



**NISHIHAMA & KISHIDA, CPA'S, INC.**  
CERTIFIED PUBLIC ACCOUNTANTS

**FINANCIAL AUDIT OF THE  
DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

**Fiscal Year Ended June 30, 2005**

**Submitted by  
The Auditor  
State of Hawaii**



**NISHIHAMA & KISHIDA, CPA'S, INC.**  
CERTIFIED PUBLIC ACCOUNTANTS

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March 28, 2006

Ms. Marion Higa  
Office of the Auditor  
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audit of the Department of Education (DOE), State of Hawaii for the fiscal year ended June 30, 2005. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the *Compliance Supplement for Single Audits of State and Local Governments*.

## **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DOE's financial statements for the fiscal year ended June 30, 2005, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the DOE's financial statements.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the DOE is entitled have been collected and accounted for in accordance with the laws, rules and regulations, administrative directives, policies and procedures of the State of Hawaii and the federal government.
3. To determine whether the DOE has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws, regulations, contracts, and grants.
4. To determine whether the DOE has complied with the laws, regulations, contracts, and grants that may have a material effect on the financial statements and on each major federal financial assistance program.

## SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2005.

## ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the DOE as of and for the fiscal year ended June 30, 2005, and our opinion on the basic financial statements.
- Part II - Our report on internal control over financial reporting and on compliance and other matters.
- Part III - Our report on compliance with requirements applicable to each major program and on internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - Corrective action plan as provided by the Department of Education, State of Hawaii.
- Part VI - The summary schedule of prior audit findings.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DOE.

Sincerely,



Ron T. Shiigi  
Principal

**DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

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**DEPARTMENT OF EDUCATION  
STATE OF HAWAII**

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**PART I**  
**FINANCIAL SECTION**



NISHIHAMA & KISHIDA, CPA's, INC.  
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## INDEPENDENT AUDITORS' REPORT

To the Auditor  
Office of the Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2005, which collectively comprise the DOE's basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the DOE's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

As discussed in Note A, the financial statements of the DOE are intended to present the financial position and the changes in financial position, where applicable, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2005, and the changes in its financial position, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the DOE, as of June 30, 2005,

and the respective changes in financial position, where applicable, thereof and the respective budgetary comparison for the general fund for the fiscal 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 February 28, 2006, on our consideration of the DOE's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the DOE's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
February 28, 2006

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**Fiscal Year Ended June 30, 2005**

The following management's discussion and analysis provides an overview of the Department of Education's financial activities for the fiscal year ended June 30, 2005. Readers should also review the basic financial statements and notes to enhance their understanding of the Department's financial performance.

## **FINANCIAL HIGHLIGHTS**

Key government-wide financial highlights for FY2004-05 are as follows:

- General fund revenues were \$1.544 billion. Federal grant, capital project, program reimbursement, and other revenues totaled \$292 million.
- Total expenses were \$1.838 billion, of which 96% or \$1.762 billion, was spent for school-level instruction and support services.
- Total assets exceeded liabilities by \$768 million (net assets). Land and depreciated capital assets (land improvements, buildings, building improvements, and equipment) comprise 83% of total assets.
- Net assets decreased by \$19 million, primarily due to current year depreciation expense and increases in net compensated absence credits and workers' compensation liability.

## **OVERVIEW OF THE FINANCIAL STATEMENTS**

The financial statements consist of three sections: management's discussion and analysis (this section), basic financial statements and notes, and required supplementary information. These sections are described below.

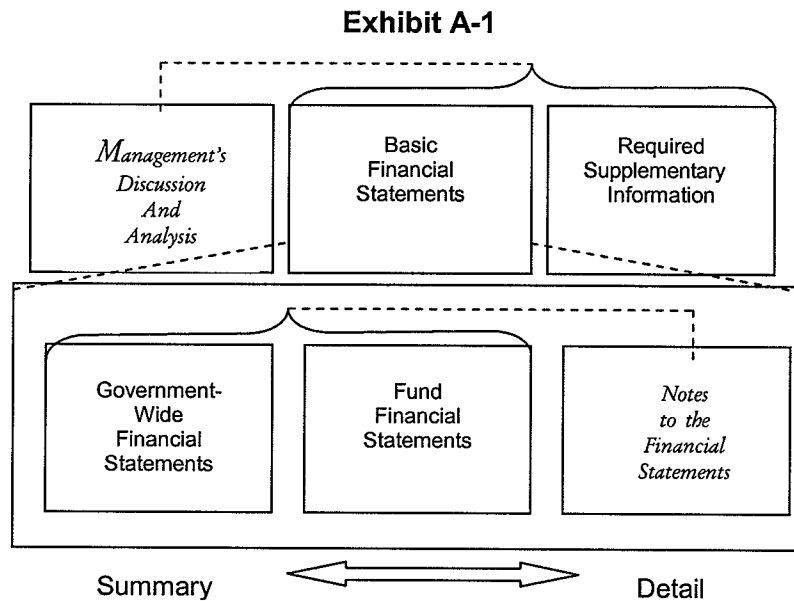
The basic financial statements include government-wide and fund financial statements, which provide different views of the Department:

- *Government-wide financial statements* provide both *long-term* and *short-term* information about the Department's *overall* financial position and results of operations. The statements are presented on an accrual basis of accounting and consist of the Statement of Net Assets and the Statement of Activities.
- *Fund financial statements* focus on *individual* parts of the Department and report operations in more detail than the government-wide statements. Governmental funds statements include most of the Department's programs and services such as instruction, support services, operation and maintenance of facilities, student transportation, and extracurricular activities and are presented on a modified accrual basis of accounting. Fiduciary funds statement report on agency funds, which are held in a custodial capacity for students' school activities that take place outside of the formal class period and are not requirements for class work or credit. Certain activities, such as depreciation expense, are included in the government-wide financial statements but not the fund financial statements. These activities are highlighted in the financial statement's *Reconciliation of the Change in Fund Balances of Governmental Funds to the Statement of Activities*.

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

Notes are included in the financial statements to explain financial statement information and provide more detailed data. The basic financial statements are followed by a section of required supplementary information. This section further explains and supports the information in the financial statements.

Exhibit A-1 shows how the required parts of this annual report are arranged and relate to one another.



**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**GOVERNMENT-WIDE FINANCIAL ANALYSIS**

The following discussion highlights management's understanding of the key aspects of the Department's financial activities.

**Net Assets.** The Department's largest portion of net assets is capital assets (e.g. land, buildings, equipment), which are unavailable for future spending. The Department's unrestricted net assets are available for future use to provide program services. However, in FY2004-05, liabilities exceeded unrestricted assets (cash and receivables).

**Exhibit A-2**  
**Government-Wide**  
**Condensed Statement of Net Assets**  
**Fiscal Years 2005 and 2004**  
**(Amounts in millions)**

	<u>Governmental Activities</u>	
	<u>2005</u>	<u>2004</u>
Assets		
Current	\$ 170.0	\$ 156.8
Non-current (Capital assets, net depreciation)	<u>807.9</u>	<u>810.0</u>
<b>TOTAL ASSETS</b>	<b>\$ <u>977.9</u></b>	<b>\$ <u>966.8</u></b>
Liabilities		
Current	\$ 138.7	\$ 122.4
Non-current	<u>70.9</u>	<u>57.0</u>
<b>Total Liabilities</b>	<b><u>209.6</u></b>	<b><u>179.4</u></b>
Net Assets		
Restricted (Capital assets, net depreciation)	807.9	810.0
Unrestricted	<u>(39.6)</u>	<u>(22.6)</u>
<b>Total Net Assets</b>	<b><u>768.3</u></b>	<b><u>787.4</u></b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ <u>977.9</u></b>	<b>\$ <u>966.8</u></b>

**Changes in Net Assets.** Total net assets decreased by \$19 million (see Exhibit A-3). However, the Department did not outspend available funds. The State's budget guidelines do not allow cash expenditures in excess of available funds. The decrease is primarily due to current year depreciation expense and increases in net compensated absence credits and workers' compensation liability. Refer to Note C for details of capital assets and depreciation by category.

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

Depreciation expense does not require the use of cash; it is an accounting term representing the decrease in assets' value over a period of time. This includes wear, tear, age, deterioration, and obsolescence. Although depreciation is a commonly known term in commercial industry, GASB 34 requires all governmental agencies to record depreciation of its capital assets.

**Exhibit A-3**  
**Government-Wide**  
**Changes in Net Assets**  
**Fiscal Years 2005 and 2004**  
**(Amounts in millions)**

	<u>Governmental Activities</u>	
	<u>2005</u>	<u>2004</u>
Revenues		
State appropriations	\$ 1,544.2	\$ 1,430.0
Federal funds	235.3	224.5
Other revenues	<u>56.7</u>	<u>45.7</u>
Total Revenues	<u>1,836.2</u>	<u>1,700.2</u>
Expenses		
School level instruction	1,063.3	1,045.5
Comprehensive student support	406.7	398.5
Instructional support	44.5	47.3
State and district administration	40.1	36.7
School support	228.1	196.3
School community service	19.3	17.6
Public libraries	31.3	29.7
Capital outlay	14.7	.7
Other	<u>7.3</u>	<u>5.7</u>
Total Expenses	<u>1,855.3</u>	<u>1,778.0</u>
Transfers	<u>--</u>	<u>.3</u>
Change in Net Assets	(19.1)	(77.5)
Beginning Net Assets	<u>787.4</u>	<u>864.9</u>
Ending Net Assets	\$ <u>768.3</u>	\$ <u>787.4</u>

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**EXPLANATION OF MAJOR DEPARTMENTAL PROGRAMS**

The State Budget is organized by major program areas. The Department's major programs are:

<u>Program #</u>	<u>Program Title</u>	<u>Program Description</u>
EDN 100	School-Based Budgeting	Instructional services, curriculum programs, at-risk programs, fringe benefits, and debt service.
EDN 150	Comprehensive Student Support Services	Special needs assessment, special education services, school-based behavioral health services, and other related services required for a free and appropriate public education, autism services, and professional development.
EDN 200	Instructional Support	Curriculum support, assessment, planning, information technology support, and school leadership training.
EDN 300	State and District Administration	Board of Education, Superintendent, Complex Area Superintendents, budget, communications, civil rights compliance, internal audit, business services, human resources, and information technology.
EDN 400	School Support	School food services, utilities, custodial services, repair and maintenance, and student transportation.
EDN 407	Hawaii State Public Library System	The Hawaii State Public Library System is included in the Department's combined financial statements since both the Library System and the Department are administratively and legally supervised by the Hawaii State Board of Education.
EDN 500	School Community Services	After school care and adult education.

**State of Hawaii  
Department of Education  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2005**

Exhibit A-4 summarizes the Department's revenue. Revenues are primarily from state general funds (taxpayer monies). Other revenues are from federal grants, special funds to support specific programs such as cafeteria collections for school food services, and donations.

**Exhibit A-4**

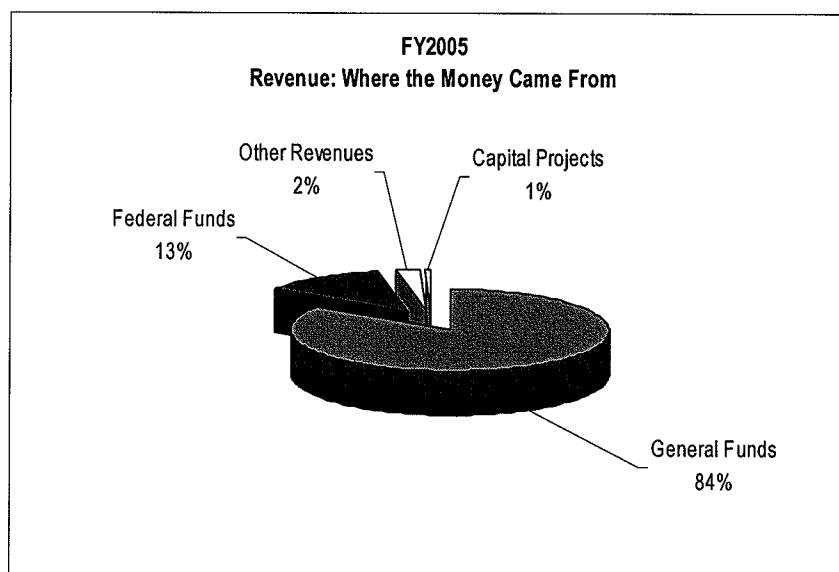
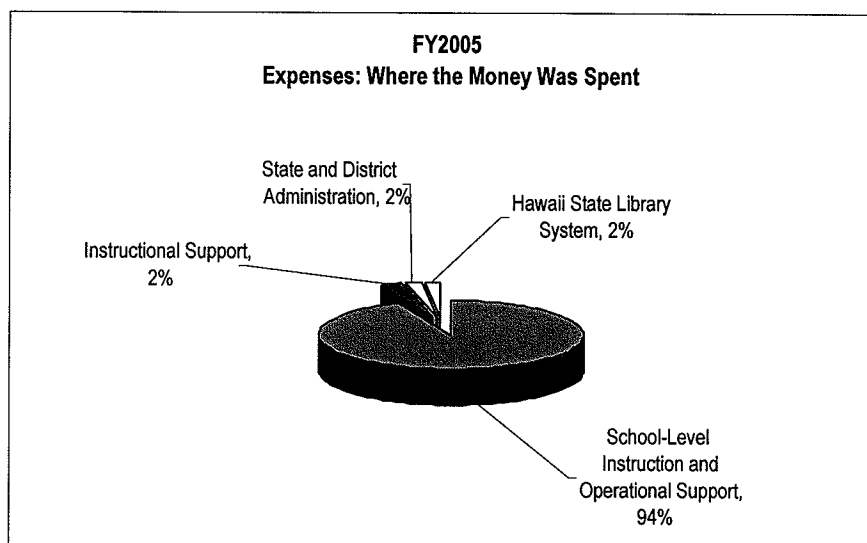


Exhibit A-5 summarizes the Department's expenses. A total of 94% of Department expenditures are for school-level instructional and support programs in EDN 100, 150, 400, and 500, while only 2% are for State and District Administration.

**Exhibit A-5**



**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**GENERAL FUND BUDGETARY HIGHLIGHTS**

The Department was appropriated general funds of \$1,547.0 million in FY2004-05. General fund allotments increased due to School Based Budgeting (\$43.0 million), Comprehensive School Support (\$8.1 million), and SLH 2005 legislative acts 6, 51, and 87 (\$32.0 million), which were offset by decreases to State and District Administration (\$1.6 million) and reduced General Fund carryover (\$9.3 million).

The law permits the Department to "carryover" up to 5% of general fund appropriations from one fiscal year to the next. The Department carried over \$12.7 million in FY2003-04 general fund appropriations for expenditures in FY2004-05. Carryover funds enable schools to make long-range fiscal plans, save for major purchases for which single year funding may not be sufficient, and provide funds to start the next school year, which occurs within weeks of the beginning of the fiscal year.

**FIDUCIARY FUNDS**

Fiduciary funds or "local school funds" are held for students in a custodial capacity and do not require deposit into the State Treasury. The fund contains monies collected and maintained by schools for students. Examples include yearbook, newspaper fund, student government dues, physical education uniform sales, and excursions. The funds are used for school activities that take place outside formal class periods and are not required for class work or credit.

Fiduciary fund net assets were \$17.4 million in FY2004-05, resulting in \$3.0 million (21%) increase from the prior fiscal year.

**CAPITAL ASSET AND DEBT ADMINISTRATION**

The Department's capital improvement program strives to provide facilities that are well placed, sufficient in number, flexible, functional, and creatively designed to accommodate population changes, support educational programs, and promote health and safety of students, employees, and the public. The Departments of Accounting and General Services, Land and Natural Resources, and Budget and Finance assist the department with various aspects of capital improvement.

Buildings, building improvements, and land improvements less than \$100,000 are not reported as capital assets. This fiscal year's capital improvements included the construction of 17 classrooms. Other projects are under construction, in the bid process, or are being designed. Four new schools - Mililani Ike Elementary, Nanaikapono Elementary, Ocean Pointe Elementary, and Maui Lani Elementary were under construction and 28 classroom projects were being designed. Please refer to Note E for capital asset details.

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

The Department's long-term debt is managed by the Department of Budget and Finance; however, general fund appropriations for interest payment and debt retirement are included in the Department's budget. Interest payments and debt retired were \$98.3 million in FY2004-05, resulting in less than a 1% decrease from the prior fiscal year.

### **ECONOMIC FACTORS AND NEXT YEAR'S BUDGET**

The State's unemployment rate has been at a record low with seasonally adjusted unemployment rate being as low as 2.7% in October. One year ago, Hawaii's seasonally adjusted unemployment rate was 3.1% while the national rate was 5.5%.

Cumulative tax collections for the first five months of FY2005-06 exceeded \$2.0 billion or \$244.4 million more than the corresponding period last year. General excise and use tax collections, which are the largest source of revenue and a good measure of economic growth, increased 13.0% in the same period.

In September 2005, the Council on Revenues estimated that the General Fund tax growth rate would be 6.0% in FY2005-06 and 6.6% in FY2006-07. Actual General Fund tax collections rose by 13.7% in the first five months of FY2005-06 from FY 2004-05. Higher general excise and use tax collections and the substantial rise in corporate income tax collections were the primary factors underlying this strong performance. In November, the Council on Revenues revised its forecast of Hawaii's growth in 2006 total personal income from 7.3% to 8.2%.

### **FUTURE EVENTS THAT WILL FINANCIALLY IMPACT THE DEPARTMENT**

Act 51, the Reinventing Education Act of 2004, has enabled the Department to significantly reshape Hawaii's public school system. The Act identifies a number of critical goals, with some financially impacting the Department.

The Act strives to address student individual needs by requiring the establishment of a weighted student formula to allocate funds to public schools. It also requires that school principals expend not less than seventy per cent (70%) of operating funds for the Department, excluding debt service and capital improvement programs. These efforts will be directed towards strengthening the relationship of financial resources to the academic plans of each school, with the overall goal of improving student achievement. The proposed weighted student formula timeline has included:

- Development of weights in school year 2004-05, with refinements in 2005-06;
- A pilot program during school years 2004-05 and 2005-06;
- Intensive training in school years 2004-05 and 2005-06; and
- Full implementation by school year 2006-07.
- Single school calendar implementation by school year 2006-07, resulting in \$24 million cost for two paychecks provided to 10-month employees affected by the calendar change.

**State of Hawaii**  
**Department of Education**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
**Fiscal Year Ended June 30, 2005**

The Act also strives to remove bureaucratic constraints that hamper the effectiveness of the Department. To do this, the Act requires that certain State functions, accounts, and personnel be transferred to the Department. The State Educational Facilities Repair and Maintenance Account and the School Physical Plant Operations and Maintenance Account (excluding positions funded by these accounts) were transferred from the Department of Accounting and General Services effective July 1, 2004.

Effective July 1, 2005, the Department of Accounting and General Services transferred capital improvement projects, contract administration functions, repair and maintenance functions, and positions to the Department. The State Department of Human Resources Development also transferred centralized human resources system, recruitment, certification, examination, management, classification, and compensation of the Department's employees, including labor relations functions to the Department.

Future transfers to the Department from other State departments will include:

- The State Department of Human Services - employment background checks for the After-School Plus Program, private vendors, and other employees
- The State Department of Health - transfer school health aides and public health nurses who supervise the school nurse aids

In addition to Act 51, the Federal No Child Left Behind Act is an under funded federal mandate. The Department estimates that as much as \$30 million in additional resources is needed for compliance in Fiscal Year 2006, and the amount will grow larger in Fiscal Year 2006 if Title I schools currently in need of improvement or corrective action do not make Adequate Yearly Progress (AYP) by 2006. Title I schools are those with the highest concentrations of poverty which are receiving federal fund support to help disadvantaged students meet the same high standards expected of all students. However, the performance goals specified by the Act call for the Department to implement the requirements for all students, not only Title I. The Act does not provide any funding to implement the requirements for non-Title I schools. Additional resources are needed to: recruit, train, and pay highly qualified professionals and paraprofessionals; provide extended school programs; provide student support services such as English for Second Language Learners (ESLL), special education, and high school reform; provide safe school environments; and implement the infrastructure required for testing, accountability analyses, and data collection.

#### **CONTACTING THE DEPARTMENT'S FINANCIAL MANAGEMENT**

The financial report is designed to provide the public with a general overview of the Department's finances and demonstrate the Department's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Office of the Superintendent, Department of Education, P.O. Box 2360, Honolulu, Hawaii 96804.

**Department of Education  
State of Hawaii  
STATEMENT OF NET ASSETS  
June 30, 2005**

<b>ASSETS</b>	<u>Governmental Activities</u>
Cash	\$ 159,107,726
Certificates of deposit	10,764
Receivables	
Due from federal government	10,178,134
Accounts receivable	633,872
Due from other agency	<u>65,628</u>
Total current assets	169,996,124
Property and equipment, net of accumulated depreciation	<u>807,922,867</u>
Total assets	\$ <u><u>977,918,991</u></u>
<b>LIABILITIES</b>	
Current liabilities	
Vouchers and contracts payable	\$ 27,175,574
Accrued wages and employee benefits	84,449,810
Accrued compensated absences	6,542,009
Current portion of workers' compensation claims	12,849,800
Deferred revenues	1,779,186
Due to State of Hawaii General Fund	5,109,076
Due to others	<u>878,447</u>
Total current liabilities	138,783,902
Accrued compensated absences, less current portion	38,464,039
Workers' compensation claims	<u>32,413,268</u>
Total liabilities	<u>209,661,209</u>
<b>NET ASSETS</b>	
Investment in capital assets	807,922,867
Unrestricted	<u>(39,665,085)</u>
Total net assets	\$ <u><u>768,257,782</u></u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2005**

19

Functions/Programs	Expenses	Program Revenues		Net Expense and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Governmental Activities
Governmental activities:				
School level instruction	\$ 1,063,377,689	\$ 8,759,381	\$ 137,006,101	\$ (917,612,207)
Comprehensive student support	406,705,714	--	37,861,026	(368,844,688)
Instructional support	44,480,426	4,191,897	11,519,113	(28,769,416)
State and district administration	40,098,443	791,648	25,414	(39,281,381)
School support	228,152,943	19,077,501	43,669,402	(165,406,040)
School community service	19,266,827	2,292,491	3,999,859	(12,974,477)
Public libraries	31,303,460	2,191,430	1,205,650	(27,906,380)
Capital outlay	14,670,408	--	10,819,000	(3,851,408)
Other	7,275,256	--	7,850,044	574,788
Total governmental activities	\$ <u>1,855,331,166</u>	\$ <u>37,304,348</u>	\$ <u>253,955,609</u>	<u>(1,564,071,209)</u>
General revenues:				
State allotted appropriations, net of lapses				1,544,199,965
Unrestricted investment earnings				<u>772,538</u>
Total general revenues				<u>1,544,972,503</u>
Change in net assets				(19,098,706)
Net assets at July 1, 2004				<u>787,356,488</u>
Net assets at June 30, 2005				\$ <u>768,257,782</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
BALANCE SHEET - GOVERNMENTAL FUNDS  
June 30, 2005**

	General	Federal	Capital Projects	Other	Total
<b>ASSETS</b>					
Cash	\$ 87,028,484	\$ 35,217,525	\$ 3,401,506	\$ 33,460,211	\$ 159,107,726
Certificates of deposit	--	--	--	10,764	10,764
Receivables					
Due from federal government	--	10,178,134	--	--	10,178,134
Accounts receivable	--	--	--	633,872	633,872
Due from other agency	--	--	--	65,628	65,628
Total assets	<u>\$ 87,028,484</u>	<u>\$ 45,395,659</u>	<u>\$ 3,401,506</u>	<u>\$ 34,170,475</u>	<u>\$ 169,996,124</u>
<b>LIABILITIES AND FUND BALANCES</b>					
<b>LIABILITIES</b>					
Vouchers and contracts payable	\$ 15,433,664	\$ 4,490,702	\$ 5,111,598	\$ 2,139,610	\$ 27,175,574
Accrued wages and employee benefits payable	78,439,778	4,285,691	21,904	1,702,437	84,449,810
Deferred revenues	--	1,779,186	--	--	1,779,186
Due to State of Hawaii General Fund	5,109,076	--	--	--	5,109,076
Due to others	--	878,447	--	--	878,447
Total liabilities	<u>98,982,518</u>	<u>11,434,026</u>	<u>5,133,502</u>	<u>3,842,047</u>	<u>119,392,093</u>
<b>FUND BALANCES</b>					
Reserved for encumbrances	37,101,100	10,900,742	36,129,485	2,535,176	86,666,503
Reserved for continuing appropriations	30,780,541	--	--	--	30,780,541
Unreserved	<u>(79,835,675)</u>	<u>23,060,891</u>	<u>(37,861,481)</u>	<u>27,793,252</u>	<u>(66,843,013)</u>
Total fund balances (deficit)	<u>(11,954,034)</u>	<u>33,961,633</u>	<u>(1,731,996)</u>	<u>30,328,428</u>	<u>50,604,031</u>
Total liabilities and fund balances	<u>\$ 87,028,484</u>	<u>\$ 45,395,659</u>	<u>\$ 3,401,506</u>	<u>\$ 34,170,475</u>	<u>\$ 169,996,124</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE  
TO THE STATEMENT OF NET ASSETS  
June 30, 2005**

<b>Total fund balances - governmental funds</b>		<b>\$ 50,604,031</b>
<b>Amounts reported for governmental activities in the statement of net assets are different because:</b>		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Governmental capital assets	\$ 1,668,331,746	
Less accumulated depreciation	<u>(860,408,879)</u>	807,922,867
Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds.		
		(45,006,048)
Accrued workers' compensation liability is not due in the current period and therefore is not reported in the governmental funds.		
		<u>(45,263,068)</u>
<b>Net assets of governmental activities</b>		<b>\$ <u>768,257,782</u></b>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
Fiscal Year Ended June 30, 2005**

	General	Federal	Capital Projects	Other	Total
<b>REVENUES</b>					
State allotments, net	\$ 1,544,199,965	\$ --	\$ --	\$ --	\$ 1,544,199,965
Intergovernmental revenues	--	235,308,762	--	--	235,308,762
Other revenues	--	--	10,819,000	45,904,733	56,723,733
	<u>1,544,199,965</u>	<u>235,308,762</u>	<u>10,819,000</u>	<u>45,904,733</u>	<u>1,836,232,460</u>
<b>EXPENDITURES</b>					
School level instruction	915,135,882	119,310,940	--	7,773,192	1,042,220,014
Comprehensive student support	355,959,817	50,745,896	--	--	406,705,713
Instructional support	31,800,606	11,519,113	--	1,377,890	44,697,609
State and district administration	36,812,473	1,673,423	--	730,159	39,216,055
School support	147,384,587	56,712,343	--	23,841,578	227,938,508
School community service	12,531,441	4,067,066	--	2,676,795	19,275,302
Public libraries	32,735,607	1,227,847	--	2,201,025	36,164,479
Capital outlay	--	--	14,670,408	--	14,670,408
Other	1,157,154	--	--	6,111,880	7,269,034
	<u>1,533,517,567</u>	<u>245,256,628</u>	<u>14,670,408</u>	<u>44,712,519</u>	<u>1,838,157,122</u>
<b>NET CHANGE IN FUND BALANCES</b>	10,682,398	(9,947,866)	(3,851,408)	1,192,214	(1,924,662)
<b>FUND BALANCES AT JULY 1, 2004</b>	<u>(22,636,432)</u>	<u>43,909,499</u>	<u>2,119,412</u>	<u>29,136,214</u>	<u>52,528,693</u>
<b>FUND BALANCES AT JUNE 30, 2005</b>	\$ <u>(11,954,034)</u>	\$ <u>33,961,633</u>	\$ <u>(1,731,996)</u>	\$ <u>30,328,428</u>	\$ <u>50,604,031</u>

See accompanying notes to the basic financial statements.

**Department of Education**  
**State of Hawaii**  
**RECONCILIATION OF THE CHANGE IN FUND BALANCE**  
**OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**  
**Fiscal Year Ended June 30, 2005**

Net change in fund balances - total governmental funds	\$ (1,924,662)
--	----------------

**Amounts reported for governmental activities in the statement of activities are different because:**

Governmental funds report capital outlays as expenditures.  
 However, in the statement of activities, the cost of those  
 assets are depreciated over their estimated useful lives.

Expenditures for capital assets	\$ 56,087,575	
Loss on disposal of capital assets	(490,338)	
Less current fiscal year depreciation	<u>(57,693,378)</u>	(2,096,141)

Change in long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	(5,105,860)
---	-------------

Change in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	<u>(9,972,043)</u>
--	--------------------

Change in net assets of governmental activities	\$ <u>(19,098,706)</u>
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See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - GENERAL FUND  
Fiscal Year Ended June 30, 2005**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Budgetary fund</b>				
<b>balance, July 1, 2004</b>	\$ <u>13,431,879</u>	\$ <u>13,431,879</u>	\$ <u>13,431,879</u>	\$ <u>          --</u>
<b>Revenues</b>				
State allotments	<u>1,543,651,357</u>	<u>1,556,577,898</u>	<u>1,544,199,965</u>	<u>(12,377,933)</u>
<b>Expenditures</b>				
School level instruction	1,046,199,168	1,049,649,168	1,016,989,783	32,659,385
Comprehensive student support services	295,369,999	294,552,069	285,527,434	9,024,635
Instructional support	30,344,769	28,788,269	28,780,264	8,005
State and district administration	33,978,255	32,024,755	32,020,492	4,263
School support	112,641,106	127,364,116	126,661,042	703,074
School community service	11,801,125	11,046,597	11,043,879	2,718
Public libraries	<u>26,748,814</u>	<u>26,584,803</u>	<u>26,584,299</u>	<u>504</u>
	<u>1,557,083,236</u>	<u>1,570,009,777</u>	<u>1,527,607,193</u>	<u>42,402,584</u>
<b>EXCESS (DEFICIENCY) REVENUES OVER EXPENDITURES</b>	(13,431,879)	(13,431,879)	16,592,772	30,024,651
<b>Budgetary fund</b>				
<b>balance, June 30, 2005</b>	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>30,024,651</u>	\$ <u>30,024,651</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - FEDERAL FUND  
Fiscal Year Ended June 30, 2005**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Revenues</b>				
Federal grants	\$ <u>229,195,787</u>	\$ <u>414,736,173</u>	\$ <u>229,401,487</u>	\$ <u>(185,334,686)</u>
<b>Expenditures</b>				
School level instruction	142,799,981	258,427,644	119,845,621	138,582,023
Comprehensive student support services	39,474,133	71,580,871	51,277,038	20,303,833
Instructional support	1,613,378	22,463,260	9,840,204	12,623,056
State and district administration	65,000	2,981,964	1,509,237	1,472,727
School support	40,669,737	50,685,809	46,479,534	4,206,275
School community service	3,208,314	6,231,481	3,965,493	2,265,988
Public libraries	<u>1,365,244</u>	<u>2,365,144</u>	<u>1,255,242</u>	<u>1,109,902</u>
	<u>229,195,787</u>	<u>414,736,173</u>	<u>234,172,369</u>	<u>180,563,804</u>
<b>EXCESS (DEFICIENCY) REVENUES OVER EXPENDITURES</b>	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>(4,770,882)</u>	\$ <u>(4,770,882)</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
STATEMENT OF ASSETS AND LIABILITIES  
AGENCY FUNDS  
June 30, 2005**

**ASSETS**

Cash and cash equivalents	\$ <u>17,408,260</u>
Total assets	\$ <u>17,408,260</u>

**LIABILITIES**

Due to student group and others	\$ <u>17,408,260</u>
Total liabilities	\$ <u>17,408,260</u>

See accompanying notes to the basic financial statements.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE A - FINANCIAL REPORTING ENTITY**

The Department of Education of the State of Hawaii (DOE), administers the statewide system of public schools and public libraries. Additionally, the DOE is responsible for administering state laws regarding regulation of private school operations through a program of inspection and licensing and the professional certification of all teachers for every academic and non-college type of school. Federal grants received to support public school and public library programs are administered by the DOE on a statewide basis.

The DOE is a part of the executive branch of the State of Hawaii (State). The DOE's basic financial statements reflect only its portion of the fund type categories. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually which includes the DOE's financial activities.

The DOE has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the DOE are such that exclusion would cause the DOE's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. The DOE has determined, based on the GASB criteria, that it has no component units.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements of the DOE have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the GASB.

- (1) ***Basis of Presentation*** - The government-wide financial statements report all assets, liabilities, and activities of the DOE as a whole. The fiduciary funds are excluded from the government-wide financial statements because the DOE cannot use those assets to finance its operations.

The financial transactions of the DOE are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and non-major funds are combined in one column. Major funds are funds which have total assets, liabilities, revenues or expenditures of the fund that are at least ten percent of the same element for all funds of its fund type or at least five percent of the same element for all governmental funds combined.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Governmental Fund Types**

General Fund - The general fund is the general operating fund of the DOE. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Special Revenue Funds - Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes. Special revenue funds include the federal fund which accounts for grants received directly from the federal government.

Capital Projects Fund - The capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

**Fiduciary Fund Type**

Agency Funds - Agency funds are used to account for assets held by the DOE on behalf of outside parties, including other governments, or on behalf of individuals.

**(2) *Measurement Focus and Basis of Accounting***

**Government-wide Financial Statements** - The economic resources measurement focus and accrual basis of accounting is used for reporting the government-wide financial statements. With this measurement focus, all assets and liabilities associated with the operations of the DOE are included on the statement of net assets. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded at the time liabilities are incurred. Revenue from grants is recognized when all eligibility requirements have been satisfied.

**Governmental Funds** - All governmental funds are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become both measurable and available. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after fiscal year-end to liquidate liabilities existing at the end of the fiscal year. For this purpose, the DOE considers revenues to be available if they are collected within sixty days of the end of the current fiscal year end. Principal revenue sources considered revenues susceptible to accrual include federal grants and charges for services. Expenditures are generally recorded when the related fund liabilities are incurred.

Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Agency Funds** - Agency funds are used to account for resources held by the DOE as an agent for individual private organizations or government agencies. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

- (3) **Use of Estimates** - The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.
- (4) **Capital Assets** - Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

The DOE has adopted the following capitalization policy:

Asset Type	Minimum Capitalization Amount	Estimated Useful Life
Land	All	Not applicable
Land improvements	\$ 100,000	15 years
Buildings and improvements	\$ 100,000	30 years
Furniture and equipment	\$ 5,000	7 years
Motor vehicles	\$ 5,000	5 years
Public library materials	All	5 years

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (5) **Deferred Revenues** - Deferred revenues at the fund level and government-wide level arise when the DOE receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the DOE has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and revenue is recognized. Deferred revenues consist primarily of federal grant funds.
- (6) **Accumulated Vacation** - Employees are credited with vacation at the rate of 96 to 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.
- (7) **Appropriations** - Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.
- (8) **Program Revenues** - Program revenues derive directly from the programs of the DOE or from parties outside of the DOE and are categorized as charges for services, operating grants and contributions, or capital grants and contributions.

Charges for services - Charges for services include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided. Revenues in this category include fees charged for meals served, educational classes, use of facilities, transportation services, and use of library materials.

Operating Grants and Contributions - Program-specific operating and capital grants and contributions include revenues arising from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program. Governmental grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

- (9) **Intrafund and Interfund Transactions** - Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the basic financial statements.
- (10) **Risk Management** - The DOE is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE C - BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and special revenue funds are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

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

Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to five percent each of any appropriation at the end of the fiscal year except for appropriations to fund certain financing agreements. These carryover funds, to the extent not expended or encumbered, lapse at June 30 of the first fiscal year of the next fiscal biennium. As of June 30, 2005, general funds carried over amounted to approximately \$30,800,000.

For purposes of budgeting, the DOE's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The DOE's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grant accruals and deferrals. These differences represent a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2005.

	<u>General</u>	<u>Federal</u>
Excess (deficiency) of revenues over expenditures and other uses - actual on a budgetary basis	\$ 16,592,772	\$ (4,770,882)
Reserved for encumbrances at fiscal year-end	37,101,100	10,900,742
Expenditures for liquidation of prior fiscal year encumbrances	(37,279,670)	(12,330,501)
Net change in unreserved liabilities	(5,731,804)	1,162,664
Accrual adjustments related to federal reimbursements for program expenditures	--	(5,147,219)
Revenues for unbudgeted programs	<u>--</u>	<u>237,330</u>
Excess (deficiency) of revenues over expenditures and other uses - GAAP basis	\$ <u>10,682,398</u>	\$ <u>(9,947,866)</u>

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE D - CASH AND CASH EQUIVALENTS**

Substantially all of the DOE's cash and certificates of deposit are held in the State Treasury. The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury. The State Director of Finance pools and invests any monies in excess of the amounts necessary for meeting specific requirements of the State. The Hawaii Revised Statutes authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions.

Information relating to custodial credit risk of cash deposits and interest rate risk, credit risk, custodial risk, and concentration of credit risk of investments in the State Treasury is available on a statewide basis and not for individual departments or agencies.

**Custodial credit risk**

Cash and deposits with financial institutions are collateralized in accordance with State statutes. 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 DOE also maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2005, the carrying amount of total bank deposits was approximately \$6,259,000 and the corresponding bank balances which are represented were approximately \$5,911,000. Of this amount, approximately \$2,596,000 is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by the DOE's agent. The uninsured and uncollateralized balance at June 30, 2005, was approximately \$3,315,000.

**Interest rate risk**

As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

**Credit risk**

The State's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating. As of June 30, 2005, the State held short-term investments in student loan resource securities maintaining a Triple-A rating.

**Custodial risk**

For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping, certain

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE D - CASH AND CASH EQUIVALENTS (Continued)**

types of securities to collateralize repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

**Concentration of credit risk**

The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

**NOTE E - CAPITAL ASSETS**

The changes in capital assets were as follows:

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005
Governmental activities				
Capital asset, not being depreciated				
Land	\$ 61,246,260	\$ --	\$ --	\$ 61,246,260
Land improvements	<u>5,781,281</u>	<u>--</u>	<u>--</u>	<u>5,781,281</u>
Total capital assets not being depreciated	<u>67,027,541</u>	<u>--</u>	<u>--</u>	<u>67,027,541</u>
Capital assets, being depreciated				
Land improvements	65,176,804	888,332	--	66,065,136
Building and improvements	1,366,892,468	35,860,576	--	1,402,753,044
Furniture and equipment	57,955,464	9,347,878	1,960,694	65,342,648
Public library materials	<u>57,152,588</u>	<u>9,990,789</u>	<u>--</u>	<u>67,143,377</u>
Total capital assets being depreciated	<u>1,547,177,324</u>	<u>56,087,575</u>	<u>1,960,694</u>	<u>1,601,304,205</u>
Less accumulated depreciation for:				
Land improvements	47,727,326	2,922,164	--	50,649,490
Building and improvements	668,010,247	44,605,762	--	712,616,009
Furniture and equipment	41,868,282	5,533,655	1,470,356	45,931,581
Public library materials	<u>46,580,002</u>	<u>4,631,797</u>	<u>--</u>	<u>51,211,799</u>
Total accumulated depreciation	<u>804,185,857</u>	<u>57,693,378</u>	<u>1,470,356</u>	<u>860,408,879</u>
Governmental activities, net	\$ <u>810,019,008</u>	\$ <u>(1,605,803)</u>	\$ <u>490,338</u>	\$ <u>807,922,867</u>

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE E - CAPITAL ASSETS (Continued)**

Depreciation expense was charged to functions as follows:

	<u>Governmental Activities</u>
School level instruction	\$ 49,687,925
Instructional support	689,110
State and district administration	585,911
School support	1,503,806
School community service	63,050
Public libraries	5,157,354
Other	<u>6,222</u>
Total depreciation expense	\$ <u>57,693,378</u>

**NOTE F - LONG-TERM LIABILITIES**

The change in the long-term liabilities during the fiscal year ended June 30, 2005, was as follows:

	<u>Accrued Compensated Absences</u>	<u>Workers' Compensation Claims</u>
Balance at July 1, 2004	\$ 39,900,188	\$ 35,291,024
Additions	12,887,795	19,320,614
Reductions	<u>(7,781,935)</u>	<u>(9,348,570)</u>
Balance at June 30, 2005	\$ <u>45,006,048</u>	\$ <u>45,263,068</u>
Due within one year	\$ <u>6,542,009</u>	\$ <u>12,849,800</u>

The compensated absences and workers' compensation liabilities have been paid primarily by the general fund in the past.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE G - FUND BALANCES**

**Reserved for Encumbrances**

Reserved for encumbrances represents the portion of the fund balance that is segregated for expenditure on vendor performance.

**Reserved for Continuing Appropriations**

Reserved for continuing appropriations represents unencumbered allotment balances that have been released and made available for encumbrance or expenditure and are legally segregated for a specific future use.

**Fund Balance Deficit**

The general fund and capital project fund had a deficit balance in the unreserved fund balance at June 30, 2005, of \$79,835,675 and \$37,861,481, respectively. The deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when funds are measurable and available.

**NOTE H - CHANGES IN ASSETS AND LIABILITIES OF THE AGENCY FUNDS**

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2005, were as follows:

	<u>Balance July 1, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2005</u>
<b>ASSETS</b>				
Cash and other assets held in trust	\$ <u>14,368,813</u>	\$ <u>28,544,985</u>	\$ <u>25,505,538</u>	\$ <u>17,408,260</u>
<b>LIABILITIES</b>				
Due to student groups and others	\$ <u>14,368,813</u>	\$ <u>28,544,985</u>	\$ <u>25,505,538</u>	\$ <u>17,408,260</u>

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE I - LEASE COMMITMENTS**

The DOE leases equipment from third party lessors under various operating leases expiring through 2011. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2005, were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2006	\$ 2,993,000
2007	2,676,000
2008	1,938,000
2009	1,055,000
2010	312,000
2011	<u>13,000</u>
	<u>\$ 8,987,000</u>

Total rent expense related to the above leases for the fiscal year ended June 30, 2005, amounted to approximately \$3,016,000.

**NOTE J - RETIREMENT BENEFITS**

**Employees' Retirement System**

Substantially all eligible employees of the DOE are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the DOE hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the DOE is required to contribute to both options at an actuarially determined rate. The portion of the contributions related to DOE's general and special revenue funds are recorded as an expenditure of the respective funds in the financial statements. Contributions by the DOE for the fiscal year ended June 30, 2005, 2004, and 2003, were approximately \$92,159,000, \$90,892,000, and \$84,364,000. The contribution rates for the fiscal years ended June 30, 2005, 2004, and 2003, were 9.14%, 8.87%, and 8.87%, respectively.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE J - RETIREMENT BENEFITS (Continued)**

**Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State, pursuant to Section 87A of the Hawaii Revised Statutes, provides certain health care and life insurance benefits to retired state employees. Contributions are financed on a pay-as-you-go basis. The DOE's general fund and special revenue fund share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2005, was approximately \$66,587,000 and \$4,599,000, respectively, and is included in the basic financial statements.

**Deferred Compensation Plan**

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

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or DOE's basic financial statements.

**NOTE K - RISK MANAGEMENT**

The DOE is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally is at risk for the first \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$100 million (\$25 million for earthquake, named hurricane and flood) and the annual aggregate for general liability losses per occurrence is \$10 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$20 million per occurrence with no annual aggregate limit. The State is generally self-insured for automobile claims.

The DOE is self-insured for workers' compensation and automobile claims. The DOE's estimated reserve for losses and loss adjustment costs include the accumulation of estimates for losses and claims reported prior to fiscal year-end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The DOE believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**Department of Education  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2005**

**NOTE L - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2005, amounted to approximately \$530,084,000.

**Litigation**

The DOE is a party to various legal proceedings. Although the DOE and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the DOE because any judgments against the DOE are judgments against the State and would be paid by legislative appropriation of the State General Fund and not by the DOE.

**NOTE M - FOOD DISTRIBUTION PROGRAM**

The DOE receives food commodities from the U.S. Department of Agriculture, Food and Nutrition Service (FNS), under the Federal Food Distribution Program. The DOE School Food Services Branch distributes the food to qualifying schools, charitable organizations, and nonprofit summer camps for children. The total value of the amount of food which the DOE is entitled to receive is determined in part by the number of meals served under the National School Lunch Program. The DOE's allocation balance is reduced as the DOE receive the food commodities. The amount charged to the DOE allocation balance is based upon the FNS's cost to purchase the commodities. The bonus commodities do not reduce the DOE's allocation balance.

The following is a summary of the value of the food commodities received by the DOE during the fiscal year ended June 30, 2005. The value of the bonus commodities is based upon the estimated costs provided by the FNS in the *Current Commodity File* report dated June 30, 2005.

	<u>Amount</u>
Basic allocation	\$ 2,441,447
Bonus commodities	<u>475,169</u>
	\$ <u>2,916,616</u>

## **SUPPLEMENTARY INFORMATION**

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2005**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
<b>U.S. Department of Agriculture</b>				
Food Donation <sup>2</sup>	10.550	--	\$ 2,916,616	\$ --
Child Nutrition Cluster:				
School Breakfast Program	10.553	--	6,668,245	302,855
National School Lunch Program	10.555	--	32,880,872	1,000,843
Special Milk Program for Children	10.556	--	9,698	9,698
Summer Food Service Program for Children	10.559	--	773,455	773,455
Child and Adult Care Food Program	10.558	--	4,982,040	4,982,040
State Administrative Expenses	10.560	--	<u>679,919</u>	<u>--</u>
<b>Total U.S. Department of Agriculture</b>			<u>48,910,845</u>	<u>7,068,891</u>
<b>U.S. Department of Defense</b>				
National Defense Authorization Act P.L. 102-484	N/A <sup>3</sup>	--	1,276,708	--
Troops To Teachers - DOD FY04	N/A <sup>3</sup>	--	41,550	--
Troops To Teachers - DOD FY05	N/A <sup>3</sup>	--	8,316	--
Passed-through State Department of Defense				
Joint Venture Education Forum	N/A <sup>3</sup>	--	<u>2,997,946</u>	<u>--</u>
<b>Total U.S. Department of Defense</b>			<u>4,324,520</u>	<u>--</u>
<b>National Oceanic and Atmospheric Administration</b>				
Coastal Services Center	11.473	--	<u>2,390</u>	<u>--</u>
<b>Total National Oceanic and Atmospheric Administration</b>			\$ <u>2,390</u>	\$ <u>--</u>

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2005**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
<b>U.S. Department of Interior</b>				
U.S. Fish & Wildlife	N/A <sup>3</sup>	--	\$ 6,516	\$ --
Passed-through State Governor's Office				
Economic, Social, and Political Development of the Territories and the Freely Associated States	15.875	GR270094	<u>913,479</u>	<u>--</u>
<b>Total U.S. Department of the Interior</b>			<b>\$ <u>919,995</u></b>	<b>\$ <u>--</u></b>
<b>U.S. Department of Justice</b>				
Title V Juvenile Delinquency Prevention Program	16.548	--	\$ 5,116	\$ --
Passed-through State Department of Human Services				
Part E State Challenge Activities	16.549	JE-FX-00146-2002	<u>14,150</u>	<u>--</u>
<b>Total U.S. Department of Justice</b>			<b><u>19,266</u></b>	<b><u>--</u></b>
<b>U.S. Department of Transportation</b>				
Passed-through State Department of Transportation				
State and Community Highway Safety	20.600	AL04-02(06-S-01)	4,849	--
		163-SA05-07(03-S-01)	11,526	
		AL05-02 (12-S-01)	<u>9,366</u>	<u>--</u>
<b>Total U.S. Department of Transportation</b>			<b><u>25,741</u></b>	<b><u>--</u></b>
<b>National Endowment for the Humanities</b>				
State Library Program	45.310	--	<u>1,189,897</u>	<u>--</u>
<b>Total National Endowment for the Humanities</b>			<b><u>1,189,897</u></b>	<b><u>--</u></b>
<b>National Science Foundation</b>				
Education and Human Resources	47.076	--	943,139	--
Passed-through Maui Economic Development Board				
Hands-On Science for Maui (Project SEED)	N/A <sup>4</sup>	ESI-9253304	<u>3,259</u>	<u>--</u>
<b>Total National Science Foundation</b>			<b>\$ <u>946,398</u></b>	<b>\$ <u>--</u></b>

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2005**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
<b>Environmental Protection Agency</b>				
Passed-through State Department of Health Nonpoint Source Implementation Grants	66.460	C9989423-00-1	\$ 70,633	\$ --
<b>Total Environmental Protection Agency</b>			<u>70,633</u>	<u>--</u>
<b>U.S. Department of Education</b>				
Adult Education - State Grant Program	84.002	--	3,968,259	--
Title I Grants to Local Educational Agencies	84.010	--	40,095,587	--
Migrant Education - State Grant Program	84.011	--	960,546	--
Title I Program for Neglected and Delinquent Children	84.013	--	205,696	--
Special Education Cluster:				
Special Education - Grants to States	84.027	--	32,414,202	--
Special Education - Children With Disabilities	84.173	--	1,292,002	--
Impact Aid	84.041	--	61,166,079	--
Safe and Drug-Free School and Community - National Programs	84.184	--	237,182	--
Byrd Honors Scholarships	84.185	--	159,000	--
Safe and Drug-Free Schools and Communities - State Grants	84.186	--	1,359,305	--
Bilingual Education - Professional Development	84.195	--	183,644	--
Education for Homeless Children and Youth	84.196	--	203,645	--
Even Start - State Educational Agencies	84.213	--	1,284,003	--
Even Start - Migrant Education	84.214	--	226,649	--
Fund for the Improvement of Education	84.215	--	1,119,168	--
Eisenhower Professional Development State Grants	84.281	--	96,076	--
Charter Schools	84.282	--	554,921	545,770
Twenty-First Century Community Learning Centers	84.287	--	4,826,222	--
Native Hawaiian Community-Based Education Learning Centers	84.296	--	62,889	--

**Department of Education**  
**State of Hawaii**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)**  
**Fiscal Year Ended June 30, 2005**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures'	Amount Provided to Subrecipient
Native Hawaiian Curriculum Development, Teacher Training and Recruitment	84.297	--	\$ 165,011	\$ --
State Grants for Innovative Programs	84.298	--	1,286,142	--
Education Technology State Grants	84.318	--	2,350,301	--
Special Education - State Program Improvement				
Grants for Children with Disabilities	84.323	--	401,272	--
Special Education - Personnel Preparation to Improve Services and Results for Children with Disabilities	84.325	--	29,040	--
Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	84.326	--	209,464	--
Advanced Placement Program	84.330	--	3,551	--
Comprehensive School Reform Demonstration	84.332	--	499,211	--
Reading Excellence	84.338	--	3,625,249	--
Class Size Reduction	84.340	--	(4,694)	--
School Renovation Grants	84.352	--	832,683	--
Reading First State Grants	84.357	--	5,283,913	--
Native Hawaiian Education	84.362	--	1,139,919	--
English Language Acquisition Grants	84.365	--	1,617,462	--
Mathematics and Science Partnerships	84.366	--	258,213	--
Improving Teacher Quality State Grants	84.367	--	13,555,674	--
Grants for State Assessments and Related Activities	84.369	--	2,290,822	--
Common Core Data Survey Basic	N/A <sup>3</sup>	--	58,300	--
NAEP State Coordinator	N/A <sup>3</sup>	--	133,251	--
			<u>184,149,859</u>	<u>545,770</u>
Passed-through Office of the State Director for Vocational Education				
Vocational Education - Basic Grants to States	84.048	V048A020011A	147,533	--
		V048A030011	1,313,094	--
		V048A020011	1,003,793	--
			<u>2,464,420</u>	<u>--</u>
Tech-Prep Education				
	84.243	V243A020011A	68,320	--
		V243A030011	243,483	--
		V243A030011	43,712	--
			<u>\$ 355,515</u>	<u>\$ --</u>

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2005**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
Passed-through State Department of Human Services				
Rehabilitation Services - Vocational Rehabilitation				
Grants to States	84.126	MOA-DHHS	\$ 85,598	\$ --
Safe and Drug-Free Schools and Communities -				
State Grants	84.186	S186B020012	198,269	--
			<u>283,867</u>	<u>--</u>
Passed-through Alu Like, Inc.				
Native Hawaiian Vocational Education	84.259	S362A0310013	388	--
		VE-03-01	27,147	--
		VE-03-03	7,746	--
		VE-03-04	21,563	--
		VE-03-05	28,703	--
		VE-04-01	102,064	--
		VE-04-04	46,900	--
		VE-04-05	74,846	--
			<u>309,357</u>	<u>--</u>
Passed-through University of Hawaii				
Gaining Early Awareness and Readiness for				
Undergraduate Programs	84.334	P334S000195-03	68,972	--
		P334S000195-03A	46,978	--
			<u>115,950</u>	<u>--</u>
Native Hawaiian Special Education	84.221	CO10147- mod #2	101,395	--
		CO10147-mod #3	1,852,197	--
			<u>1,953,592</u>	<u>--</u>
<b>Total U.S. Department of Education</b>			<b>\$ 189,632,560</b>	<b>\$ 545,770</b>
<b>U.S. Department of Health and Human Services</b>				
Passed-through State Department of Health				
Block Grants for Prevention and Treatment of	93.959	MOA-DOH	\$ 4,080	\$ --
Substance Abuse				
Passed-through State Department of Human Services				
Temporary Assistance for Needy Families	93.558	G050001HTNS	72,847	
Child Care and Development Block Grant	93.575	G0100HICCD2	271,755	--
Teen Pregnancy Prevention	N/A <sup>3</sup>	DHS-04-BESSD-1898	34,861	--
		DHS-05-BESSD-2125	99,412	--
<b>Total U.S. Department of Health and Human Services</b>			<b>482,955</b>	<b>--</b>

**Department of Education  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2005**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
<b>Corporation for National and Community Service</b>				
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	--	<u>740,090</u>	<u>--</u>
<b>Passed-through State Department of Labor</b>				
Learn and Serve America - School and Community Based Programs	94.004	00LSFHI101	14,172	--
		03KSPH1001	<u>45,962</u>	<u>--</u>
			<u>60,134</u>	<u>--</u>
<b>Total Corporation for National and Community Service</b>			<u>800,224</u>	<u>--</u>
<b>TOTAL FEDERAL GRANT FUND EXPENDITURES</b>			<b>\$ <u>247,325,424</u></b>	<b>\$ <u>7,614,661</u></b>

<sup>1</sup> The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.

<sup>2</sup> Expenditures for the Food Donation Program (CDFA No., 10.550) are based on the value of food commodities received.

<sup>3</sup> Not applicable.

<sup>4</sup> Not available.

**PART II**

**AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS**



NISHIHAMA & KISHIDA, CPA'S, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED  
ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Auditor  
State of Hawaii

We have audited the financial statements of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2005, and have issued our report thereon dated February 28, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the DOE'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 internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the DOE's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2005-01 to 2005-03.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal

control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to the management of the DOE in a separate letter dated February 28, 2006.

### **Compliance and Other Matters**

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

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

*Nishihama & Kishida, CPA's, Inc.*

Honolulu, Hawaii  
February 28, 2006

**PART III**

**AUDITORS' REPORT ON COMPLIANCE  
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR  
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE**



NISHIHAMA & KISHIDA, CPA'S, INC.  
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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Auditor  
State of Hawaii

**Compliance**

We have audited the compliance of the Department of Education of the State of Hawaii (DOE) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2005. The DOE's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the DOE's management. Our responsibility is to express an opinion on the DOE's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the DOE's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the DOE's compliance with those requirements.

In our opinion, the DOE complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2005-04 to 2005-05.

## Internal Control Over Compliance

The management of the DOE 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 DOE's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the DOE's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 2005-04 to 2005-05.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We also noted other matters involving the internal control over compliance that we have reported to the management of the DOE in a separate letter dated February 28, 2006.

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

*Nishihama & Kishida, CPAs Inc.*

Honolulu, Hawaii  
February 28, 2006

**PART IV**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**Fiscal Year Ended June 30, 2005**

**SECTION I - SUMMARY OF AUDITORS' RESULTS**

**Financial Statements**

Type of auditors' report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no
Reportable condition(s) identified not considered to be material weaknesses?	<input checked="" type="checkbox"/> yes <input type="checkbox"/> none reported
Noncompliance material to the financial statements noted?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no

**Federal Awards**

Internal control over major program:	
Material weakness(es) identified?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no
Reportable condition(s) identified not considered to be material weaknesses?	<input checked="" type="checkbox"/> yes <input type="checkbox"/> none reported

Type of auditors' report issued on compliance for major programs:	Unqualified
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Any audit findings disclosed that are required to be reported in accordance with OMB Circular A-133, Section .510(a)?	<input checked="" type="checkbox"/> yes <input type="checkbox"/> no
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Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
10.550	Food Donation
10.553	Child Nutrition Cluster:
10.555	School Breakfast Program
10.556	National School Lunch Program
10.559	Special Milk Program for Children
	Summer Food Service Program for Children
10.558	Child and Adult Care Food Program
84.041	Impact Aid
84.298	State Grants for Innovative Programs
84.318	Education Technology State Grants
84.357	Reading First State Grants
84.367	Improving Teacher Quality State Grants

Dollar threshold used to distinguish between Type A and Type B programs:	\$3,000,000
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Auditee qualified as a low-risk auditee?	<input type="checkbox"/> yes <input checked="" type="checkbox"/> no
--	---

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref**  
**No. Internal Control Findings**

**2005**  
**- 01 Improve Compensating Controls For Inadequate Segregation Of Duties over Local School Funds**

Most, if not all, of a school's cash functions are handled by a school's school administrative services assistant (SASA) or account clerk. One person receives the cash, prepares the receipts for deposit to the bank, prepares the checks, records the receipts and disbursements, and prepares the bank reconciliation.

No one person should have access to both physical assets and the related accounting records, or to handle all phases of a transaction. Without adequate segregation of duties, funds may be lost, unrecorded or misused.

For many schools, it is not possible to delegate the duties to another person. To compensate for inadequate segregation of duties, the DOE established control procedures that are to be performed by the school principal or designee. The control procedures are enumerated in Exhibit 9-12 of the FMS User Policy and Process Flow Guide (Guide) as well as on the DOE's website.

We visited ten schools during our test of the nonappropriated local school funds and noted the following conditions:

- Seven schools had inadequate segregation of duties but did not perform all the compensating controls enumerated in the Guide. The schools did not conduct unannounced cash counts of the school petty cash fund or check if cash receipts were deposited daily. Two of the schools did not review bank reconciliations in a timely manner.
- Three schools performed all the compensating controls and used the administrator's checklist that was available on the DOE's website to document their performance of the compensating controls. However, the checklist alone did not provide sufficient information on whether any discrepancies were found.

Exhibit 9-12 of the Guide provides the following compensating controls:

1. Conduct periodic unannounced cash counts of the school petty cash fund.
2. Verify that monthly reconciliations between the bank statement and the school's check register are being performed.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**Ref**

**No.**

**Internal Control Findings (Continued)**

**2005**

**- 01**

**Improve Compensating Controls For Inadequate Segregation Of Duties over Local School Funds**

3. Inspect checks outstanding for more than six months ("stale" checks) during the review of the monthly bank reconciliations. These checks should be cancelled.
4. Check if cash receipts are deposited daily. The dates on the Official Receipts Form 239 should be the same as the bank deposit slip date.
5. The principal or designee will prepare a report of the reviews conducted during the year indicating the areas reviewed, the date of the reviews, discrepancies found and the report should be kept on file for audit purposes.

**Recommendation**

The school principal or designee should perform all compensating controls enumerated in Exhibit 9-12 of the Guide, including documentation of the procedures performed and the results. In addition, appropriate action should be taken and documented for any discrepancies noted.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**Ref**

**No. Internal Control Findings (Continued)**

**2005**

**- 02 Strengthen Controls Over Workers' Compensation Data**

Workers' compensation payment data, estimated and actual, are maintained using the Renaissance (REN) software program and are used for multiple purposes. However, the DOE cannot be assured of the completeness and accuracy of wage loss payments. In addition reserves on open claims had negative balances as of June 30, 2005.

In prior years, due to software licensing issues and incompatibility with the DOE's payroll system, paid wage loss information was maintained separately from REN which resulted in inefficiencies and inaccuracies in financial reporting. The DOE has implemented different procedures to improve their workers' compensation information system.

Effective October 1, 2004, the Workers' Compensation office maintained an electronic spreadsheet of claims filed and paid in order to track unpaid claims. Maintaining the spreadsheet was time-consuming. We were informed that tracking unpaid claims could not be done using REN because REN did not allow the input of estimated wage loss payments. In August 2005, the DOE upgraded REN which enabled the DOE to record estimated and actual wage loss payments which allowed DOE to track unpaid claims more efficiently. However actual payments recorded in REN were not reconciled to payments recorded in the DOE's payroll system to ensure completeness and accuracy.

Finally, we noted numerous open claims as of June 30, 2005, with negative reserve balances that totaled over \$4 million. Reserves were not adjusted when actual payments exceeded the initial reserve amount for the claim.

The DOE needs complete and accurate wage loss payments recorded in REN to properly identify unpaid wage loss claims that may result in late payment penalties, identify potential incorrect payments, and to provide historical payments that can be used to evaluate a component of workers compensation liability for financial statement reporting. Reserves on open claims represent estimates of payment amounts to settle claims which should be periodically readjusted and should not have negative balances.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**Ref**

**No.**

**Internal Control Findings (Continued)**

**2005**

**- 02 Strengthen Controls Over Workers' Compensation Data**

**Recommendation**

The DOE should strengthen its controls over workers' compensation data maintained in REN by performing the following:

1. Reconcile the wage loss payments recorded in REN to the payments recorded in the payroll system to ensure completeness and accuracy of both the wage loss data recorded in REN and payments made by the Payroll Section. The Workers Compensation Office and the Payroll Section should investigate discrepancies between their records and make necessary corrections for any recording or payment errors.
2. Periodically re-evaluate and adjust reserve balances, particularly balances that are at risk of becoming negative, to ensure reasonableness of reserve amount.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**Ref**  
**No. Internal Control Findings (Continued)**

**2005**  
**- 03 Improve Monitoring System for Vacation and Sick Leave Records**

The DOE uses a computerized leave accounting system to compile and print accrued compensated absences information for reporting the liability to the State Comptroller. All leave taken are transmitted from the TSEA (electronic substitute teacher system) for teachers or recorded in the computerized leave accounting system by the DOE's Payroll Section for all other employees. A manual form is submitted to the Payroll Section for recording leave taken in instances when TSEA is not used.

The official record for compensated absences is the *Employee Leave Record* (Form 7), which is separately maintained electronically or manually by the various schools and offices. All leave taken recorded in the computerized leave accounting system and Form 7 is supported by the approved *Application for Leave of Absence*, Forms G-1, 400 or 400A, which documents the request and approval of absences.

During our testing of accrued vacation and sick leave records for eight employees, we noted the following conditions:

- In 7 instances, the vacation and sick leave balances calculated using the computerized leave accounting system as of June 30, 2005, did not agree to Form 7.
- In 2 instances, leave recorded on the Form 7 was not supported by an *Application for Leave of Absence*.
- In 2 instances, the *Application for Leave of Absence* was not dated or dated after the leave was taken.
- In 2 instances, the signed *Application for Leave of Absence* did not indicate whether the leave was approved or denied.

In addition, we noted 5 instances in which the computerized leave accounting system included vacation balances for terminated employees. We were informed that not all leave taken may have been recorded in the computerized leave accounting system because the schools did not submit copies of the *Application for Leave of Absence* in a timely manner to the Payroll Section. Similarly, termination documents were not submitted to the Payroll Section in a timely manner.

**Recommendation**

The DOE should improve its monitoring system to ensure that the schools prepare leave documents completely and accurately, and submit the necessary leave documents to the Payroll Section in a timely manner.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

**SECTION III - FEDERAL AWARD FINDINGS**

<b>Ref No.</b>	<b>Compliance and Internal Control Findings</b>	<b>Questioned Costs</b>
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2005

**- 04    Ensure Accurate Meal Counts Are Obtained for the School Lunch  
And Breakfast Programs.**

7 CFR 210 provides meal reimbursement requirements for the National School Lunch Program (CFDA 10.555) and School Breakfast Program (CFDA 10.553). To be eligible for federal reimbursement, meals must be served to eligible children and must be supported by accurate meal counts and records indicating the number of meals served by category and type. The DOE's policies and procedures over this requirement are communicated to the schools in its Standards and Procedures for Free and Reduced Price Meals which require School Food Service managers to prepare and sign the daily and monthly "Computation of Daily/Monthly School Food Service Transactions," Form SL-5, reports.

These daily and monthly Form SL-5 are used to compile monthly lunch counts that are submitted for reimbursements by the federal award agency.

During our testing of the National School Lunch and School Breakfast Programs, we noted the following:

- Three instances where the amounts reported on daily Form SL-5 did not agree to the supporting documents.
- One instance where amounts per the validated deposit slip did not agree to the daily SL-5.

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**Recommendation**

The DOE should ensure that the daily and monthly Form SL-5 be properly completed and supported by the schools to ensure an accurate claim for reimbursement is made.

**Department of Education**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2005**

<b><u>Ref</u></b> <b><u>No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned</u></b> <b><u>Costs</u></b>
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2005

**- 05    Ensure Annual Verification Procedures are Completed Timely and Accurately**

7 CFR 245.6a requires that by December 15 of each school year, the School Food Authority shall have selected and verified a sample of their approved free and reduced price applications in accordance with federal regulations for the National School Lunch Program (CFDA 10.555) and the School Breakfast Program (CFDA 10.553). The DOE communicates this requirement and the procedures on completing the verification process to the schools in their "Verification Guidance" manual that the School Food Services Branch distributes.

During our testing of this verification process, we noted the following:

- Two schools reported counts on the "Report on Verification of Free and Reduced-Price Meal Application" that did not agree to the actual verification results.
- Three schools completed and submitted the "Report on Verification of Free and Reduced-Price Meal Application" late.
- Two schools discarded the "Report on Verification of Free and Reduced-Price Meal Application." As a result, the report was not available for our review.

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**Recommendation**

Schools should follow the Verification Guidance provided and submit the reports in a timely manner. They should also review their "Report on Verification of Free and Reduced-Price Meal Application" prior to submission to ensure accuracy of the report.

**PART V**

**CORRECTIVE ACTION PLAN**

**(Provided by the Department of Education, State of Hawaii)**



STATE OF HAWAII  
DEPARTMENT OF EDUCATION  
P.O. BOX 2360  
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

March 28, 2006

Nishihama & Kishida, CPA's, Inc.  
Certified Public Accountants  
American Savings Bank Tower  
1001 Bishop Street, Suite 1700  
Honolulu, Hawaii 96813-3696

Ladies and Gentlemen:

We appreciate your assistance in our successful completion of the Single Audit of the State of Hawaii Department of Education within the nine-month timeline in accordance with OMB Circular A-133. We are pleased that your audit has concluded the following:

Report on Compliance -- Financial Reporting:

"The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*." (Page 48)

Internal Control Over Financial Reporting:

"None of the reportable conditions...is a material weakness." (Page 48)

Report on Compliance -- Major Federal Programs:

"Except for...[the programs described on page 50]...the DOE complied, in all material respects, with the requirements...that are applicable to each of its major federal programs for the year ended June 30, 2005." (Page 50)

In addition, the following Federal program audits resulted in no reportable conditions and no material items of non-compliance: Food Donation, Special Milk Program for Children, Summer Food Service Program for Children, Child and Adult Care Food Program, Impact Aid, State Grants for Innovative Programs, Education Technology State Grants, Reading First State Grants, and Improving Teacher Quality State Grants.

However, we recognize that further improvements can be made. In accordance with OMB Circular A-133, on the following pages are the Corrective Action Plan and Summary Schedule of Prior Audit Findings of the State of Hawaii Department of Education for the year ended June 30, 2005.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Patricia Hamamoto".

Patricia Hamamoto  
Superintendent

PH:DY

Attachments

**STATE OF HAWAII DEPARTMENT OF EDUCATION  
SINGLE AUDIT -- CORRECTIVE ACTION PLAN  
Fiscal Year Ended June 30, 2005**

**FINANCIAL STATEMENT FINDINGS**

**2005-1 Improve Compensating Controls For Inadequate Segregation of Duties over Local School Funds (Pages 54 to 55)**

**Corrective Action Plan**

The lack of business support staff continues to be a problem at the schools, rendering it difficult to segregate cash functions. The Department of Education has established five "compensating control" procedures for the school administrators to oversee and review the work done by the school staff. The five compensating control procedures are part of the Department's Financial Management System User Policy and Process Flow Guide, Chapter 9, "Non-Appropriated Local School Fund Policies on Compensating Internal Controls." Additionally, the department has established an "Administrator's Checklist" to further aide in the implementation of these controls.

It should be noted that the principals have been charged with a myriad of additional curriculum and instruction mandates, such as implementing standards based educational reforms, addressing Federal requirements such as No Child Left Behind, as well as more recently developing and implementing academic and financial plans pursuant to the State of Hawaii weighted student formula legislation (Act 51, amended Act 221, 2005 Hawaii State Legislative Session). Under these circumstances, the relative priority of implementing, the "Administrator's Checklist" has been problematic. This is often compounded by the lack of formal business training of the principals, rendering it even more difficult for them to conduct this function.

To address this finding the department will continue to provide training to the support staff as well as continue to provide reminders to the educational officers through our publication "NOTES & NEWS" and memorandums. Additionally, complex administrative services assistants may be delegated by their principals to perform the task of completing the Administrator's Checklist.

Contact Persons:     Mr. Chris Ito, Accounting Director  
                              Mr. Charles Kagawa, School Business Specialist III

Anticipated Completion Date:     December 31, 2006

**Corrective Action Plan**

The Workers' Compensation (WC) Unit will implement the following corrective action plan to address audit findings and recommendations:

1) In August 2005, the DOE upgraded REN and established an internal procedure to enable the WC Unit to enter estimated wage loss payments when authorized for payment to the Payroll Section, enter actual payment information when confirmation of payment is provided by the Payroll Section, and track and report unpaid claims more efficiently. Currently, the WC Unit provides the Payroll Section with a monthly report showing all authorized but unpaid wage loss payments for their reconciliation and resolution. The WC Unit will continue to provide this report to the Payroll Section and, effective April 1, 2006, the WC Unit will also enter comments provided by the Payroll Section in response to the monthly reports on the REN for accurate reporting; and verify and reconcile the batched payment verification documents (Form O9s) received from the Payroll Section on the 10th and 25th of each month to resolve any discrepancies internally or with the Payroll Section, as applicable.

2) Effective immediately, the WC Unit will more aggressively monitor and enforce the Reserve Methodology Procedure, adopted on August 1, 2004, which includes the requirement to re-evaluate and adjust reserve amounts when cumulative actual payments reach 75% of the reserve balance recorded on REN and/or when changes in the claim necessitate the adjustment. The WC Unit will also seek assistance from the auditors to ensure that reserve procedures are updated and more accurate.

Contact Persons: Ms. Merlene Akau, Acting Personnel Director  
Office of Human Resources

Anticipated Completion Date: December 31, 2006

**Corrective Action Plan:**

The DOE recognizes its responsibility to ensure leave documents are completed accurately and submitted in a timely manner. The Leave Accounting Unit returns leave forms which have material defects. Examples of material defects include: (1) the signature of the employee or supervisor is missing; (2) the amount of leave taken does not match the number of hours or days of leave taken; or (3) required documents to support sick leave of five (5) or more consecutive days or jury leave are not attached to the leave application. Also, copies of vacation leave forms approved after the date of the absence are returned to the school/office with a reminder that approval for vacation must precede the date of the absence.

Training of personnel on the proper completion of leave forms will continue at the School Support Section workshops. Reminders are also disseminated through the "NOTES & NEWS" publication, emphasizing the importance of obtaining prior approval of all vacation leave and proper completion of the leave forms. Administrative Services Assistants are also available to support the effort for proper completion and prompt submission of these forms.

In spite of the steps noted above, the problem with late submission of monthly leave applications by some schools and offices have resulted in leave data recorded on the Form 7, but not reflected in the computerized leave accounting system. To address this, we will send quarterly reports of these delinquent schools and offices to the respective Complex Area Superintendents for them to have the schools and offices comply with this reporting requirement.

The DOE is working towards clearing the backlog of leave accounting reports to eliminate the problem of including vacation balances for terminated employees. Data House has been contracted to facilitate the update of approximately 4,000 leave records for 12-month salaried employees. Anticipated filling of several vacancies in the Payroll Unit will enable the continued update of leave records for certificated employees in the near future.

The implementation of the KRONOS Time and Attendance system should eliminate the untimely update of employee leave balances because each school or office will have timekeepers which directly record leaves taken into the system. All State and Complex offices, as well as pilot schools, are scheduled to be on this system by summer 2006, with scheduled phase-in of the rest of the Department over the next few years.

Contact Persons:     Mr. Chris Ito, Accounting Director  
                              Mr. Alan Shimono, Accounting Operations Specialist

Anticipated Completion Date:     December 31, 2006

## **FEDERAL AWARDS**

### **U.S. Department of Agriculture**

#### **2005-4 Ensure Accurate Meal Counts are Obtained for the School Lunch and Breakfast Programs** (Page 59)

##### **Corrective Action Plan:**

During the months of June and July 2006, the School Food Services Branch Director and staff will conduct a special training session for the school staff with this audit finding. The training will include procedures to ensure that the daily form SL-5 is properly completed with supporting documentation and reported on the monthly form SL-5 correctly. The training will focus on requiring the schools to be more accurate when completing the daily deposit slip by having a check and balance system utilizing two people to verify the accuracy of the deposit. A validated copy of the deposit slip will be given to the School Food Services Manager to ensure the deposit matches with the Daily SL-5. The school staff will also be reminded to double check math computations and use calculators with printed tapes to verify that the entries are accurate.

Also included in the training sessions will be suggested methods to eliminate mathematical errors and omissions.

Contact Person: Ms. Terri-Jean Kam-Ogawa, Acting Director  
School Food Services Branch

Anticipated Completion Date: September 2006

**2005-5 Ensure Annual Verification Procedures are Completed Timely and Accurately**  
(Page 60)

**Corrective Action Plan:**

The Child and Nutritional Reauthorization of 2004 (P.L. 108-265) required School Food Services to verify the household income eligibility after processing their free or reduced price meals application. As of July 2005, School Food Services Branch centralized the Determination of Eligibility and the Verification Process. The schools are no longer responsible to verify a sample of the approved free and reduced meal applications.

Contact Person: Ms. Terri-Jean Kam-Ogawa, Acting Director  
School Food Services Branch

Anticipated Completion Date: July 2005

**PART VI**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**(Provided by the Department of Education, State of Hawaii)**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**  
**Prior Fiscal Year Ended June 30, 2004**

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**SECTION II - FINANCIAL STATEMENT FINDINGS**

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**2004-1 Improving Compensating Controls For Inadequate Segregation of Duties over Local School Funds**

(Pages 57 to 58 of the Prior Year June 30, 2004 Report)

**Status** -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2005-1.

**2004-2 Improve Information System For Workers' Compensation**

(Pages 59 to 60 of the Prior Year June 30, 2004 Report)

**Status** -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2005-2.

**2004-3 Establish Monitoring System for Vacation and Sick Leave Records**

(Page 61 of the Prior Year June 30, 2004 Report)

**Status** -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Financial Statement Finding No. 2005-3.

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### **SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

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#### **U.S. Department of Agriculture**

##### **2004-4 Establish Procedures to Ensure Cohesive Management of the Food Donation Program**

(Pages 62 to 64 of the Prior Year June 30, 2004 Report)

**Status** -- Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.

##### **2004-5 Ensure Accurate Meal Counts are Obtained for the School Lunch and Breakfast Programs**

(Page 65 of the Prior Year June 30, 2004 Report)

**Status** -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response to Federal Award Findings and Questioned Costs Finding No. 2005-4.

##### **2004-6 Ensure Annual Verification Procedures are Completed Timely and Accurately**

(Page 66 of the Prior Year June 30, 2004 Report)

**Status** -- Verification process now centralized at the School Food Services Branch. Please refer to the current year response to Federal Award Findings and Questioned Costs No. 2005-5.