

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

**Financial Statements**

**June 30, 2013**

**Submitted by  
The Auditor  
State of Hawaii**

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
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**June 30, 2013**

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## Report of Independent Auditors

The Auditor  
State of Hawaii

### **Report on the Financial Statements**

We have audited the accompanying statement of net position of the State of Hawaii, Drinking Water Treatment Revolving Loan Fund (the "Fund") as of June 30, 2013, and the related statements of revenues, expenses and change in net position, and cash flows for the year then ended, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

#### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### ***Auditors' Responsibility***

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinion.

#### ***Opinion***

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, 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

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. Our opinion is not modified with respect to this matter.

***Other Matters******Required Supplementary Information***

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.

***Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. 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 relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2013 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* in considering the Fund's internal control over financial reporting and compliance.

*Accuity LLP*

Honolulu, Hawaii  
November 15, 2013

# **Financial Statements**

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Statement of Net Position**  
**June 30, 2013**

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**Assets**

Current assets	
Equity in cash and cash equivalents and investments in State Treasury	\$ 64,924,192
Loan fees receivable	628,538
Accrued interest on loans	62,065
Other accrued interest	42,126
Due from federal government	492,371
Current maturities of loans receivable	<u>4,364,033</u>
Total current assets	70,513,325
Loans receivable, net of current maturities	56,972,708
Capital assets, net of accumulated depreciation	<u>184,683</u>
Total assets	<u>\$ 127,670,716</u>

**Liabilities and Net Position**

Current liabilities	
Accounts payable and other accrued liabilities	<u>\$ 349,062</u>
Total current liabilities	349,062
Accrued vacation, net of current portion	132,877
Other postemployment benefits	<u>489,814</u>
Total liabilities	971,753
Commitments and contingencies	
Net position	
Invested in capital assets	184,683
Restricted – expendable	<u>126,514,280</u>
Total net position	<u>126,698,963</u>
Total liabilities and net position	<u>\$ 127,670,716</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 Position**  
**Year Ended June 30, 2013**

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<b>Operating revenues</b>	
Interest income from loans	\$ 226,483
Administrative loan fees	2,227,522
Total operating revenues	<u>2,454,005</u>
<b>Operating expenses</b>	
Administrative	751,362
State program management	1,220,000
Water protection	638,121
Total operating expenses	<u>2,609,483</u>
Operating loss	(155,478)
<b>Nonoperating revenues and expenses</b>	
State contributions	2,715,000
Federal contributions	4,381,776
Federal ARRA contributions	367,813
Principal forgiveness for ARRA	(6,211,200)
Principal forgiveness for SRF	(1,003,006)
Other interest income	299,279
Total nonoperating revenues and expenses	<u>549,662</u>
Change in net position	394,184
<b>Net position</b>	
Beginning of year	<u>126,304,779</u>
End of year	<u>\$ 126,698,963</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, 2013**

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<b>Cash flows from operating activities</b>	
Interest income from loans	\$ 230,212
Administrative loan fees	2,282,949
Principal repayments on loans	15,132,349
Disbursement of loan proceeds	(3,315,509)
Payments to employees	(863,199)
Payments to vendors	(1,351,984)
	<u>12,114,818</u>
Net cash provided by operating activities	<u>12,114,818</u>
<b>Cash flows from noncapital financing activities</b>	
State contributions	2,715,000
Federal contributions	4,129,006
Federal ARRA contributions	367,813
Disbursement of ARRA advances	(367,813)
	<u>6,844,006</u>
Net cash provided by noncapital financing activities	<u>6,844,006</u>
<b>Cash flows from investing activities</b>	
Other interest income	<u>281,523</u>
Net cash provided by investing activities	<u>281,523</u>
Net increase in cash	19,240,347
<b>Equity in cash and cash equivalents and investments in State Treasury</b>	
Beginning of year	<u>45,683,845</u>
End of year	<u>\$ 64,924,192</u>
<b>Reconciliation of operating loss to net cash provided by operating activities</b>	
Operating loss	\$ (155,478)
Adjustments to reconcile operating loss to net cash provided by operating activities	
Depreciation expense	83,971
Principal forgiveness for SRF	(1,003,006)
Change in assets and liabilities	
Loans receivable	12,819,846
Accrued interest on loans	3,727
Loan fees receivable	55,429
Accounts payable and other accrued liabilities	148,016
Other postemployment benefits	162,313
Net cash provided by operating activities	<u>\$ 12,114,818</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, 2013**

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

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

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

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

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

The financial statements of the Fund are presented using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles prescribed by the Governmental Accounting Standards Board ("GASB") for proprietary funds. Accordingly, the Fund has adopted all GASB pronouncements, including the adoption of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, ("GASB Statement No. 62") in fiscal year 2013.

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 for loans and ARRA advances are reported as nonoperating expense.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2013**

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**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, 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, 2013, 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.

The State Department of Accounting and General Services (“DAGS”) informed State agencies that the State Treasury Investment Pool sold auction rate securities at par value in March 2013, which resulted in a gain. The Fund’s portion of the allocated gain for 2013 amounted to approximately \$140,000 and is included in other interest income.

**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 was 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, elected not to do so. ARRA funds provided to counties were classified as “ARRA Advances” on the Statement of Net Position upon disbursement. The ARRA advances were forgiven and expensed once all of the conditions and compliance requirements have been satisfied by the counties.

**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, 2013**

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**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, 2013, accumulated sick leave was approximately \$302,000.

**Net Position**

The Fund's net position is classified into two net position 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:** Restricted assets less liabilities 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 administrative loan fees and federal set aside funds.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2013**

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**Expenses**

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

**New Accounting Pronouncements**

Effective for the year ended June 30, 2013, the Fund adopted GASB Statement No. 62. The adoption of the statement did not have a material effect on the Fund's financial statements.

Effective for the year ended June 30, 2013, the Fund adopted GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The adoption of this statement did not have a material effect on the Fund's financial statements in fiscal year 2013. However, this statement may have a more material effect on the Fund's financial statements upon the adoption of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB Statement No. 65").

In April 2012, GASB issued Statement No. 65. 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.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. This statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. The provisions of this statement are effective for reporting periods beginning after June 15, 2013 with earlier application encouraged. 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, 2013**

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**3. Loans Receivable**

At June 30, 2013, 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.	\$ 19,420,959
Eleven loans receivable from the County of Hawaii, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.37%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	12,911,310
Eight loans receivable from the County of Maui, Department of Water Supply, due in semi-annual payments, including interest ranging from 0.00% to 1.00%, commencing not later than one year after project completion, notice to proceed, or loan agreement date. Final payment is due not later than twenty years after project completion.	5,250,969
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>23,753,503</u>
	61,336,741
Less: Current portion	<u>4,364,033</u>
Noncurrent portion	<u>\$ 56,972,708</u>

Loans are expected to mature at various dates through 2032. The scheduled principal payments on loans maturing in subsequent years are as follows:

2014	\$ 4,364,033
2015	4,389,817
2016	4,406,264
2017	4,423,177
2018	4,439,890
Thereafter	<u>39,313,560</u>
	<u>\$ 61,336,741</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 2013, \$1,003,000 and \$6,211,000 in loans and ARRA advances, respectively, were forgiven. All loans and advances were forgiven in accordance with the required conditions.

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2013**

At June 30, 2013, \$17,211,721, \$23,402,434 and \$20,898,104 were committed to be loaned to the County of Hawaii, City and County of Honolulu, and County of Maui, 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, 2013:

Budget Period	Amount	Total Draws at June 30, 2012	Total 2013 Cash Draws	Funds Available
10/01/05 – 06/30/13	\$ 8,303,100	\$ 8,122,093	\$ 181,007	\$ -
09/01/06 – 06/30/16	8,285,500	6,975,669	590,582	719,249
07/01/07 – 06/30/17	8,229,300	6,353,578	113,584	1,762,138
03/01/08 – 06/30/17	8,229,000	6,807,528	371,287	1,050,185
10/01/08 – 06/30/13 (ARRA)	19,500,000	19,132,187	367,813	-
03/01/09 – 06/30/18	8,146,000	585,778	395,987	7,164,235
01/01/10 – 06/30/19	8,146,000	178	175,761	7,970,061
04/01/11 – 06/30/17	13,573,000	380,148	979,171	12,213,681
09/30/11 – 06/30/18	9,268,000	230,121	1,321,445	7,716,434
09/28/12 – 06/30/19	9,125,000	-	182	9,124,818
	<u>\$ 100,804,900</u>	<u>\$ 48,587,280</u>	<u>\$ 4,496,819</u>	<u>\$ 47,720,801</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, 2013, the Fund was in compliance with the 20 percent State matching requirement. The required State match through June 30, 2013 approximated \$28.0 million, of which approximately \$19.4 million has been utilized and \$8.6 million was available to be loaned out at June 30, 2013.

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, 2013 is as follows:

	Balance at July 1, 2012	Additions	Retirements/ Transfers	Balance at June 30, 2013
Equipment	\$ 1,236,989	\$ -	\$ -	\$ 1,236,989
Accumulated depreciation	(968,335)	(83,971)	-	(1,052,306)
	<u>\$ 268,654</u>	<u>\$ (83,971)</u>	<u>\$ -</u>	<u>\$ 184,683</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Notes to Financial Statements**  
**June 30, 2013**

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**6. Accrued Vacation**

At June 30, 2013, long-term obligations included accrued vacation as follows:

Balance at July 1, 2012	\$ 133,590
Increase	51,552
Decrease	<u>(28,521)</u>
Balance at June 30, 2013	156,621
Less: Current portion	<u>23,744</u>
Noncurrent portion	<u>\$ 132,877</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 DAGS website: [ags.hawaii.gov/reports/financial-reports/](http://ags.hawaii.gov/reports/financial-reports/). 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, 2013**

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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, 2013:

Annual OPEB cost	\$ 223,387
Less: contributions made	<u>(61,074)</u>
Increase in net OPEB obligation	162,313
Net OPEB obligation	
Beginning of year	<u>327,501</u>
End of year	<u>\$ 489,814</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, 2013, 2012 and 2011 approximated \$61,000, \$47,000 and \$29,000, 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, 2013**

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**Receipts**

Principal repayments on loans	\$ 15,132,349
Interest income from loans	230,212
State contributions	2,715,000
Federal contributions	4,129,006
Federal ARRA contributions	367,813
Administrative loan fees	2,282,949
Investment interest	<u>281,523</u>
Total receipts	25,138,852

**Disbursements**

Disbursement of loan proceeds	3,315,509
Disbursement of ARRA advances	367,813
Administrative	510,840
State program management	1,070,443
Small systems	12,575
Water protection program	<u>621,325</u>
Total disbursements	<u>5,898,505</u>
Excess of receipts over disbursements	19,240,347

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

Beginning of year	<u>45,683,845</u>
End of year	<u>\$ 64,924,192</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Combining Statement of Net Position**  
**June 30, 2013**

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	<b>State Revolving Fund Activity</b>	<b>Non-SRF Activity</b>	<b>Total</b>
<b>Assets</b>			
Current assets			
Equity in cash and cash equivalents and investments in State Treasury	\$ 61,045,472	\$ 3,878,720	\$ 64,924,192
Loan fees receivable	-	628,538	628,538
Accrued interest on loans	62,065	-	62,065
Other accrued interest	42,126	-	42,126
Due from federal government	81,258	411,113	492,371
Current maturities of loans receivable	4,364,033	-	4,364,033
Total current assets	65,594,954	4,918,371	70,513,325
Loans receivable, net of current maturities	56,972,708	-	56,972,708
Capital assets, net of accumulated depreciation	-	184,683	184,683
Total assets	<u>\$ 122,567,662</u>	<u>\$ 5,103,054</u>	<u>\$ 127,670,716</u>
<b>Liabilities and Net Position</b>			
Current liabilities			
Accounts payable and other accrued liabilities	\$ -	\$ 349,062	\$ 349,062
Total current liabilities	-	349,062	349,062
Accrued vacation, net of current portion	-	132,877	132,877
Other postemployment benefits	-	489,814	489,814
Total liabilities	-	971,753	971,753
Net position			
Invested in capital assets	-	184,683	184,683
Restricted – expendable	122,567,662	3,946,618	126,514,280
Total net position	<u>122,567,662</u>	<u>4,131,301</u>	<u>126,698,963</u>
Total liabilities and net position	<u>\$ 122,567,662</u>	<u>\$ 5,103,054</u>	<u>\$ 127,670,716</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Combining Statement of Revenues, Expenses and Change in Net Position**  
**Year Ended June 30, 2013**

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	State Revolving Fund Activity	Non-SRF Activity	Total
<b>Operating revenues</b>			
Interest income from loans	\$ 226,483	\$ -	\$ 226,483
Administrative loan fees	-	2,227,522	2,227,522
Total operating revenues	226,483	2,227,522	2,454,005
<b>Operating expenses</b>			
Administrative	-	751,362	751,362
State program management	-	1,220,000	1,220,000
Water protection	-	638,121	638,121
Total operating expenses	-	2,609,483	2,609,483
Operating income (loss)	226,483	(381,961)	(155,478)
<b>Nonoperating revenues and expenses</b>			
State contributions	2,715,000	-	2,715,000
Federal contributions	2,169,210	2,212,566	4,381,776
Federal ARRA contributions	367,813	-	367,813
Principal forgiveness for ARRA	(6,211,200)	-	(6,211,200)
Principal forgiveness for SRF	(1,003,006)	-	(1,003,006)
Other interest income	299,279	-	299,279
Total nonoperating revenues and expenses	(1,662,904)	2,212,566	549,662
Interfund transfers	1,471,897	(1,471,897)	-
Change in net position	35,476	358,708	394,184
<b>Net position</b>			
Beginning of year	122,532,186	3,772,593	126,304,779
End of year	<u>\$ 122,567,662</u>	<u>\$ 4,131,301</u>	<u>\$ 126,698,963</u>

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Schedule of Operating Expenses**  
**Year Ended June 30, 2013**

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	<b>State Revolving Fund Activity</b>	<b>Non-SRF Activity</b>	<b>Total</b>
Personnel	\$ -	\$ 1,053,305	\$ 1,053,305
Professional services	-	833,445	833,445
Services rendered by other State agencies	-	374,972	374,972
Travel	-	105,806	105,806
Depreciation	-	83,971	83,971
Repairs and maintenance	-	70,031	70,031
Training	-	53,392	53,392
Office and other supplies	-	16,874	16,874
Miscellaneous	-	17,687	17,687
Total	<u>\$ -</u>	<u>\$ 2,609,483</u>	<u>\$ 2,609,483</u>

**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, 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, 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, 2013, and the related notes to the financial statements, and have issued our report thereon dated November 15, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

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

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**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 November 15, 2013.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Accuity LLP

Honolulu, Hawaii  
November 15, 2013

**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, 2013, and have issued our report thereon dated November 15, 2013.

**Report on Compliance**

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 Fund's program (CFDA No. 66.468) (the "Program") for the year ended June 30, 2013.

***Management's Responsibility***

The management of the Fund is responsible for the Fund's compliance with the requirements of laws, regulations, contracts, and grants applicable to the Program.

***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the 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 Program occurred. An audit includes examining, on a test basis, evidence about the Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the Program. However, our audit does not provide a legal determination of the Fund's compliance with the compliance requirements referred to above.

### **Opinion**

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, 2013.

### **Other Matters**

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. 13-01. Our opinion on the Program is not modified with respect to this matter.

The Fund's response to the finding identified in our audit is described in the Fund's Corrective Action Plan. The Fund's response was not subjected to auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

### **Report on Internal Control Over Compliance**

Management of the Fund is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Fund's internal control over compliance with the types of requirements that could have a direct and material effect on the Program to determine the auditing procedures that are appropriate in the circumstances 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 the 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 the Program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of the Program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. 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. 13-01. We also noted certain matters that we reported to the Auditor and management of the Fund in a separate letter dated November 15, 2013.

The Fund's response to the internal control over compliance finding identified in our audit is described in the Fund's Corrective Action Plan. The Fund's response was not subjected to auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the *Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Accordingly, this report is not suitable for any other purpose.

Accuity LLP

Honolulu, Hawaii  
November 15, 2013

# **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, 2013**

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		<b>Questioned Cost</b>
<b>Finding No. 13-01:</b>	<b>Reporting (Significant Deficiency)</b>	<b>\$ _____ -</b>
<b>Federal Agency:</b>	Environmental Protection Agency ("EPA")	
<b>CFDA Number and Title:</b>	66.468 – Capitalization Grants for Drinking Water State Revolving Funds	
<b>Award Number and Award Year:</b>	FS-99986513-0	9/28/2012-6/30/2019

**Finding and Cause and Effect**

During our testing of the reporting compliance requirement, we noted that the Fund did not report subawards in the Federal Funding Accountability and Transparency Subaward Reporting System on FSRS.gov required under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2013 federal awards.

Program management misunderstood guidance from the EPA requiring states to report subaward information to the EPA on its Projects and Benefits Reporting ("PBR") system but also report the required subaward information on FSRS.gov to comply with FFATA. Although the Program properly reported subaward information on PBR, it did not report the required subaward information on FSRS.gov.

Noncompliance with FFATA reporting requirements reduces transparency of federal awards and could result in sanctions by the EPA including increased oversight and/or reduction or elimination of federal awards.

**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 FSRS.gov.

**Recommendation**

We recommend that the Fund implement policies and procedures to ensure required subawards are properly reported on FSRS.gov to comply with FFATA.

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

**State of Hawaii**  
**Drinking Water Treatment Revolving Loan Fund**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2013**

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

During our prior year 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.

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

**Status**

Unresolved. A similar finding is reported in current year Finding No. 13-01. Therefore, this finding will not be carried forward.

**Corrective Action Plan**  
**(Unaudited)**

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  
StateAuditor02.docx

November 18, 2013

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 for the finding noted in the *State of Hawaii Drinking Water Treatment Revolving Loan Fund Financial Statements* audit report, dated June 30, 2013.

We appreciate the opportunity to comment on the report.

Sincerely,

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

AC:mc

Attachment

**Drinking Water Treatment Revolving Loan Fund  
Federal Award Finding and Questioned Costs**

**Finding No. 13-01: Reporting (Significant Deficiency)**

Finding and Cause and Effect

During our testing of the reporting compliance requirement, we noted that the Fund did not meet the deadline for submission of reports under the Federal Funding Accountability and Transparency Act ("FFATA") for subrecipient awards made from its fiscal year 2013 federal awards.

Program management misunderstood guidance from the EPA requiring states to report subaward information to the EPA on its Projects and Benefits Reporting ("PBR") system but also report the required subaward information on FSRS.gov to comply with FFATA. Although the Program properly reported subaward information on PBR, it did not report the required subaward information on FSRS.gov.

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 FFATA Subaward Reporting System on FSRS.gov no later than the last day of the month following the month in which the subaward obligation was made.

Corrective Action Plan

The Safe Drinking Water Branch will submit the FFATA report for SFY 2013 to [www.FSRS.gov](http://www.FSRS.gov) by December 2, 2013. For future FFATA reporting on FSRS, the date that the loan is "made and entered into," as stated in the first paragraph of the final loan, will be tracked to ensure that PBR and FSRS.gov reporting is completed no later than the last day of the month following the month in which the final loan was "made and entered into."

Person Responsible for Corrective Action

Safe Drinking Water Branch Chief

Completion Date

December 2, 2013