FINANCIAL AUDIT OF THE DEPARTMENT OF EDUCATION STATE OF HAWAII

Fiscal Year Ended June 30, 2004

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

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May 29, 2007

Ms. Patricia Hamamoto
Superintendent of Education
Department of Education
State of Hawaii

Dear Ms. Hamamoto:

This is our revised report on the financial audit of the Department of Education (DOE), State of Hawaii for the fiscal year ended June 30, 2004. This report replaces the previous report which was issued on March 29, 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, 2004, 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, 2004.

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, 2004, 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 Superintendent
Department of Education
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, 2004, 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, 2004, 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, 2004, 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, 2005, 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 read in conjunction with this report in considering 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, 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, 2004. 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 FY2003-04 are as follows:

- General fund revenues were $1.430 billion. Federal grant, program reimbursement, and other revenues totaled $263 million.
- Total expenses were $1.778 billion, of which 94% or $1.664 billion, was spent for school-level instruction and other support services.
- Total assets exceeded liabilities by $787.3 million (net assets). Land and depreciated capital assets (land improvements, buildings, building improvements, and equipment) comprise 84% of total assets.
- Net assets decreased by $77.5 million, primarily due to current year depreciation expense and an increase in payroll for ten-month employees.

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:

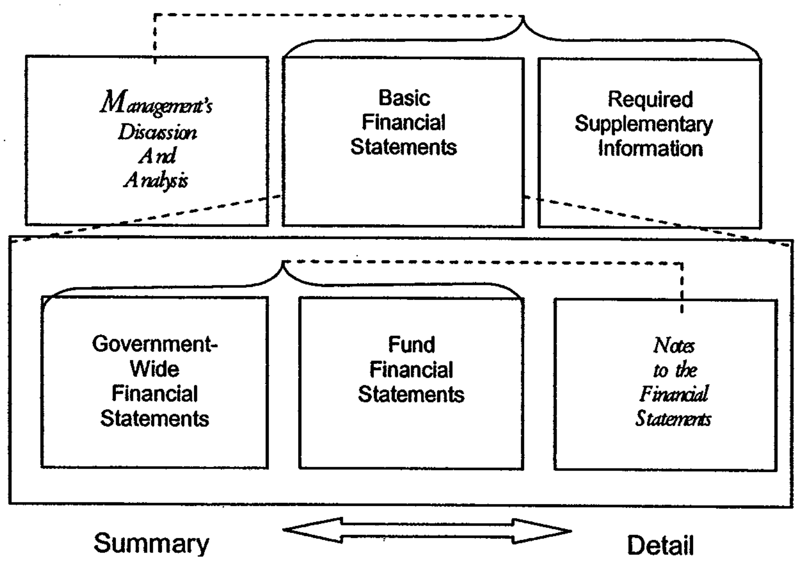
- *Government-wide financial statements* provide both *long-term* and *short-term* information about the Department's *overall* financial position and results of operations. The statements are presented on an accrual basis of accounting and consist of the Statement of Net Assets and the Statement of 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 fund statements 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.*

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.

Exhibit A-1



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 FY2003-04, liabilities exceeded unrestricted assets (cash and receivables).

Exhibit A-2
Government-Wide
Condensed Statement of Net Assets
Fiscal Years 2004 and 2003
(Amounts in millions)

	Governmental Activities	
	2004	2003 (Restated)
Assets		
Current	$ 156.8	$ 169.2
Non-current (Capital Assets, net depreciation)	810.0	850.0
TOTAL ASSETS	$ 966.8	$ 1,019.2
Liabilities		
Current	122.4	99.7
Non-current	57.0	54.6
Total Liabilities	179.4	154.3
Net Assets		
Restricted (Capital Assets, net depreciation)	810.0	850.0
Unrestricted	(22.6)	14.9
Total Net Assets	787.4	864.9
TOTAL LIABILITIES AND NET ASSETS	$ 966.8	$ 1,019.2

Changes in Net Assets. Total net assets decreased by $77.5 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 $50.4 million in current depreciation. Refer to Note C for details of capital assets and depreciation by category. Depreciation expense does not require the use of cash; it is an accounting term that represents a process of allocation of the cost of assets over the estimated useful lives of the assets. This includes wear and 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 capital assets.

Exhibit A-3
Government-Wide
Changes in Net Assets
Fiscal Years 2004 and 2003
(Amounts in millions)

	Governmental Activities	
	2004	2003 (Restated)
Revenues		
State appropriations	$ 1,430.0	$ 1,430.5
Federal funds	224.5	190.8
Other revenues	45.7	31.6
Total Revenues	1,700.2	1,652.9
Expenditures		
School level instruction and support	1,045.5	1,073.9
Comprehensive student support	398.5	304.6
Instructional support	47.3	38.0
State and district administration	36.7	29.9
School support	196.3	176.6
School community service	17.6	23.0
Public libraries	29.7	26.3
Capital outlay	.7	3.3
Other	5.8	6.5
Total Expenditures	1,778.1	1,682.1
Transfers	.3	--
Change in Net Assets	(77.6)	(29.2)
Beginning Net Assets	864.9	747.1
Prior Period Adjustment	--	147.0
Beginning Net Assets - Restated	864.9	894.1
Ending Net Assets	$ 787.3	$ 864.9

EXPLANATION OF MAJOR DEPARTMENTAL PROGRAMS

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

Program #	Program Title	Program Description
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, and information technology support
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 Pubic Library System is included in the Department of Education's 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

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

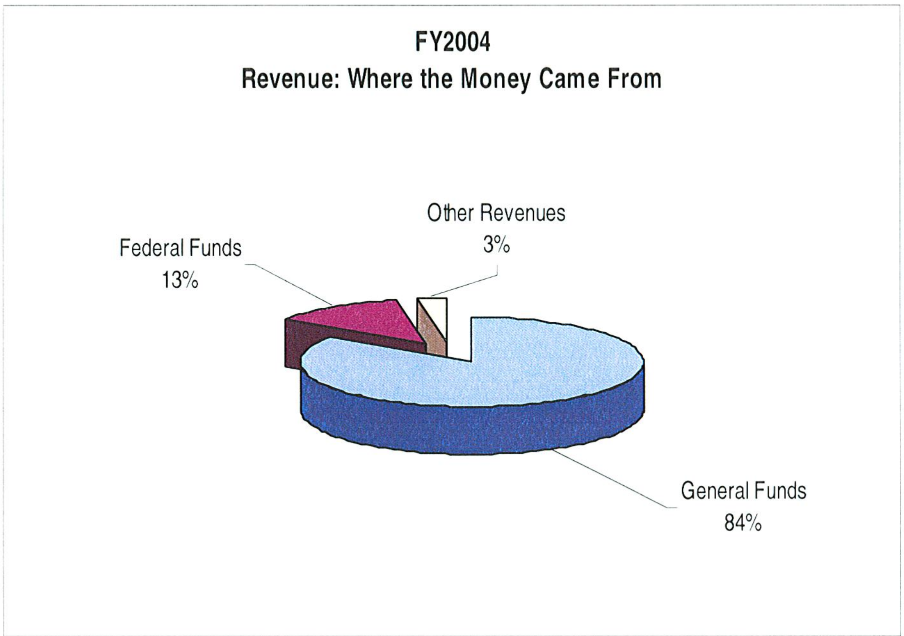
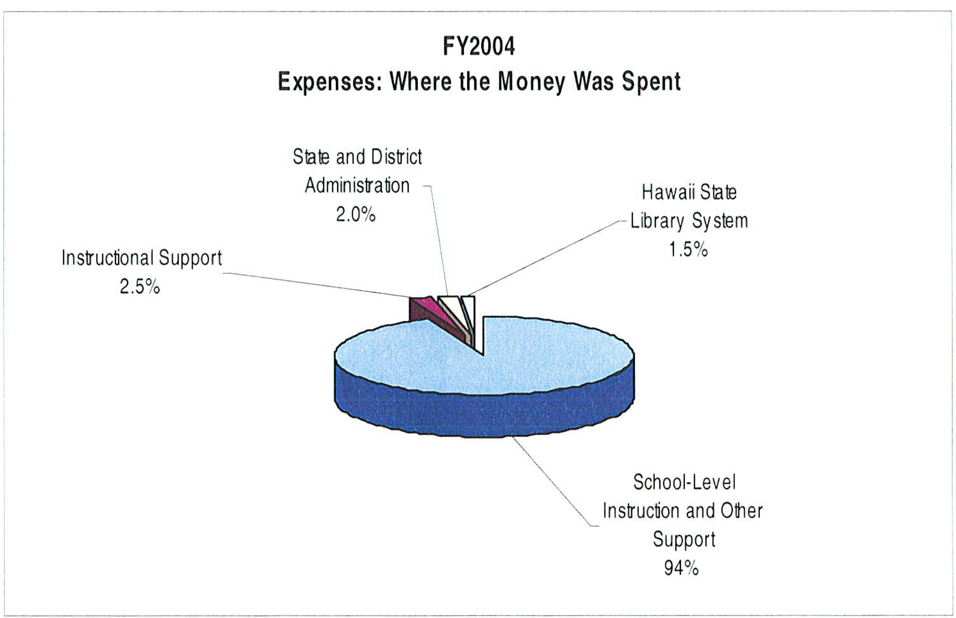


Exhibit A-5 summarizes the Department's expenses. A total of 94% of Department expenditures are for school-level instructional and support programs in EDN 100, 150, 400, and 500, while only 2% are for State and District Administration.

Exhibit A-5



GENERAL FUND BUDGETARY HIGHLIGHTS

The Department was appropriated general funds of $1,444.4 million in FY2003-04. General fund allotments to School Based Budgeting ($17.6 million) and Comprehensive School Support ($12.6 million) increased, which were offset by decreases to School Support ($12.1 million), School Community Services ($7.5 million) and reduced General Fund carryover ($8.9 million).

The law permits the Department to "carryover" up to 5% of appropriations, for school level instruction and comprehensive school support services, from one fiscal year to the next. The Department carried over $18.9 million for FY2002-03 and $3.8 million for FY2001-02 general fund appropriation for expenditure in FY2003-04. Carry over 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 in a custodial capacity for students. The fund contains monies collected and maintained by the school for the students that do not require deposit into the State Treasury. 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 $14.4 million in FY2003-04, resulting in $1.2 million (9%) 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. Some building and land improvements were not reported as capital assets in FY2002-03 but are included in FY2003-04. There were also 34 land parcels not reported in FY2002-03 but included in FY2003-04. As a result of this restatement, net assets at July 1, 2003 increased by $144 million. Land, land improvements, building, building improvements, and equipment were $810 million (net of accumulated depreciation) in FY2003-04, resulting in 5% decrease from the prior fiscal year primarily due to increased accumulated depreciation.

This year's capital improvements included the construction of three classrooms. Other projects are under construction, in the bid process, or are being designed. Please refer to Note E of the financial statements for capital asset details.

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 $98.9 million in FY2003-04. This resulted in a $22 million (18%) decrease in interest payments and debt retired from the prior fiscal year.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

In recent months, the State's unemployment rate has been at a record low with seasonally adjusted unemployment rate being below 3.5%. One year ago, Hawaii's seasonally adjusted unemployment rate was 4.4% while the national rate was 5.9%.

Cumulative tax collections for the first five months of FY2004-05 exceeded $1.8 billion or $239.4 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 15.3% in the same period.

In September 2004, the Council on Revenues estimated that the General Fund tax growth rate would be 8.8% in FY2004-05 and 5.3% in FY2005-06. While the current condition of Hawaii's economy is good, the projected growth in tax revenues remains a concern. Based on this concern and increasing fixed costs, the Governor has imposed a 1% across-the-board restriction on all General Fund discretionary expenditures of all executive Branch departments and agencies for FY2004-05. Consultant and personal service contracts greater than $25,000 and the filling of nonessential positions continue to require the approval of the Governor and other expenditures controls implemented in FY2003-04 continue to be in force.

FUTURE EVENTS THAT WILL FINANCIALLY IMPACT THE DEPARTMENT

Act 51, the Reinventing Education Act of 2004, enables 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 of Education, 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 includes:

- 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.

The Act also strives to remove bureaucratic constraints that hamper the effectiveness of the Department of Education. 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.

The Department of Accounting and General Services is required to transfer capital improvement projects and contract administration functions, as well as repair and maintenance functions that are not covered in the abovementioned paragraphs by July 1, 2005. The Department of Human Resources Development is also required to transfer the centralized human resources system, recruitment, certification, examination, management, classification, and compensation of Department of Education employees, including labor relations functions, to the Department of Education by July 1, 2005.

By July 1, 2006, the Department of Budget and Finance will be required to transfer funding for collective bargaining agreement increases and the securing, administration, use and custodial supervision of federal funds and other aid to the Department of Education. The Department of the Attorney General must transfer the duties relating to the negotiation of workers' compensation claims and labor management relations to the Department of Education. The Department of Human Services is required to transfer employment background checks for the After-School Plus Program, private vendors, and other employees, and the Department of Heath is required to transfer school health aides and public health nurses who supervise the school nurse aids, effective July 1, 2006.

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 2005, 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. Due to the State's current economic uncertainty, it will be extremely difficult to comply with the requirements of the No Child Left Behind Act within the timelines defined, without substantial additional resources and funding.

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, 2004

	Governmental Activities
ASSETS	
Cash	$ 141,519,742
Certificates of deposit	10,764
Receivables	
Due from federal government	14,541,147
Accounts receivable	714,411
Due from other agency	2,699
Total current assets	156,788,763
Property and equipment, net of accumulated depreciation	810,019,007
Total assets	$ 966,807,770
LIABILITIES	
Current liabilities	
Vouchers and contracts payable	$ 13,011,759
Accrued wages and employee benefits	83,592,443
Accrued compensated absences	7,981,375
Current portion of workers' compensation claims	10,186,400
Deferred revenues	1,873,426
Due to State of Hawaii General Fund	5,078,678
Due to others	703,764
Total current liabilities	122,427,845
Accrued compensated absences, less current portion	31,918,813
Wokers' compensation claims	25,104,624
Total liabilities	179,451,282
NET ASSETS	
Investment in capital assets	810,019,007
Unrestricted	(22,662,519)
Total net assets	$ 787,356,488

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2004

		Program Revenues		Net Expense and Changes in Net Assets
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Governmental Activities**
Governmental activities:				
School level instruction and support	$ 1,045,525,473	$ 8,184,534	$ 105,050,741	$ (932,290,198)
Comprehensive student support	398,506,805	--	43,766,218	(354,740,587)
Instructional support	47,329,381	3,485,269	21,825,460	(22,018,652)
State and district administration	36,690,871	1,242,122	1,842,704	(33,606,045)
School support	196,287,811	19,469,372	45,267,722	(131,550,717)
School community service	17,621,060	2,091,919	6,319,668	(9,209,473)
Public libraries	29,676,087	2,033,719	450,055	(27,192,313)
Capital outlay	656,627	--	--	(656,627)
Other	5,797,891	--	8,625,080	2,827,189
Total governmental activities	$ 1,778,092,006	$ 36,506,935	$ 233,147,648	(1,508,437,423)
General revenues:				
State allotted appropriations, net of lapses				1,429,927,842
Unrestricted investment earnings				637,143
Transfers				324,185
Total general revenues and transfers				1,430,889,170
Change in net assets				(77,548,253)
Net assets at June 30, 2003				719,003,680
Prior period adjustments				145,901,061
Net assets restated at July 1, 2003				864,904,741
Net assets at June 30, 2004				$ 787,356,488

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2004

	General	Federal	Other	Total
ASSETS				
Cash	$ 67,458,348	$ 40,882,696	$ 33,178,698	$ 141,519,742
Certificates of deposit	--	--	10,764	10,764
Receivables				
Due from State of Hawaii	--	--	2,699	2,699
Due from federal government	--	14,541,147	--	14,541,147
Accounts receivable	--	--	714,411	714,411
Total assets	$ 67,458,348	$ 55,423,843	$ 33,906,572	$ 156,788,763
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Vouchers and contracts payable	$ 9,824,178	$ 2,380,148	$ 807,433	$ 13,011,759
Accrued wages and employee benefits payable	75,191,924	6,557,006	1,843,513	83,592,443
Deferred income	--	1,873,426	--	1,873,426
Due to State of Hawaii	5,078,678	--	--	5,078,678
Due to others	--	703,764	--	703,764
Total liabilities	90,094,780	11,514,344	2,650,946	104,260,070
FUND BALANCES				
Reserved for encumbrances	38,275,432	15,121,694	4,777,842	58,174,968
Reserved for continuing appropriations	13,431,879	--	--	13,431,879
Unreserved	(74,343,743)	28,787,805	26,477,784	(19,078,154)
Total fund balances (deficit)	(22,636,432)	43,909,499	31,255,626	52,528,693
Total liabilities and fund balances	$ 67,458,348	$ 55,423,843	$ 33,906,572	$ 156,788,763

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, 2004

Total fund balances - governmental funds		$ 52,528,693
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Governmental capital assets	$ 1,614,204,864	
Less accumulated depreciation	(804,185,857)	810,019,007
Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds.		(39,900,188)
Accrued workers' compensation liability is not due in the current period and therefore is not reported in the governmental funds.		(35,291,024)
Net assets of governmental activities		$ 787,356,488

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, 2004

	General	Federal	Other	Total
REVENUES				
State allotments, net	$ 1,429,927,842	$ --	$ --	$ 1,429,927,842
Intergovernmental revenues	--	224,554,023	--	224,554,023
Other revenues	--	--	45,737,703	45,737,703
	1,429,927,842	224,554,023	45,737,703	1,700,219,568
EXPENDITURES				
School level instruction	884,612,340	107,426,433	7,508,835	999,547,608
Comprehensive student support	355,541,422	42,965,383	--	398,506,805
Instructional support	24,445,549	21,962,392	1,531,564	47,939,505
State and district administration	33,145,369	1,011,875	737,621	34,894,865
School support	115,354,171	54,962,332	25,400,291	195,716,794
School community service	9,511,025	6,144,720	1,968,249	17,623,994
Public libraries	28,705,455	483,637	1,919,537	31,108,629
Capital outlay	--	--	656,627	656,627
Other	288,520	--	5,503,150	5,791,670
	1,451,603,851	234,956,772	45,225,874	1,731,786,497
EXCESS OF REVENUES OVER EXPENDITURES	(21,676,009)	(10,402,749)	511,829	(31,566,929)
OTHER FINANCING SOURCES				
Transfer in	--	--	324,185	324,185
	--	--	324,185	324,185
NET CHANGE IN FUND BALANCES	(21,676,009)	(10,402,749)	836,014	(31,242,744)
FUND BALANCES AT JUNE 30, 2003	49,781,066	1,893,772	30,419,612	82,094,450
Prior period adjustements	(50,741,489)	52,418,476	--	1,676,987
FUND BALANCES RESTATED AT JULY 1, 2003	(960,423)	54,312,248	30,419,612	83,771,437
FUND BALANCES AT JUNE 30, 2004	$ (22,636,432)	$ 43,909,499	$ 31,255,626	$ 52,528,693

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, 2004

Net change in fund balances - total governmental funds		$ (31,242,744)
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	$ 10,453,310	
Less current fiscal year depreciation	(50,429,111)	(39,975,801)
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.		(4,624,056)
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.		(1,705,652)
Change in net assets of governmental activities		$ (77,548,253)

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, 2004

	Original	Final	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Revenues				
State allotments	$ 1,436,974,016	$ 1,444,391,652	$ 1,429,927,842	$ (14,463,810)
Expenditures				
School level instruction	967,163,889	974,581,525	949,878,209	24,703,316
Comprehensive student support services	284,039,732	286,849,732	285,161,168	1,688,564
Instructional support	20,314,325	19,262,325	19,259,980	2,345
State and district administration	31,226,941	29,468,941	29,467,877	1,064
School support	101,481,391	101,481,391	101,469,181	12,210
School community service	8,216,835	8,216,835	8,175,595	41,240
Public libraries	24,530,903	24,530,903	24,336,547	194,356
	1,436,974,016	1,444,391,652	1,417,748,557	26,643,095
EXCESS REVENUES OVER EXPENDITURES	$ --	$ --	$ 12,179,285	$ 12,179,285

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, 2004

	Original	Final	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Revenues				
Federal grants	$ 197,729,967	$ 383,875,165	$ 208,949,079	$ (174,926,086)
Expenditures				
School level instruction	115,318,574	226,664,905	110,389,374	116,275,531
Comprehensive student support services	33,903,370	58,473,077	43,196,641	15,276,436
Instructional support	1,413,378	36,633,545	23,459,827	13,173,718
State and district administration	65,000	2,293,050	1,411,830	881,220
School support	43,247,751	48,973,615	46,723,242	2,250,373
School community service	2,916,650	9,577,107	6,387,508	3,189,599
Public libraries	865,244	1,259,866	516,669	743,197
	197,729,967	383,875,165	232,085,091	151,790,074
EXCESS REVENUES OVER EXPENDITURES	$ --	$ --	$ (23,136,012)	$ (23,136,012)

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
STATEMENT OF ASSETS AND LIABILITIES
AGENCY FUNDS
June 30, 2004

ASSETS

Cash and cash equivalents	$ 14,368,813
Total assets	$ 14,368,813

LIABILITIES

Due to student group and others	$ 14,368,813
Total liabilities	$ 14,368,813

See accompanying notes to the basic financial statements.

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.

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.

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) ***Cash and Cash Equivalents*** - Cash and cash equivalents, includes all cash and investments with original maturities of three months or less.

(5) ***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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) ***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 consists primarily of federal grant funds.

(7) ***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.

(8) ***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.

(9) ***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 nonexchange 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.

(10) ***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.

(11) ***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.

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 for the school-based budgeting and comprehensive support services programs at the end of the fiscal year. 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, 2004, general funds carried over amounted to approximately $13,400,000.

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, 2004.

	General	Federal
Excess of revenues over expenditures and other uses - actual on a budgetary basis	$ 12,179,285	$ (23,136,012)
Reserved for encumbrances at fiscal year-end	38,275,432	15,121,694
Expenditures for liquidation of prior fiscal year encumbrances	(52,312,952)	(3,719,967)
Net change in unreserved liabilities	(19,817,774)	(5,092,053)
Accruals related to federal reimbursements for program expenditures	--	4,509,092
Revenues for unbudgeted programs	--	1,914,497
Excess of revenues over expenditures and other uses - GAAP basis	$ (21,676,009)	$ (10,402,749)

NOTE D - CASH AND CASH EQUIVALENTS

The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). 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. 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, 2004, the carrying amount of total bank deposits was approximately $5,886,000 and the corresponding bank balances which are represented were approximately $14,143,000. Of this amount, approximately $3,336,000 is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by the DOE's agent. The uninsured and uncollaterized balance at June 30, 2004 is approximately $10,807,000.

NOTE E - CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance July 1, 2003	Prior-period Adjustment	Balance July 1, 2003 Restated	Additions	Deductions	Balance June 30, 2004
Governmental activities						
Capital asset, not being depreciated						
Land	$ 41,410,285	$ 19,835,975	$ 61,246,260	$ –	$ –	$ 61,246,260
Land improvements	–	5,781,281	5,781,281	–	–	5,781,281
Total capital assets not being depreciated	41,410,285	25,617,256	67,027,541	–	–	67,027,541
Capital assets, being depreciated						
Building and improvements	1,214,551,819	217,120,997	1,431,672,816	396,454	–	1,432,069,270
Furniture and equipment	53,295,899	–	53,295,899	5,722,283	1,062,717	57,955,465
Public library materials	–	52,463,058	52,463,058	4,689,530	–	57,152,588
Total capital assets being depreciated	1,267,847,718	269,584,055	1,537,431,773	10,808,267	1,062,717	1,547,177,323
Less accumulated depreciation for:						
Building and improvements	570,090,996	103,327,313	673,418,309	42,319,264	–	715,737,573
Furniture and equipment	33,396,274	4,233,686	37,629,960	4,946,082	707,760	41,868,282
Public library materials	–	43,416,237	43,416,237	3,163,765	–	46,580,002
Total accumulated depreciation	603,487,270	150,977,236	754,464,506	50,429,111	707,760	804,185,857
Governmental activities, net	$ 705,770,733	$ 144,224,075	$ 849,994,808	$ (39,620,844)	$ 354,957	$ 810,019,007

NOTE E - CAPITAL ASSETS (Continued)

Depreciation expense was charged to functions as follows:

	Governmental Activities
School level instruction	$ 44,070,169
Instructional support	556,955
State and district administration	534,767
School support	1,498,934
School community service	43,278
Public libraries	3,718,786
Other	6,222
Total depreciation expense	$ 50,429,111

NOTE F - LONG-TERM LIABILITIES

The change in the long-term liabilities during the fiscal year ended June 30, 2004, was as follows:

	Accrued Compensated Absences	Workers' Compensation Claims
Balance at July 1, 2003	$ 35,276,132	$ 33,585,371
Additions	14,624,410	10,725,468
Reductions	(10,000,354)	(9,019,815)
Balance at June 30, 2004	$ 39,900,188	$ 35,291,024
Due within one year	$ 7,981,375	$ 10,186,400

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

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 had a deficit balance in the unreserved fund balance at June 30, 2004, of $74,343,743. The deficit 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, 2004, were as follows:

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004
ASSETS				
Cash and other assets held in trust	$ 13,199,810	$ 26,666,856	$ 25,497,853	$ 14,368,813
LIABILITIES				
Due to student groups and others	$ 13,199,810	$ 26,666,856	$ 25,497,853	$ 14,368,813

NOTE I - LEASE COMMITMENTS

The DOE leases equipment from third party lessors under various operating leases expiring through 2010. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2004, are as follows:

Fiscal Year Ending June 30,	Amount
2005	$ 2,660,000
2006	2,398,000
2007	2,087,000
2008	1,347,000
2009	476,000
2010	8,000
	$ 8,976,000

Total rent expense related to the above leases for the fiscal year ended June 30, 2004, amounted to approximately $2,402,000.

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 statue 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. No contributions were required or made by the DOE for the fiscal year ended June 30, 2002. Contributions by the DOE for the fiscal year ended June 30, 2004 and 2003, were approximately $90,892,000 and $84,364,000. The contribution rate for the fiscal years ended June 30, 2004 and 2003, was 8.87%.

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, 2004, was approximately $66,679,000 and $7,100,000, 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 $4 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.

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, 2004, amounted to approximately $482,490,000.

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, 2004. 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, 2004.

	Amount
Basic allocation	$ 1,438,846
Bonus commodities	139,443
	$ 1,578,289

NOTE N - PRIOR PERIOD ADJUSTMENTS

Certain adjustments were made to net assets to restate the balance as of June 30, 2003.

	Increase(decrease) in net assets as of June 30, 2003
Certain capital improvements and public library materials were not previously capitalized and the related accumulated depreciation was not recognized.	$ 144,224,075
Total effect on net assets invested in capital assets	144,224,075
Fund balances for certain federal grant programs were erroneously classified as deferred revenues.	52,418,476
State allotment was improperly accrued in the amount of general funded accrued payroll expenditures as of June 30, 2003.	(35,881,183)
Payroll expenditures incurred but paid in the subsequent fiscal year were not accrued as of June 30, 2003.	(18,678,293)
Balance on state appropriations for the fiscal year ended June 30, 2002 that were carried over to the fiscal year ended June 30, 2004, as allowed by section 37-41.5 of the Hawaii Revised Statutes were incorrectly reported as lapsed for the fiscal year ended June 30, 2003.	3,817,986
Total effect on unrestricted net assets	1,676,986
Total effect on net assets	$ 145,901,061

SUPPLEMENTARY INFORMATION

Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures[1]	Amount Provided to Subrecipient
U.S. Department of Agriculture				
Food Donation[2]	10.550	--	$ 1,578,289	$ --
Child Nutrition Cluster:				
School Breakfast Program	10.553	--	6,220,621	273,981
National School Lunch Program	10.555	--	38,459,106	920,826
Special Milk Program for Children	10.556	--	6,830	6,830
Summer Food Service Program for Children	10.559	--	730,300	730,300
Child and Adult Care Food Program	10.558	--	4,973,979	4,973,979
State Administrative Expenses	10.560	--	506,675	--
Total U.S. Department of Agriculture			52,475,800	6,905,916
U.S. Department of Defense				
National Defense Authorization Act P.L. 102-484	N/A[3]	--	1,991,407	--
Troops To Teachers - DOD FY03	N/A[3]	--	42,399	--
Troops To Teachers - DOD FY04	N/A[3]	--	43,340	--
Pass-through State Department of Defense				
Joint Venture Education Forum	N/A[3]	--	2,514,412	--
Total U.S. Department of Defense			4,591,558	--
U.S. Department of Interior				
Pass-through State Governor's Office				
Economic, Social, and Political Development of the Territories and the Freely Associated States	15.875	GR270094	2,054,607	--
Total U.S. Department of the Interior			$ 2,054,607	$ --

Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures[1]	Amount Provided to Subrecipient
U.S. Department of Justice				
Title V Juvenile Delinquency Prevention Program	16.548	--	$ 5,116	$ --
Pass-through State Department of Human Services Part E State Challenge Activities	16.549	00-JE-FX-0015	129,751	--
Total U.S. Department of Justice			134,867	--
U.S. Department of Labor				
Youth Opportunity Grants	17.263	--	74,847	--
Total U.S. Department of Labor			74,847	--
U.S. Department of Transportation				
Pass-through State Department of Transportation State and Community Highway Safety	20.600	AL03-02 (06-O-01)	26,327	--
		AL04-02 (06-S-01)	47,651	--
Total U.S. Department of Transportation			73,978	--
National Endowment for the Humanities				
Pass-through State Foundation on Culture and the Arts Promotion of the Arts Partnership Agreements	45.025	FY02-002	12,724	--
Total National Endowment for the Humanities			12,724	--
National Science Foundation				
Education and Human Resources	47.076	--	1,205,038	--
Pass-through Maui Economic Development Board Hands-On Science for Maui (Project SEED)	N/A[4]	ESI-9253304	3,554	--
Total National Science Foundation			$ 1,208,592	$ --

Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures[1]	Amount Provided to Subrecipient
Environmental Protection Agency				
Pass-through State Department of Health				
Nonpoint Source Implementation Grants	66.460	C9989785-01-0	$ 8,321	$ --
		C9989423-00-1	21,358	--
Total Environmental Protection Agency			29,679	--
U.S. Department of Education				
Adult Education - State Grant Program	84.002	--	2,943,897	--
Title I Grants to Local Educational Agencies	84.010	--	31,636,444	--
Migrant Education - State Grant Program	84.011	--	1,027,746	--
Title I Program for Neglected and Delinquent Children	84.013	--	95,693	--
Special Education Cluster:				
Special Education - Grants to States	84.027	--	34,330,471	--
Special Education - Preschool Grants	84.173	--	1,087,334	--
Impact Aid	84.041	--	48,244,095	--
Emergency Immigrant Education	84.162	--	(2,072)	--
Safe and Drug-Free School and Community - National Programs	84.184	--	1,037,129	--
Byrd Honors Scholarships	84.185	--	163,500	--
Safe and Drug-Free Schools and Communities - State Grants	84.186	--	1,584,396	--
Bilingual Education - Professional Development	84.195	--	318,478	--
Education for Homeless Children and Youth	84.196	--	155,221	--
Even Start - State Educational Agencies	84.213	--	1,127,828	--
Even Start - Migrant Education	84.214	--	390,769	--
Fund for the Improvement of Education	84.215	--	719,289	--
Native Hawaiian Special Education	84.221	--	13,375	--
Eisenhower Professional Development State Grants	84.281	--	1,340,283	--
Charter Schools	84.282	--	1,357,243	1,114,398
Twenty-First Century Community Learning Centers	84.287	--	3,489,503	--
Bilingual Education - Program Development and Implementation Grants	84.288	--	18,364	--
Foreign Language Assistance	84.293	--	909	--
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, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures[1]	Amount Provided to Subrecipient
Native Hawaiian Curriculum Development, Teacher Training and Recruitment	84.297	--	$ 468,552	$ --
State Grants for Innovative Programs	84.298	--	1,680,656	--
National Challenge Grants for Technology in Educatior	84.303	--	5,752	--
Even Start-Statewide Family Literacy Program	84.314	--	80,889	--
Education Technology State Grants	84.318	--	1,964,978	--
Special Education - State Program Improvement Grants for Children with Disabilities	84.323	--	483,531	--
Special Education - Personnel Preparation to Improve Services and Results for Children with Disabilities	84.325	--	29,426	--
Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	84.326	--	116,678	--
Advanced Placement Program	84.330	--	21,150	--
Comprehensive School Reform Demonstration	84.332	--	984,609	--
Teacher Quality Enhancement Grants	84.336	--	2,091	--
Reading Excellence	84.338	--	8,767,632	--
Class Size Reduction	84.340	--	824,291	--
Title I Accountability Grants	84.348	--	355,510	--
School Renovation Grants	84.352	--	3,349,482	--
Reading First State Grants	84.357	--	2,033,107	--
Native Hawaiian Education	84.362	--	20,013	--
English Language Acquisition Grants	84.365	--	810,017	--
Mathematics and Science Partnerships	84.366	--	82,144	--
Improving Teacher Quality State Grants	84.367	--	7,908,879	--
Grants for State Assessments and Related Activities	84.369	--	6,657,870	--
Common Core Data Survey Basic	N/A[3]	--	77,762	--
NAEP State Coordinator	N/A[3]	--	137,612	--
			168,005,415	1,114,348
Pass-through Office of the State Director for Vocational Education				
Vocational Education - Basic Grants to States	84.048	V048A000011A	57	--
		V048A010011A	143,492	--
		V048A020011A	1,094,123	--
		V048A030011	1,338,582	--
			2,576,254	--
Tech-Prep Education	84.243	V243A010011	124,840	--
		V243A020011A	238,831	--
		V243A030011	21,417	--
			$ 385,088	$ --

Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures [1]	Amount Provided to Subrecipient
Pass-through State Department of Human Services				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126	MOA-DHHS	$ 84,296	$ --
Safe and Drug-Free Schools and Communities - State Grants	84.186	S186B020012	4,629	--
			88,925	--
Pass-through Alu Like				
Native Hawaiian Vocational Education	84.259	VE-02-03	40,353	--
		VE-02-02	8,586	--
		VE-03-01	50,459	--
		VE-01-11	27	--
		VE-00-02	27	--
		S362A0310013	517	--
		VE-02-04	19,285	--
		VE-03-03	88,578	--
		VE-03-05	61,761	--
		VE-03-04	95,008	--
			364,601	--
Pass-through Western Consortium for Accelerated Learning Opportunities				
Advanced Placement Program	84.330	S330A000029-01	115,384	--
Pass-through University of Hawaii				
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	P334S000195-01	103,910	--
		P334S000195-02	283,335	--
			387,245	--
Native Hawaiian Special Education	84.221	CO10147	104,596	--
		CO10147-mod #1	1,668,220	--
			1,772,816	--
Total U.S. Department of Education			$ 173,695,728	$ 1,114,398

Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2004

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number		Federal Expenditures[1]		Amount Provided to Subrecipient
U.S. Department of Health and Human Services						
Pass-through State Department of Health						
Block Grants for Prevention and Treatment of Substance Abuse	93.959	MOA-DOH	$	79,959	$	--
Pass-through State Department of Human Services						
Child Care and Development Block Grant	93.575	G0100HICCD2		266,729		--
Temporary Assistance for Needy Families	93.558	DHS-04-BESSD-1898		59,505		--
Total U.S. Department of Health and Human Services				406,193		--
Corporation for National and Community Service						
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	--		288,910		--
Pass-through State Department of Labor						
Learn and Serve America - School and Community Based Programs	94.004	00LSFHI101		37,105		--
		03KSPHI001		15,494		--
				52,599		--
Total Corporation for National and Community Service				341,509		--
TOTAL FEDERAL GRANT FUND EXPENDITURES			$	235,100,082	$	8,020,315

[1] The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.
[2] Expenditures for the Food Donation Program (CDFA No., 10.550) are based on the value of food commodities received.
[3] Not applicable.
[4] 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 Superintendent
Department of Education
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, 2004, and have issued our report thereon dated February 28, 2005. 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 2004-01 to 2004-03.

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, 2005.

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, CPAs, Inc.

Honolulu, Hawaii
February 28, 2005

PART III

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

N&K
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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 Superintendent
Department of Education
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, 2004. 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.

As described in items 2004-07 to 2004-14 in the accompanying schedule of findings and questioned costs, the DOE did not comply with the following requirements:

[illegible]	[illegible]	[illegible]	[illegible]
10.558	Child and Adult Care Food Program	Subrecipient Monitoring	2004-07, 2004-08
84.010	Title I Grants to Local Educational Agencies	Allowable Costs	2004-09
84.287	Twenty-First Century Community Learning Centers	Allowable Costs Matching	2004-09 2004-12
84.338	Reading Excellence	Allowable Costs Reporting Cash Management	2004-09 2004-10 2004-11
84.352	School Renovation Grants	Earmarking Davis-Bacon	2004-13 2004-14
84.367	Improving Teacher Quality	Allowable Costs	2004-09
84.369	Grants for State Assessments and Related Activities	Allowable Costs	2004-09

Compliance with such requirements is necessary, in our opinion, for the DOE to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, 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, 2004. The results of our auditing procedures also disclosed other 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 2004-04 to 2004-06.

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 2004-07 to 2004-14.

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, 2005.

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, 2005
(except for Federal Award Findings 2004-07 through 2004-14
as to which date is May 14, 2007)

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Education
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2004

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	__ yes	✓ no
Reportable condition(s) identified not considered to be material weaknesses?	✓ yes	__ none reported
Noncompliance material to the financial statements noted?	__ yes	✓ no

Federal Awards

Internal control over major program:		
Material weakness(es) identified?	__ yes	✓ no
Reportable condition(s) identified not considered to be material weaknesses?	✓ yes	__ none reported
Type of auditors' report issued on compliance for major programs:	Qualified	
Any audit findings disclosed that are required to be reported in accordance with OMB Circular A-133, Section .510(a)?	✓ yes	__ no

Identification of major programs:

CFDA Number	Name of Federal Program
10.550	Food Donation
	Child Nutrition Cluster:
10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children
10.558	Child and Adult Care Food Program
	Special Education Cluster
84.027	Special Education - Grants to States (IDEA, Part B)
84.173	Special Education - Preschool Grants, IDEA Preschool
84.010	Title I Grants to Local Educational Agencies (LEAs)
84.041	Impact Aid
84.287	Twenty-First Century Community Learning Centers
84.338	Reading Excellence
84.352	School Renovation Grants
84.367	Improving Teacher Quality State Grants
84.369	Grants for State Assessments & Related Activities

Dollar threshold used to distinguish between Type A and Type B programs:	$3,000,000	
Auditee qualified as a low-risk auditee?	__yes	✓ no

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref No. **Internal Control Findings**

2004 - 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.
- Two 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. Five other schools also used a version of the administrator's checklist for documentation. However, the checklist alone did not provide sufficient information on whether any discrepancies were found.
- Many of the schools did not conduct unannounced cash counts of the school petty cash fund or check if cash receipts were deposited daily.

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.

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

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.

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

2004 - 02 **Improve Information System For Workers' Compensation**

Workers' compensation payment data, actual and estimated, are maintained using the Renaissance (REN) software program. Due to software licensing issues and incompatibility with the DOE's payroll system, paid wage loss information was maintained separately which resulted in inefficiencies and inaccuracies in financial reporting. Furthermore, the DOE cannot be certain of the completeness of wage loss information submitted to the DOE's Workers' Compensation office.

The information in REN did not include wage loss payments to employees that were made through the DOE payroll system. We were informed that the payments were not inputted to REN due to insufficient staffing at the Workers' Compensation office, and the Payroll section personnel of the Administrative Services Branch was not licensed to use REN. Software program incompatibility did not allow the electronic transfer of the data. Due to the incomplete data stored in REN, obtaining historical payment and complete closed claim information from REN was difficult.

Although wage loss payments were inputted to REN for more complete information effective October 1, 2004, there were no procedures to ensure that the wage loss data input was accurate and complete. We were informed that procedures to ensure accuracy and completeness of data will be in place effective with the payroll period ended February 28, 2005.

Prior to October 1, 2004, the DOE was unable to determine whether all claims for wage loss were paid. Effective October 1, 2004, the Workers' Compensation office maintained an electronic spreadsheet of claims filed and paid to track unpaid claims. However, there were no follow-up procedures to ensure the unpaid claims were resolved. In addition, maintaining the spreadsheet is time-consuming and in part duplicated information in REN. We were informed that tracking of unpaid claims could not be done using REN because REN did not allow the input of estimated wage loss. We were also informed that it may be possible to input estimated wage loss as a pending field with an upgraded version of REN.

During our testing of the estimated reserves for claims, we noted numerous open claims as of June 30, 2004, with negative reserve balances that totaled over $8 million. Reserves were not adjusted when actual payments exceeded the initial reserve amount for the claim due to the lack of staffing.

We were informed that for fiscal year ending June 30, 2005, reserve balances would be re-evaluated and adjusted as necessary when cumulative actual payments reach a certain percentage of the reserve balance recorded in REN.

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

Recommendation

The DOE should improve its workers' compensation information system by performing the following:

1. Perform batch controls of wage loss information input in REN and make necessary corrections for any input discrepancies to ensure completeness and accuracy of wage loss information.

2. Continue to pursue the possibility of maintaining estimated wage loss data in REN to allow a more efficient means of monitoring unpaid wage loss claims.

3. Periodically re-evaluate and adjust reserve balances, particularly balances that are at risk of becoming negative, to ensure reasonableness of reserve amount.

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

2004 - 03 **Establish 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 20 employees, we noted the following conditions:

- In 12 instances, the vacation and sick leave balances calculated using the computerized leave accounting system as of June 30, 2004, did not agree to Form 7. The balances from the computerized leave accounting system were generally higher than the balances on Form 7.

- In 5 instances, the computerized leave accounting system included vacation balances for terminated employees.

- In 5 instances, the *Application for Leave of Absence* was not dated or dated after the leave was taken.

- In 6 instances, the signed *Application for Leave of Absence* did not indicate whether the leave was approved or denied.

- In 2 instances, the date of absence on Form 7 did not agree to the *Application for Leave of Absence* and there was no documentation to explain the discrepancy.

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 establish a 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.

SECTION III - FEDERAL AWARD FINDINGS

Ref No.	Compliance and Internal Control Findings	Questioned Costs

2004 - 04 Establish Procedures to Ensure Cohesive Management of the Food Donation Program

Effective July 1, 2003, the Office of Hawaii Child Nutrition Programs (OHCNP) officially became the state agency for the USDA's Child Nutrition Programs, Nutrition Education Training and Program, Child and Adult Care Food Program, and Food Distribution Program, which includes the Food Donation Program (CFDA No. 10.550). Prior to July 1, 2003, the School Food Services Branch (SFSB) of the DOE acted as both the state agency and as one of the school food authorities participating in the Child Nutrition Programs.

During our testing of the Food Donation Program, we noted there was confusion over the responsibilities of the OHCNP and the SFSB regarding inventory at the storage facilities.

The same storage facilities were used under the same contract to warehouse food commodities for both the state agency and for its school food authority. The SFSB informed us that personnel at the storage facilities conducted an annual physical inventory, but the SFSB did not perform an observation of the inventory or review the physical inventory process and procedures. The SFSB stated that the OHCNP was responsible as the state agency to conduct and oversee the physical inventory.

Conversely, the OHCNP stated that the SFSB was responsible to conduct and oversee the physical inventory since the SFSB contracted with the storage facilities to warehouse and distribute food commodities. In addition, the SFSB is the entity that received reports (e.g., bills of lading, etc.) from the shippers and storage facilities and is in constant communication with the storage facilities.

As a result of this lack of cohesive management, there were no records to document that there had been a physical inventory conducted and that inventory records were reconciled to the physical counts.

As part of their annual review of the storage facilities required for state agencies, the OHCNP conducted random checks of inventory items on hand to the warehouse inventory records. However, the inventory review documentation was incomplete as there was no documentation of any resolution to the discrepancies found (e.g., whether the lower physical

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**

counts were due to inventory items withdrawn prior to the physical count but not yet posted to the inventory records, or whether there were actual shortages and therefore, the inventory records had to be adjusted, etc.).

7 CFR 250.2(b) states in part, "...The distributing agency is responsible for effective and efficient administration of program operations within its jurisdiction and shall administer the program in accordance with the requirements of this part and FNS guidelines and instructions. Distributing agencies may impose additional requirements for participation that are not inconsistent with the provisions of this part....The distributing agency shall provide guidance to subdistributing agencies and recipient agencies on all aspects of program operations."

7 CFR Section 250.3 defines a distributing agency and a subdistributing agency as follows:

"Distributing agency means a State, Federal or private agency... which enters into an agreement with the Department for the distribution of donated foods to eligible recipient agencies and recipients and the Food and Nutrition Service of the Department when it accepts title to commodities from the Commodity Credit Corporation (CCC) for distribution to eligible recipient agencies pursuant to the National Commodity Processing System. A distributing agency may also be a recipient agency.

Subdistributing agency means an agency performing one or more distribution functions for a distributing agency other than, or in addition to, functions normally performed by common carriers or warehousemen. A subdistributing agency may also be a recipient agency."

7 CFR 250.14(c) states in part, "Reviews. All distributing agency-level storage facilities shall be reviewed annually. Distributing agencies shall ensure that subdistributing and recipient agencies conduct annual reviews of their respective storage facilities. Documentation shall be maintained on file at the distributing agency or local level as appropriate to reflect compliance with this section, including documentation of corrective action in cases of noncompliance. Corrective action must be taken immediately on all deficiencies identified in the review and the results of the corrective action must be forwarded to the distributing agency...."

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**
	7 CFR 250.14(e) states in part, "Physical inventory. During the annual review required by paragraph (c) of this section, distributing agencies and subdistributing agencies shall take a physical inventory of their storage facilities. The physical inventory shall be reconciled with each storage facility's book inventory. The reconciliation records shall be maintained by the agency that contracted for or maintained the storage facility. Food items that have been lost, stolen, or found to be out of condition, shall be identified and recorded....Corrective action on each deficiency noted during these inventories shall be initiated immediately, and a written report of those corrective actions shall be forwarded to the distributing agency...."	
	Based upon the federal regulations above, the OHCNP as a distributing agency and the SFSB as a subdistributing agency, are both required to perform an annual review of their storage facilities and perform physical inventories. However, this would result in duplication of efforts and inefficiencies in reviewing the same warehouse.	$ --
	Recommendation	
	As the agency responsible for effective and efficient administration of the Food Donation Program, the OHCNP should establish written procedures to ensure cohesive management of the Food Donation Program. Procedures should address proper annual reviews of storage facilities, including conducting physical inventory, reconciling the physical counts to the storage facility's book inventory, resolving discrepancies found, and documenting the reviews.	

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**

2004 - 05 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:

- Two instances where the amounts reported on daily Form SL-5 did not agree to the supporting documents and one instance where the amounts reported on the monthly Form SL-5 did not agree to supporting documents.
- Three instances where amounts per the validated deposit slip did not agree to the daily SL-5.
- Four instances where the Form SL-5 contained mathematical errors. $ --

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.

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2004 - 06	**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:

- Four instances where the results documented on the "Report on Verification of Free and Reduced-Price Meal Application" did not agree to the actual verification results.
- One instance where the "Report on Verification of Free and Reduced-Price Meal Application" was completed and submitted late.
- One instance where the "Report on Verification of Free and Reduced-Price Meal Application" had mathematical errors. $ --

Recommendation

Schools should establish procedures to 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.

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**
2004 - 07	**Improve Monitoring Function**	

As the administering agency of the Child and Adult Care Food Program (CFDA 10.558), the DOE is responsible for monitoring the sponsoring organizations and providers to ensure they are in compliance with program regulations in accordance with 7 CFR 226. 7 CFR 226.6(m) provides guidelines on administrative reviews to be performed by the DOE.

We noted the DOE does not have formal policies and procedures over the monitoring process which results in inconsistencies in the level of documentation, procedures performed in each area of compliance, and policies and procedures over follow-up and closure for each review. Specifically, we noted the following deficiencies:

- Documentation did not demonstrate that review priorities were considered when selecting sponsors to be reviewed. For example, sponsors whose prior review revealed serious deficiencies should be targeted.
- Review forms used to document required administrative reviews were not always completed in their entirety and did not always support conclusions reported.
- A formal report summarizing the findings and the required corrective action was not always issued to the providers.
- Corrective action plans were not always obtained from providers.
- Closure of the administrative reviews, including any follow-up on corrective actions or financial adjustments was not performed, or if performed, not documented.
- As part of their administrative reviews, the DOE should review for compliance with 7 CFR 226.16(d) which requires sponsoring organizations to perform a review of their new providers within the first six weeks of operation and for ongoing providers a minimum of three times each year. The review of this requirement lacked documentation and did not properly support the conclusion.

The primary purpose of the monitoring function is to ensure the integrity of the program. $ --

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

Recommendation

The DOE should improve its monitoring procedures by establishing formal policies and procedures and revising its review templates to ensure required monitoring is performed and adequately documented.

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs

2004 - 08 Improve Documentation of Subrecipient Eligibility Determination

As the administering agency of the Child and Adult Care Food Program (CFDA 10.558), the DOE is responsible for establishing all subrecipient eligibility at the time of institution application for the program in accordance with 7 CFR 226.15. Other applicable institution specific requirements are stated in 7 CFR 226.16 for sponsoring organizations, 7 CFR 226.17 for child care centers, 7 CFR 226.18 for day care homes, and 7 CFR 226.19a for adult day care centers.

We noted the DOE does not have formal policies and procedures over the application process which results in the lack of adequate documentation to properly determine subrecipient eligibility prior to acceptance into the program. Some of the instances of inadequate documentation were as follows:

- Documentation did not demonstrate that the National Disqualified List (NDL) was reviewed to determine whether the applicant or any key employees were included on the list in accordance with 7 CFR 226.6(b)(12).

- Documentation did not demonstrate that there was any consideration of whether the applicant, or any of its key employees, were, in the past seven (7) years, been declared ineligible for any publicly funded program by reason of violating another publicly funded program's requirements, in accordance with 7 CFR 226.6(b)(13).

- Documentation did not demonstrate that there was any consideration of whether the applicant, or any of its key employees, were, in the past seven (7) years, convicted of any act that indicated a lack of business integrity in accordance with 7 CFR226.6 (b)(14).

- Documentation did not demonstrate that there was an outside employment policy that "restricts other employment by employees that interferes with an employee's performance of Program-related duties and responsibilities, including outside employment that constitutes a real or apparent conflict of interest" in accordance with 7 CFR 226.6(b)(16).

- Adequate documentation was not obtained to properly determine whether the applicant could demonstrate financial viability, management capability, and organizational accountability in accordance with 7 CFR 226.6(b)(18). $ --

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

Recommendation

The primary purpose of the application and renewal process is to ensure that all participating organizations are eligible as required by 7 CFR 226. The DOE should establish formal policies and procedures and revise review templates to ensure required documentation is obtained timely and is adequate to properly determine subrecipient eligibility.

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs

2004 - 09 Document Time Spent on Federal Programs

The DOE relied on the schools to maintain certain documentation that supports payroll expenditures charged to federal programs. The schools did not prepare certifications for numerous employees certifying that those employees worked solely on a single federal award. The payroll expenditures for those employees in our test sample are summarized in the following table.

Program Title	CFDA No.	Count	Payroll Cost
Title I Grants to Local Educational Agencies	84.010	9	$ 391,330
Reading Excellence	84.338	10	588,496
Improving Teacher Quality	84.367	15	834,805
Grants for State Assessments and Related Activities	84.369	3	186,641
ESEA Administrative Cost Pool		5	338,957
Total		42	$ 2,340,229

Attachment B, Paragraph 8.h(1) of the Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, codified in 2 CFR 225 states, "Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit."

Paragraph 8.h(3) adds, "Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee."

The schools were unaware of the requirement for periodic certification to support charges for employees who worked solely on a single federal award or cost objective.

As a result of inadequate payroll documentation, $2,340,229 is considered questioned costs. $ 2,340,229

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs

Recommendation

The DOE should prepare and maintain payroll documentation in accordance with OMB Circular A-87, including periodic certifications for employees who worked solely on a federal program or cost objective. Certifications should be prepared in a timely manner to ensure that they are readily available to support time charged to federal programs.

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**
2004 -10	**Maintain Supporting Worksheets**	
	Our review of the Annual Performance Report for the period August 2, 2002 to August 1, 2003, for the Reading Excellence program (CFDA No. 84.338) disclosed that the DOE did not maintain the supporting worksheets used to prepare the report.	$ --
	Recommendation	
	The DOE program personnel should exercise more care in ensuring supporting worksheets and accounting records used to prepare financial reports are retained.	

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2004 - 11	**Improve Cash Management Procedures**	
	34 CFR 205.33(a) states in part, "A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs...."	
	The DOE held a cash balance over $100,000 for nine consecutive business days for the Reading Excellence (CFDA No. 84.338) program. Total expenditures for the month in which the cash was held amounted to approximately $750,000. Over 10% of the program's needs for the month was held for nearly half the month.	$ --
	Recommendation	
	The DOE should improve its cash management procedures to increase the predictability of disbursements and time draw down of federal funds to minimize the amount of cash held.	

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2004 - 12	**Provide Accounting of Cost Share**	

Two grant awards for the Twenty-First Century Community Learning Centers (CFDA 84.287) program, grant numbers S287B001887 and S287B012137, had non-federal cost sharing requirements. The total non-federal cost share amount for the budget period that occurred in the fiscal year ended June 30, 2004, was $42,000 and $49,000, respectively.

The DOE was unable to support whether they provided the required cost share.

34 CFR 76.730 states, "A State and a subgrantee shall keep records that fully show:

(a) The amount of funds under the grant or subgrant;

(b) How the State or subgrantee uses the funds;

(c) The total cost of the project;

(d) The share of that cost provided from other sources; and

(e) Other records to facilitate an effective audit."

34 CFR 76.731 states, "A State and a subgrantee shall keep records to show its compliance with program requirements."

Because the DOE could not support their compliance with the cost share requirement, the total amount of cost share of $91,000 is considered questioned costs. $ 91,000

Recommendation

The DOE should provide an accounting of the cost share for the Twenty-First Century Community Learning Centers grants and work with the federal awarding agency to determine the necessary course of action.

Ref No.	**Compliance and Internal Control Findings (Continued)**	**Questioned Costs**
2004 - 13	**Establish Procedures to Monitor Limitation for Administrative Expenses**	
	During our testing of the School Renovation Grants (CFDA 84.352), we noted that the administrative expenses incurred for the grant were not monitored to ensure that not more than one percent of the grant was used for administrative purposes.	
	Section 321(b)(1)(A) of Public Law 106-554 requires the State agency to reserve not more than one percent of the grant award for administering the grant.	
	The DOE did not monitor actual administrative expenses due to the lack of a formal policy to do so. Without a procedure to monitor administrative expenses incurred for the grant, there is risk that administrative costs charged to the federal program may exceed the one percent ceiling.	
	However, we were able to validate during our audit that actual administrative expenses did not exceed the one percent ceiling.	$ --
	Recommendation	
	The DOE should establish procedures to monitor actual administrative expenses incurred for the grant to ensure compliance with the one percent limitation on administrative expenses.	

Ref No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2004 - 14	**Maintain Documentation for Compliance with the Davis Bacon Act**	
	During our testing of the School Renovation Grants (CFDA 84-352A), the DOE was unable to locate the documentation that showed that contractors were monitored for compliance with the Davis Bacon Act.	
	34 CFR 80.42 requires that financial records, supporting documents, statistical records, and all other records pertinent to an award be retained for a period of three years from the date of submission of the final expenditure report. This grant award remained active at the end of the fiscal year ended June 30, 2004, and therefore records documenting compliance with this requirement should still be maintained.	$ --
	Recommendation	
	The DOE should maintain the weekly payroll certifications which are required by the Davis Bacon Act.	

PART V

CORRECTIVE ACTION PLAN

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

LINDA LINGLE
GOVERNOR

PATRICIA HAMAMOTO
SUPERINTENDENT

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

OFFICE OF THE SUPERINTENDENT

May 29, 2007

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 received a letter from you dated April 9, 2007 that the United States Department of Education Office of Inspector General (OIG) notified you that you were required to test seven additional federal programs of the State Department of Education (DOE) for the fiscal year ended June 30, 2004. In addition, you were also required to **reissue** the Single Audit report and related data collection form.

Needless to say, this was a difficult task, as many of the documents were archived and numerous program managers employed during the 2003-2004 period were no longer available to assist in this process. Still, the Department believes in working together with your staff to provide the necessary documents for your testing to comply with the OIG and appreciate your efforts to meet the OIG deadline.

In accordance with OMB Circular A-133, on the following pages are the original and additional **Corrective Action Plan** and **Summary Schedule of Prior Audit Findings** of the State of Hawaii Department of Education for the year ended June 30, 2004.

In addition, attached is my original letter dated March 29, 2005, which was included in the original Financial Audit of the Department of Education, State of Hawaii for the Fiscal Year Ended June 30, 2004, which we acknowledge is still timely.

Very truly yours,

Patricia Hamamoto

Patricia Hamamoto
Superintendent

PH:DY
Attachments

LINDA LINGLE
GOVERNOR

PATRICIA HAMAMOTO
SUPERINTENDENT

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

OFFICE OF THE SUPERINTENDENT

March 29, 2005

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:

<u>Report on Compliance -- Financial Reporting</u>:
"The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*" (Page 50)
<u>Internal Control Over Financial Reporting</u>:
"None of the reportable conditions...is a material weakness." (Page 50)
<u>Report on Compliance -- Major Federal Programs</u>:
"Except for...[the programs described on page 53]...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, 2004." (Page 53)

In addition, the following Federal program audits resulted in <u>no reportable conditions and no material items of non-compliance</u>: Summer Food Service Program for Children, Title I, Safe and Drug-Free Schools and Communities--State Grants, Public Charter Schools, 21st Century Learning Centers and Reading Excellence Act.

However, we recognize that further improvements can be made. In accordance with OMB Circular A-133, on the following pages are the **<u>Corrective Action Plan</u>** and **<u>Summary Schedule of Prior Audit Findings</u>** of the State of Hawaii Department of Education for the year ended June 30, 2004.

Very truly yours,

Patricia Hamamoto

Patricia Hamamoto
Superintendent

PH:DY
Attachments

FINANCIAL STATEMENT FINDINGS

2004-1 Improve Compensating Controls For Inadequate Segregation of Duties over Local School Funds (Pages 57 to 58)

Corrective Action Plan

The lack of business support staff continues to be a problem at the schools, rendering it problematic to segregate cash functions. The Department of Education (Department) has established five "compensating control" procedures for the school administrations 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 as "Administrator's Checklist" to further aide in implementing these controls.

It should be noted that school principals have been assuming more responsibilities for the provision of services for special education students, implementing standards based educational reforms, addressing Federal requirements such as No Child Left Behind, as well as dealing with other curriculum related issues. Under these circumstances, the relative priority of implementing, the "Administrator's Checklist" has been problematic. This is further often exacerbated by the lack of formal business training of the principals, rendering it even more difficult for them to conduct this function.

In FY 2002, business support personnel for school complexes were established. These positions were classified in the State Civil System as Complex Administrative Services Assistants and provide direct school level support to principals in the areas of financial and facilities management. Due to the overload of curriculum and instruction tasks delegated to the principals, the Complex Administration Services Assistants will need to undertake this task, if so delegated by the schools they service. To further ensure that this task is done, the Office of Business Services will institute a benchmark check during a certain point in the fiscal year. This benchmark check will provide a uniformed time frame for the execution of this task.

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

Anticipated Completion Date: June 30, 2005

2004-2 <u>Improve Information System For Workers' Compensation</u> (Pages 59 to 60)

<u>Corrective Action Plan</u>

The Workers' Compensation (WC) Section has been working with previous auditor's prior year findings and recommendations and the implementation and maintenance phase is already in progress as noted below:

1. As of January 1, 2005, the WC Section has assigned a Personnel Clerk V to perform batch controls of wage loss information input in REN by the Payroll section after every pay period and have been making necessary corrections for any input discrepancies to ensure completeness and accuracy of wage loss information. Recommendation already implemented.

2. Although the WC Section's current REN software program does not allow for the input of estimated wage loss information, the WC Section will continue to pursue the possibility of maintaining estimated wage loss data in the REN (e.g. pursue upgrade version capabilities on REN). Currently electronic spreadsheets are forwarded to the Payroll Section monthly to help ensure unpaid claims are resolved. Recommendation implemented.

3. Effective August 1, 2004, the WC Section has implemented a Reserve Methodology Procedure 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 change. Recommendation already implemented.

Contact Persons: Ms. Merlene Akau, Personnel Specialist
Workers' Compensation

Anticipated Completion Date: June 30, 2005

2004-3 <u>Establish Monitoring System For Vacation and Sick Leave Records</u> (Page 61)

<u>Corrective Action Plan</u>:

The DOE does monitor the proper completion of leave forms submitted for processing. Leave forms are returned to the school or office by the Leave Accounting Unit for proper completion or correction whenever material defects are discovered. In order to minimize delays in updating leaves, errors that are deemed less serious are processed. However, 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.

The DOE concurs that the conditions stated do occur. Therefore, training of personnel at schools and offices will continue. Reminders on proper completion of leave forms will be made at School Support workshops and through its newsletter, emphasizing the importance of obtaining prior approval of all vacation leave and proper completion of the leave forms... Administrative Service Assistants are also available to support the effort for proper completion and prompt submission of these forms.

The Leave Accounting Unit also monitors the timely submission of leave forms each month by each school/office. Reminders to submit monthly leave forms are sent to delinquent schools and offices.

The Department is committed towards maintaining accurate leave balances for its employees and will work to reconcile discrepancies cited in the audit findings.

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

Anticipated Completion Date: June 30, 2005

FEDERAL AWARDS

U.S. Department of Agriculture

2004-4 Establish Procedures to Ensure Cohesive Management of the Food Donation Program (Pages 62 to 64)

Corrective Action Plan:

The warehouse contract on Oahu, Hawaii, and Kauai is out for bid to close 3/31/05. When those contracts are awarded and signed the contract will be between the Storage Company and OHCNP. Presently these contracts are with School Food Service Branch. We will then have a clear line of authority and will know our responsibilities. OHCNP already has the contract for Maui.

OHCNP shall review storage facilities annually. During the annual review a physical inventory will be taken. The physical inventory shall be reconciled with each storage facility's book inventory. The reconciliation records shall be maintained by the OHCNP. Food items that have been lost, stolen, or found to be out of condition, shall be identified and recorded. Corrective action on each deficiency noted and a written report of those corrective actions shall be made.

OHCNP shall ensure that sub distributing and recipient agencies conduct annual reviews of their respective storage facilities. Documentation shall be maintained on file including documentation of corrective action in cases of noncompliance. Corrective action must be taken immediately on all deficiencies identified in the review.

Contact Person: Ms. Janice Low, Acting Food Service Manager
Office of Hawaii Child Nutrition Programs

Anticipated Completion Date: June 30, 2005

2004-5 Ensure Accurate Meal Counts are Obtained for the School Lunch and Breakfast Programs (Page 65)

Corrective Action Plan:

During the months of April and May 2005, 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 also 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, if necessary, to verify the accuracy of the deposit. 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.

In addition, for all other school administrators and staff, training on the specific findings will be conducted during the months of July and August 2005 at the annual School Food Services Program principal's training.

At both training sessions, all of the findings will be discussed and suggested methods to eliminate mathematical errors and omissions will be emphasized.

Contact Person: Mr. Eugene Kaneshiro, Director
School Food Services Branch

Anticipated Completion Date: September 30, 2005

2004-6 Ensure Annual Verification Procedures are Completed Timely and Accurately
(Pages 66)

Corrective Action Plan:

During the months of April and May 2005, 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 Verification Report results are accurate against the actual application forms and school roster. The training will emphasize using two people, if necessary, to verify the completeness and accuracy (math and omissions) to cross check the accuracy of the report. The schools will be reminded to submit the reports on time.

In addition, for all other school administrators and staff, training on the specific findings will be conducted during the months of July and August 2005 at the annual School Food Services Program principal's training.

At both training sessions, all of the findings will be discussed and suggested methods to eliminate mathematical errors and omissions and meeting the posted deadlines will be emphasized.

Contact Person: Mr. Eugene Kaneshiro, Director
School Food Services Branch

Anticipated Completion Date: September 30, 2005

CORRECTIVE ACTION PLANS TO THE ADDITIONAL FEDERAL PROGRAMS AUDITED in April, 2007

2004-7 Improve Monitoring Function
(Pages 67 to 68)

Corrective Action Plan:
The Office of Hawaii Child Nutrition Programs (OHCNP) Child and Adult Care Food Program (CACFP) team is working with a contractor to develop and publish policies and procedures for the CACFP. The CACFP Policy and Procedure Manual will be published August 2007.

Review priorities, sponsor selection and documentation requirements have been addressed in the draft CACFP administrative review and corrective action procedure developed April 2007. The final procedure will be included in the CACFP Policy and Procedure Manual.

Written draft procedures for closure of administrative reviews, including any follow-up on corrective actions or financial adjustments is being implemented during Federal FY 2007. Template letters have been developed to be used in this process to address audit findings.

The administrative review tool used during Federal FY 2004 is no longer being used. For Federal FY 2005 OHCNP adopted a new comprehensive review tool. On January 28, 2005, the new review tool was revised to better address monitoring of sponsoring organization's centers to ensure the integrity of the program.

Contact Person: Ms. Susan Uyehara, Director
Office of Hawaii Child Nutrition Programs

Anticipated Completion Date: August 30, 2007

2004-8 Improve Documentation of Subrecipient Eligibility Determination
(Pages 69 to 70)

The Office of Hawaii Child Nutrition Programs (OHCNP) Child and Adult Care Food Program (CACFP) team is working with a contractor to develop and publish policies and procedures for the CACFP. The CACFP Policy and Procedure Manual will be published August 2007.

The process to access the National Disqualified List (NDL) was changed by USDA effective Federal FY 2007. Staff is in the process of obtaining level 2 USDA eAuthentication clearance to access the NDL. OHCNP staff will review and complete the check of the NDL by the end of Federal FY 2007.

Findings identified for lack of documentation have been addressed at the start of the new triennial CACFP Application and Agreement period using forms 12 Management Plan, 13 Budget Information, 14 Information to Gather from Principals of Organizations Applying or Reapplying to Participate in the CACFP, and 19 Outside Employment. Forms were revised and updated for Federal FY 2007 effective October 1, 2006. Revisions were implemented to address financial viability, management capability, organizational accountability, record keeping, and monitoring issues.

Contact Person: Ms. Susan Uyehara, Director
Office of Hawaii Child Nutrition Programs

Anticipated Completion Date: August 30, 2007

2004-9 Improve Documentation of Subrecipient Eligibility Determination
(Pages 71 to 72)

The Department of Education was made aware of the preparing and maintaining payroll documentation in accordance with OMB Circular A-87 in the audit findings of 2005-2006, released March 31, 2007. Subsequently, in May, 2007, the Department developed a standard practice to complete periodic certifications for employees who worked solely on a federal program or cost objective. These certifications will be prepared in a timely manner to ensure that they are readily available to support time charged to federal programs.

The fact that we are now receiving this finding from the 2004 revised audit in May, 2007 is a moot point, as corrective action has already been taken as a result of the finding in the FYE 2006 audit.

Contact Person: Robert Campbell, Ph.D., Director
Program Support and Development

Anticipated Completion Date: June 30, 2007

2004-10 **Maintain Supporting Worksheets**
(Page 73)

Although OCISS no longer has personnel for the Reading Excellence Act, we will pay special attention to keeping, maintaining, and storing accurate supporting worksheets and accounting records for future monies that we are awarded.

Contact Person: Ms. Judy McCoy, Educational Specialist III
Languages Section
Instructional Services Branch

Anticipated Completion Date: May 30, 2007

2004-11 Improve Cash Management Procedures
(Page 74)

The Accounting Section exercises oversight for all cash withdrawals made by the accounting staff. Our current procedures require the accountant to analyze, prepare, and submit a worksheet showing current cash requirements for each federal fund grant to his/her supervisors for review to minimize excess cash balances or cash shortages.

Currently, financial information is obtained from a variety of sources – Financial Management System (FMS) on-line inquiry, FMS reports (DAFR4210 Letter of Credit report), payroll summary report, and casual payroll information from an electronic financial data warehouse. FMS generated reports are provided to the accountants one or two days prior to the withdrawal to aid them in projecting cash requirements. The accountants may also draw down additional cash based on program manager requests.

Accounting section staff will be reminded to better monitor their cash draw downs and balances to avoid having federal cash on hand more than three working days.

Contact Persons: Ms. Lisa Hankins, Fiscal Specialist III
Accounting Section
Office of Fiscal Services

Anticipated Completion Date: June 30, 2007

2004-12 Provide Accounting of Cost Share
(Page 75)

In the future, we will track the cost share by:

1. Making activity sign in sheets for the site coordinators. This would include information about any activities that took place outside of the regular grant time and participants involved. These would include planning meetings as well as student or family activities. Then permission to use the average teacher, principal, and VP salary would be obtained from the Federal officer. Community and volunteer time would also be factored. In this way a cost share dollar amount could be arrived at for each activity. Sign in sheets would be collected at the monthly site coordinators' meetings.

2. An accounting of the facilities used at each site would be assessed including classroom, cafeteria, restrooms, gym or any other school space utilized for the grant as well as custodial staff time. This facilities report would be signed off by the principal and collected monthly.

3. Lastly any donations or purchases made by the school site to the grant would be documented and signed off by the principal.

Contact Person: Mr. Wayne Kozuma, Resource Teacher
Health, P.E., Social Studies and Student Programs Section
Instructional Services Branch

Anticipated Completion Date: June 30, 2007

2004-13 Establish Procedures to Monitor Limitation for Administrative Expenses
(Page 76)

Currently, each program manager is responsible for monitoring and assuring that actual administrative expenses incurred for the grant is in compliance with the one percent limitation on administrative expenses. In this situation, the grant was implemented by three (3) different offices: Office of Business Services, Office of Information Technology Services, and Office of Curriculum, Instruction and Student Support, thus, having three different program managers. Each one had the responsibility to be in compliance.

Fortunately, it was validated during the audit that actual administrative expenses did not exceed the one percent ceiling.

In the future, we concur that departmental procedures should be established to monitor actual administrative expenses incurred for the grant to be in compliance with the one percent limitation on administrative expenses.

Contact Person: Mr. Raynor Minami, Director
Facilities Support Branch
Office of Business Services

Anticipated Completion Date: June 30, 2007

2004-14 **<u>Maintain Documentation for Compliance with the Davis Bacon Act</u>**
(Page 77)

During the 2003-2004 audit period, the consulting, contracting and construction projects for the DOE were done through the Department of Accounting and General Services (DAGS). We de-linked these functions from DAGS on June 30, 2005.

The current DOE practice does require contractors to submit a copy of their payroll affidavit as required by the Davis Bacon Act along with their payment request invoice. The submittals are retained by the Facilities Development Branch.

Contact Person: Mr. Raynor Minami, Director
Facilities Support Branch
Office of Business Services

Anticipated Completion Date: Already completed

PART VI

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

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

U.S. Department of Agriculture

2003-7 Food Donation Program (CFDA No. 10.550) - Reporting
(Pages 57 to 58 of the Prior Year June 30, 2003 Report)

Status -- Partially Accomplished. Please refer to the current year response to the Federal Award Findings and Questioned Costs, Finding No. 2004-4.

2003-8 Food Donation Program (CFDA No. 10.550) - Subrecipient Monitoring
(Page 58 of the Prior Year June 30, 2003 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. See reference D in separate management advisory report.

2003-9 Child Nutrition Cluster: National School Lunch Program (CFDA No. 10.555) and School Breakfast Program (CFDA No. 10.553) -- Activities Allowed or Unallowed
(Pages 58 to 59 of the Prior Year June 30, 2003 Report)

Status -- Partially Accomplished. Please refer to the current year response to the Federal Award Findings and Questioned Costs, Finding No. 2004-6.

2003-10 Child Nutrition Cluster: National School Lunch Program (CFDA No. 10.555) and School Breakfast Program (CFDA No. 10.553) -- Eligibility and Special Tests and Provisions
(Pages 60 to 61 of the Prior Year June 30, 2003 Report)

Status -- Partially Accomplished. Please refer to the current year response to the Federal Award Findings and Questioned Costs, Finding No. 2004-7.

2003-11 Child Nutrition Cluster: Summer Food Service Program for Children (CFDA No. 10.559) -- Subrecipient Monitoring
(Page 61 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

U.S. Department of Education

2003-12 Title I (CFDA No. 84.010) – Cash Management
(Page 61 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

2003-13 Safe and Drug-Free Schools and Communities - State Grants (CFDA No. 84.186) - Allowable Costs
(Pages 61 and 62 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

2003-14 Public Charter Schools (CFDA No. 84.282) – Cash Management
(Page 62 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

2002-15 21st Century Learning Centers (CFDA No. 84.0287) Cash Management
(Pages 62 and 63 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

2002-16 Reading Excellence Act (CFDA No. 84.338) - Allowable Costs
(Page 63 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

2002-17 Reading Excellence Act (CFDA No. 84.338) - Allowable Costs
(Page 63 of the Prior Year June 30, 2003 Report)

Status -- Accomplished.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Prior Fiscal Year Ended June 30, 2003

SECTION II - FINANCIAL STATEMENT FINDINGS

2003-1 <u>Local School Fund Bank Reconciliations</u>
(Pages 52 to 53 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Partially Accomplished. Corrective action and monitoring is in progress. See reference A in separate management advisory report.

2003-2 <u>Improving Compensating Controls Over Local School Funds</u>
(Pages 53 to 54 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Partially Accomplished. Please refer to the current year response to Financial Statement Finding No. 2004-1.

2003-3 <u>Processing Disbursements of Local School Funds</u>
(Pages 54 to 55 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Partially Accomplished. Corrective action and monitoring is in progress. See reference A in separate management advisory report.

2003-4 <u>Prohibited use of Local School Funds</u>
(Page 55 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Advancing of funds were not noted during the auditors testing of the non-appropriated local school funds.

2003-5 <u>Accrued Vacation</u>
(Pages 55 to 56 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Partially Accomplished. Please refer to the current year response to Financial Statement Finding No. 2004-3.

2003-6 <u>Workers' Compensation/Payroll</u>
(Pages 56 to 57 of the Prior Year June 30, 2003 Report)

<u>Status</u> -- Partially Accomplished. Please refer to the current year response to Financial Statement Finding No. 2004-2.