

Disbursements

Disbursement of loan proceeds	3,353,292
Disbursement of ARRA advances	789,257
Administrative	442,319
State program management	1,291,654
Water protection program	<u>1,172,810</u>
Total disbursements	<u>7,049,332</u>
Excess of receipts over disbursements	9,221,158

**Equity in cash and cash equivalents
and investments in State Treasury**

Beginning of year	<u>36,462,687</u>
End of year	<u>\$ 45,683,845</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Net Assets
June 30, 2012

	State Revolving Fund Activity	Non-SRF Activity	Total
Assets			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 42,442,047	\$ 3,241,798	\$ 45,683,845
Loan fees receivable	-	683,964	683,964
Accrued interest on loans	65,792	-	65,792
Other accrued interest	24,373	-	24,373
Due from federal government	-	239,601	239,601
Current maturities of loans receivable	5,053,880	-	5,053,880
Total current assets	47,586,092	4,165,363	51,751,455
ARRA advances	5,843,387	-	5,843,387
Loans receivable, net of current maturities	69,102,707	-	69,102,707
Capital assets, net of accumulated depreciation	-	268,654	268,654
Total assets	<u>\$ 122,532,186</u>	<u>\$ 4,434,017</u>	<u>\$ 126,966,203</u>
Liabilities and Net Assets			
Current liabilities			
Accounts payable and other accrued liabilities	\$ -	\$ 234,612	\$ 234,612
Total current liabilities	-	234,612	234,612
Accrued vacation, net of current portion	-	99,311	99,311
Other postemployment benefits	-	327,501	327,501
Total liabilities	-	661,424	661,424
Net assets			
Invested in capital assets	-	268,654	268,654
Restricted – expendable	122,532,186	3,503,939	126,036,125
Total net assets	<u>122,532,186</u>	<u>3,772,593</u>	<u>126,304,779</u>
Total liabilities and net assets	<u>\$ 122,532,186</u>	<u>\$ 4,434,017</u>	<u>\$ 126,966,203</u>

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Combining Statement of Revenues, Expenses and Change in Net Assets
Year Ended June 30, 2012

	State Revolving Fund Activity	Non-SRF Activity	Total
Operating revenues			
Interest income from loans	\$ 275,163	\$ -	\$ 275,163
Administrative loan fees	-	2,421,462	2,421,462
Total operating revenues	275,163	2,421,462	2,696,625
Operating expenses			
Administrative	-	550,713	550,713
State program management	-	1,165,596	1,165,596
Water protection	-	1,188,539	1,188,539
Small systems	-	12,576	12,576
Total operating expenses	-	2,917,424	2,917,424
Operating income (loss)	275,163	(495,962)	(220,799)
Nonoperating revenues and expenses			
State contributions	2,715,000	-	2,715,000
Federal contributions	1,980,429	2,871,687	4,852,116
Federal ARRA contributions	789,257	-	789,257
Principal forgiveness for ARRA	(13,288,800)	-	(13,288,800)
Other interest income	146,800	-	146,800
Total nonoperating revenues and expenses	(7,657,314)	2,871,687	(4,785,627)
Interfund transfers	1,972,378	(1,972,378)	-
Change in net assets	(5,409,773)	403,347	(5,006,426)
Net assets			
Beginning of year	127,941,959	3,369,246	131,311,205
End of year	\$ 122,532,186	\$ 3,772,593	\$ 126,304,779

State of Hawaii
Drinking Water Treatment Revolving Loan Fund
Schedule of Operating Expenses
Year Ended June 30, 2012

	State Revolving Fund Activity	Non-SRF Activity	Total
Professional services	\$ -	\$ 1,272,734	\$ 1,272,734
Personnel	-	946,672	946,672
Services rendered by other State agencies	-	285,139	285,139
Depreciation	-	96,932	96,932
Travel	-	81,870	81,870
Repairs and maintenance	-	76,681	76,681
Office and other supplies	-	64,003	64,003
Training	-	49,290	49,290
Rental	-	11,200	11,200
Telephone	-	5,072	5,072
Equipment	-	4,093	4,093
Advertising and printing	-	2,320	2,320
Miscellaneous	-	21,418	21,418
Total	<u>\$ -</u>	<u>\$ 2,917,424</u>	<u>\$ 2,917,424</u>



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 State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund"), as of and for the year ended June 30, 2012, and have issued our report thereon dated December 5, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The

results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated December 5, 2012.

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

Accuity LLP

Honolulu, Hawaii
December 5, 2012



CERTIFIED PUBLIC ACCOUNTANTS

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

The Auditor
State of Hawaii

We have audited the financial statements of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of and for the year ended June 30, 2012, and have issued our report thereon dated December 5, 2012.

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

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

that are applicable to its Capitalization Grants for Drinking Water State Revolving Funds program (CFDA No. 66.468) for the year ended June 30, 2012. The management of the Fund is responsible for the Fund's compliance with these requirements. Our responsibility is to express an opinion on those requirements based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the United States *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the compliance requirements referred to above that could have a direct and material effect on the Capitalization Grants for Drinking Water State Revolving Funds program (CFDA No. 66.468) occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with the compliance requirements referred to above 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 Fund's compliance with the compliance requirements referred to above.

In our opinion, the Fund complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Funds program (CFDA No. 66.468) for the year ended June 30, 2012. However, the results of our auditing procedures disclosed an instance of noncompliance with those compliance requirements, which are required to be reported in accordance with the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Funds* and which is described in the accompanying schedule of findings and questioned costs as Finding No. 12-01.

Internal Control Over Compliance

Management of the Fund 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 Fund's internal control over compliance with the requirements that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Funds program (CFDA No. 66.468) to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of 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. However, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as Finding No. 12-01. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We also noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated December 5, 2012.

The Fund's response to the finding identified in our audit is described in the Fund's Corrective Action Plan. We did not audit the Fund's response and, accordingly, we express no opinion on it.

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

Accuity LLP

Honolulu, Hawaii
December 5, 2012

Schedule of Findings and Questioned Costs

**State of Hawaii
 Drinking Water Treatment Revolving Loan Fund
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2012**

		Questioned Cost
Finding No. 12-01:	Reporting (Significant Deficiency)	\$ _____ -
Federal Agency:	Environmental Protection Agency	
CFDA Number and Title:	66.468 - Capitalization Grants for Drinking Water State Revolving Funds	
Award Number and Award Year:	FS-99986511-0 FS-99986512-0	4/1/2011-6/30/2017 9/30/2011-6/30/2018

Finding and Cause and Effect

During our testing of the reporting compliance requirement, we noted that the Fund did not have supporting documentation available for the submission of the reporting required under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2011 and 2012 federal awards. The Fund did not establish adequate policies and procedures to ensure compliance with FFATA reporting requirements.

Criteria

In accordance with 2 Code of Federal Regulations Part 170, the Fund is required to report executive compensation and first-tier subcontract awards on contracts and orders expected to be \$25,000 or more made with a new Federal Assistance Identification Number effective October 1, 2010 through the Federal Funding Accountability and Transparency Subaward Reporting System on USASpending.gov.

Recommendation

We recommend that the Fund implement policies and procedures to maintain adequate supporting documentation of the submission of the required FFATA reporting for applicable subrecipient awards.

Corrective Action Plan

NEIL ABERCROMBIE
GOVERNOR OF HAWAII



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

STATE OF HAWAII
DEPARTMENT OF HEALTH
SAFE DRINKING WATER BRANCH
919 ALA MOANA BLVD., ROOM 308
HONOLULU, HI 96814-4920

In reply, please refer to:
File: SDWB
State Auditor1.Doc

December 5, 2012

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

Dear State Auditor:

Attached is the Department of Health's Corrective Action Plan to the finding on the audit report for fiscal year 2012 for the Drinking Water Treatment Revolving Loan Fund.

We appreciate the opportunity to comment on the audit report.

Sincerely,

JOANNA L. SETO, P.E., CHIEF
Safe Drinking Water Branch

AC:cb

Attachment

Federal Award Findings and Questioned Costs

Finding No. 12-01: Reporting (Significant Deficiency)

Finding and Cause and Effect

During our testing of the reporting compliance requirement, we noted that the Fund did not have supporting documentation available for the submission of the reporting required under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2011 and 2012 federal awards. The fund did not establish adequate policies and procedures to ensure compliance with FFATA reporting requirements.

Corrective Action Plan

The Safe Drinking Water Branch will be seeking advice from USEPA to establish policies and procedures to comply with the FFATA reporting requirements for fiscal year 2011 and 2012 federal awards and subsequent awards.

Person Responsible for Corrective Action

Safe Drinking Water Branch Chief

Anticipated Completion Date

December 31, 2012