



**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Financial Statements

June 30, 2010

(With Independent Auditors' Report Thereon)

Submitted by

**THE AUDITOR
STATE OF HAWAII**



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

March 31, 2011

Ms. Marion Higa
Office of the Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education

Dear Ms. Higa and the Board of Education:

This is our report on the financial audit of the Department of Education, State of Hawaii (DOE), as of and for the year ended June 30, 2010. 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*.

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 as of and for the fiscal year ended June 30, 2010 and to comply with the requirements of OMB Circular A-133.

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, 2010.

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, 2010 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 DOE
- Part VI – The summary schedule of prior audit findings

Ms. Marion Higa
Office of the Auditor
Board of Education
State of Hawaii, Department of Education
March 31, 2011
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We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DOE.

Very truly yours,

KPMG LLP

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STATE OF HAWAII**

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PART I

Financial Section



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education:

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, State of Hawaii (the DOE), as of and for the year ended June 30, 2010, which collectively comprise the DOE's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DOE's management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

At June 30, 2010, the DOE had not maintained adequate records for the public charter schools. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of the impact of the exclusion of the public charter schools' financial information in the accompanying financial statements as of June 30, 2010. Such amounts enter into the determination of the financial position of the governmental activities and the general fund and the respective changes in financial position.

As discussed in note 1, the financial statements of the DOE are intended to present the financial position and the changes in financial position 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, 2010, and the changes in its financial position for the year then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, except for the effects on the 2010 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to the public charter schools, as discussed in the preceding paragraph, 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 of the DOE, as of June 30, 2010, and the respective changes

in financial position thereof, and, where applicable, the respective budgetary comparisons for the general fund and federal fund for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2011 on our consideration of the DOE's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of DOE's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 14 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions 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 of the DOE. The schedule of expenditures of federal awards 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.

KPMG LLP

March 31, 2011

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

The following management's discussion and analysis provides an overview of the Department of Education's (Department or DOE) financial activities for the fiscal year ended June 30, 2010. 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 Fiscal Year (FY) 2009-10 compared to the prior FY 2008-09 are as follows:

- Total revenues were \$1.895 billion in FY 2009-10, a decrease of \$751.9 million from \$2.647 billion in FY 2008-09. The decrease was primarily due to a change in the State's method of appropriating funds for the DOE's retirement benefit payments, health premium benefit payments, and debt service payments. As further discussed on page 6 in the Overall Results of Operations, in FY 2009-10, such appropriations were accounted for by the DOE as transfers. In previous years they were recorded as general revenues. As such, net transfers for FY 2009-10 increased by \$622.6 million.
- Total FY 2009-10 expenses were \$2.232 billion, a decrease of 8% over the prior fiscal year. Of the total FY 2009-10 expenses, 92% or \$2.052 billion, was spent for school-related expenditures, and 4% or \$80.7 million was spent on capital outlays. Total FY 2008-09 expenses were \$2.433 billion, an increase of 4% over the prior fiscal year. Of the total FY 2008-09 expenses, 92% or \$2.246 billion, was spent for school-related expenditures, and 3% or \$69.3 million was spent on capital outlays.
- Total assets exceeded liabilities as of June 30, 2010 by \$1.163 billion (net assets), compared to \$1.109 billion as of the prior fiscal year end, an increase of 5%.
- Capital assets, net of accumulated depreciation, comprised 96% of total net assets as of June 30, 2010, compared to 97% as of the prior fiscal year end.

Overview of the Financial Statements

The financial statements consist of three sections: management's discussion and analysis (this section), basic financial statements and notes to the financial statements, 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.

**DEPARTMENT OF EDUCATION
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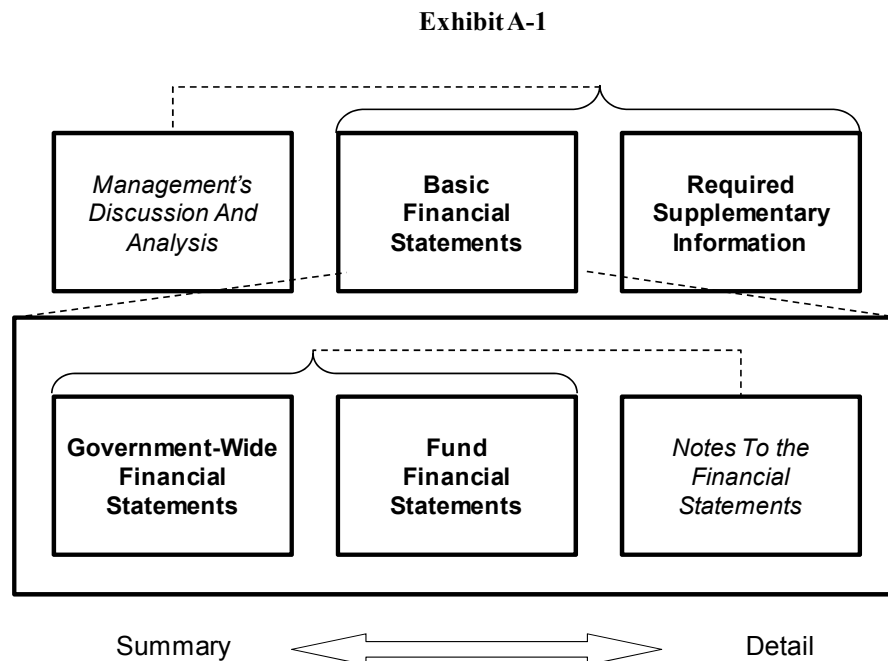
Management's Discussion and Analysis

June 30, 2010

- *Fund financial statements* focus on *individual* parts of the Department and report operations in more detail than the government-wide statements. Governmental funds statements include most of the Department's programs and services such as instruction, support services, operation and maintenance of facilities, student transportation, and extracurricular activities and are presented on a modified accrual basis of accounting. Fiduciary funds statement report on agency funds (or "local school funds" as the term is used in our schools), 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 related:



**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

Government-Wide Financial Analysis

The following discussion highlights management's understanding of the key aspects of the Department's financial activities. Certain reclassifications have been made to the FY 2008-09 financial statements to conform to the FY 2009-10 presentation. Such reclassifications had no effect on previously reported change in net assets.

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.

Exhibit A-2
Government-Wide
Statement of Net Assets
Fiscal years 2010 and 2009
(Amounts in millions)

			2010 – 2009	
	Governmental activities		Increase	Percentage
	2010	2009	(decrease)	change
Assets:				
Current	\$ 353.8	326.4	27.4	8%
Noncurrent (capital assets, net of depreciation)	1,121.2	1,078.7	42.5	4
Total assets	<u>\$ 1,475.0</u>	<u>1,405.1</u>	<u>69.9</u>	<u>5%</u>
Liabilities:				
Current	\$ 216.5	216.7	(0.2)	—%
Noncurrent	95.9	79.6	16.3	20
Total liabilities	<u>312.4</u>	<u>296.3</u>	<u>16.1</u>	<u>5</u>
Net assets:				
Investment in capital assets	1,121.2	1,078.7	42.5	4
Unrestricted	41.4	30.1	11.3	38
Total net assets	<u>1,162.6</u>	<u>1,108.8</u>	<u>53.8</u>	<u>5</u>
Total liabilities and net assets	<u>\$ 1,475.0</u>	<u>1,405.1</u>	<u>69.9</u>	<u>5%</u>

Overall Financial Position. The DOE's overall financial position has increased as of June 30, 2010 compared to the prior fiscal year end.

Changes in Net Assets. Total government-wide net assets increased by \$53.8 million, primarily due to a higher investment in capital assets.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

Exhibit A-3
Government-Wide
Changes in Net Assets
Fiscal years 2010 and 2009
(Amounts in millions)

	Governmental activities		2010 – 2009	
	2010	2009	Increase (decrease)	Percentage change
Revenues:				
Program revenues:				
Charges for services	\$ 39.8	47.1	(7.3)	(15)%
Operating grants and contributions	310.7	276.3	34.4	12
General revenues:				
State allotted appropriations, net of lapses	1,542.1	1,854.0	(311.9)	(17)
Nonimposed employee fringe benefits	—	471.5	(471.5)	(100)
Unrestricted investment earnings	2.8	(1.6)	4.4	275
Total	<u>1,895.4</u>	<u>2,647.3</u>	<u>(751.9)</u>	<u>(28)</u>
Expenses:				
School-related	2,051.7	2,245.9	(194.2)	(9)
State and complex area administration	56.5	75.5	(19.0)	(25)
Public libraries	43.3	42.6	0.7	2
Capital outlay	80.7	69.3	11.4	17
Total	<u>2,232.2</u>	<u>2,433.3</u>	<u>(201.1)</u>	<u>(8)</u>
Transfers, net	<u>390.6</u>	<u>(232.0)</u>	<u>622.6</u>	<u>268</u>
Change in net assets	<u>\$ 53.8</u>	<u>(18.0)</u>	<u>71.8</u>	<u>399%</u>

Overall Results of Operations. As shown above, the DOE's results of operations for FY 2009-10 have resulted in an increase in net assets of \$53.8 million. Total revenues were \$1.895 billion in FY 2009-10, a decrease of \$751.9 million from \$2.647 billion in FY 2008-09. The decrease was primarily due to the change in the State's method of appropriating funds for the DOE's retirement benefit payments, health premium benefit payments, and debt service payments. In FY 2009-10, appropriations for these items were made to the Department of Budget and Finance. Accordingly, for FY 2009-10, such appropriations were accounted for by the DOE as transfers. In previous years they were recorded as general revenues. As such, net transfers for FY 2009-10 increased by \$622.6 million. Total expenses decreased by \$201.1 million, primarily due to the Governor-imposed budget reductions, which the DOE managed with a combination of layoffs of personnel, program reductions, program eliminations, and labor savings achieved through furloughs.

**DEPARTMENT OF EDUCATION
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Management's Discussion and Analysis

June 30, 2010

Individual Funds. Within the "Governmental Funds" financial statements, for the various fund sources (including general, federal, capital projects and other funds), FY 2009-10 has resulted in a net positive fund balance for the governmental funds as of June 30, 2010. Restrictions or commitments of fund balances are designated on the "Governmental Funds" balance sheet as "reserved for encumbrances" and "reserved for continuing appropriations." Please refer to *note 7 – Fund Balance* for more information on those fund balances. The DOE does not expect these restrictions to significantly affect the availability of fund resources for future use.

Budget Results. Variations of "Final" compared to "Original" budgeted amounts as reported on the *Statements of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – General Fund* are primarily due to legislative appropriations for collective bargaining increases. For the general fund, the DOE is allowed to carry over up to 5% of any appropriation at the end of the fiscal year. As of June 30, 2010, general funds carried over totaled to \$20.2 million, representing 1.5% of appropriations. For federal funds, since most grants stipulate a 27-month expenditure period, expenditures during a specific fiscal year may exceed revenues, due to the timing of expenditures compared to receipts. The DOE expended \$23.7 million more than it received in federal funds during FY 2009-10; this merely reflects the timing of expenditures versus grants that may have been received during the prior year.

Explanation of Major Departmental Programs

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

<u>Program</u>	<u>Program title</u>	<u>Program description</u>
EDN 100	School-Based Budgeting	Instructional services, curriculum programs, at-risk programs
EDN 150	Comprehensive Student Support Services	Special needs assessment, special education services, school-based behavioral health services, and other related services required for a free and appropriate public education, autism services, and professional development
EDN 200	Instructional Support	Curriculum support, assessment, planning, information technology support, and school leadership training
EDN 300	State and Complex Administration	Board of Education, Superintendent, Complex Area Superintendents, budget, communications, civil rights compliance, internal audit, business services, human resources, and information technology
EDN 400	School Support	School food services, utilities, custodial services, repair and maintenance, and student transportation
EDN 407	Hawaii State Public Library System	The Hawaii State Public Library System is included in the Department of Education's combined financial statements since both the Library System and the Department are administratively and legally supervised by the Hawaii State Board of Education
EDN 500	School Community Services	After school care and adult education.
EDN 600	Public Charter Schools	Public charter schools.

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June 30, 2010

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

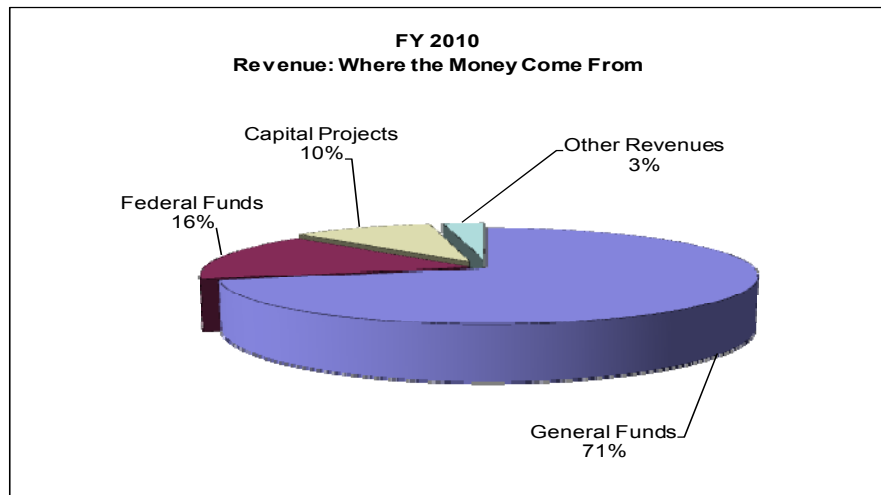
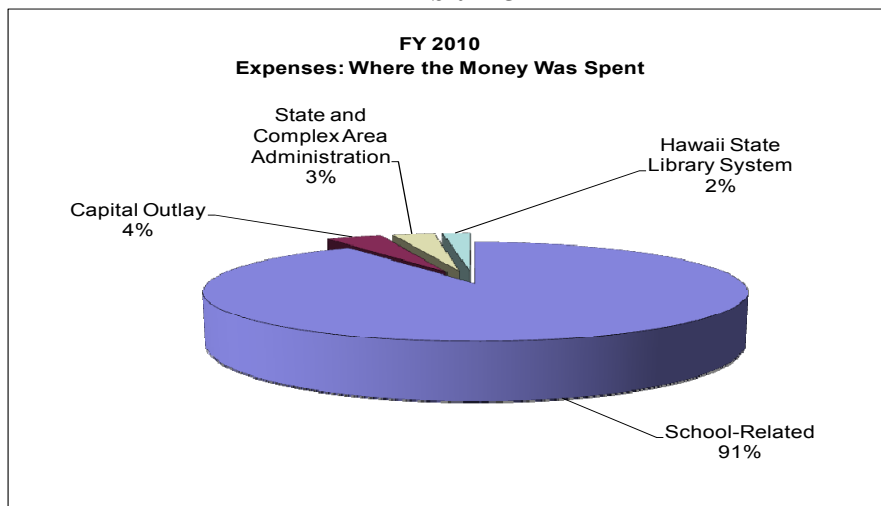


Exhibit A-5 summarizes the Department's expenses. A total of 91% of Department expenditures are for school-level instructional and related programs in EDN 100, 150, 400, 500, and 600, while only 3% are for State and Complex Area Administration.

Exhibit A-5



**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

General Fund Budgetary Highlights

The Department was appropriated general funds of \$1,343.4 million in FY 2009-10.

State law permits the Department to "carryover" up to 5% of general fund appropriations from one fiscal year to the next. The Department carried over \$20.2 million in FY 2009-10 general fund appropriations for expenditures in FY 2010-11. Carryover funds enable schools to make long-range fiscal plans, save for major purchases for which single year funding may not be sufficient, and provide funds to start the next school year. Under the Department's single school calendar, schools start their school year in July statewide, within weeks of the beginning of the fiscal year.

Agency Funds

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

Agency fund net assets were \$22.1 million in FY 2009-10 representing an 8% increase from the prior fiscal year.

Capital Asset and Debt Administration

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

Buildings, building improvements, and land improvements less than \$100,000 are not reported as capital assets. This year's capital improvements are summarized as follows:

Representative Highlights of Major CIP Projects Completed

Major Buildings

Kapolei High School, Athletic Complex
Hana High and Elementary School, 6 – Classroom Building
Kilauea Elementary School, New Cafeteria
Fifteen (15) Neighbor Island septic tank installations totaling \$29.9 million

Portable Classrooms (Quantity)

Campbell High School (6)
Farrington High School (4)
Aiea Intermediate School (2)
Kahuku High and Intermediate School (1)
Ewa Elementary School (1)

**DEPARTMENT OF EDUCATION
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Management's Discussion and Analysis

June 30, 2010

Representative Highlights of Major Repair and Maintenance Work Completed

Multi-Component Repair and Maintenance Projects

Konawaena High School, Refurbish Locker/Shower
Lahainaluna High School, Resurface Main Road and Parking Lot

Electrical, Bell, and Fire Alarm Upgrades

Kaiser High School, Building A, Replace Transformers
Honokaa High and Elementary, Replace/Upgrade Campus Fire Alarm System
Kauai High School, Replace Program Bell System
Lanikai Elementary School, Replace Packaged A/C Unit
Haleiwa Elementary School, Building J and K - Add Circuits

Reroofing

Leilehua High School, Reroof six Buildings on Campus
King Kaumuali'i Elementary School, Replace Rain Gutters Campus-Wide
Laie Elementary School, Repair and Reroof Covered Walkways
Mililani High School, Building J Reroof

Other Significant Work

Baldwin High School, Repair and Replace Campus Security Screens
Mililani-Ike Elementary School, Playground Drainage Improvements
Stevenson Intermediate School, Replace Science Lab Tables (Room 109)
Kalaheo High School, Replace Library Air Conditioning Unit
Puunene Elementary School, Renovate Building F

Repairs and Maintenance (R&M) funds were used to initiate projects that were procured through the Hawaii Electronic Procurement Program and through a formal bidding process. The bid amount for these projects ranged from \$25,000 to major renovation work which costs several million dollars. Statewide, \$89.3 million was expended in FY 2009-10 on R&M projects that were funded by CIP appropriations.

Whole School Classroom Renovations Statewide

Since the program's inception in FY 2007-08, a total of \$170 million in funding has been allotted for whole classroom renovations. This includes renovation of the remaining 96 schools that are 25 years or older. To date, \$168.5 million has been obligated, of which \$130.0 million has been expended. A total of only \$1.5 million remains unencumbered.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

Program status as of June 30, 2010 was as follows:

19	Schools completed prior to July 1, 2009
25	School completed in FY 2009-10
18	Under construction
25	Bidding completed, pending award, or Notice to Proceed
2	Design completed, pending bid phase
7	Deferred due to closure or change in school status
96	Total schools

The following whole school classroom renovation projects were completed during FY 2009-10:

Ben Parker Elementary School
Fern Elementary School
Haaheo Elementary School
Hahaione Elementary School
Hilo Union Elementary School
Kaiser High School
Kalihi Uka Elementary School
Kamiloa Elementary School
Kamiloiki Elementary School
Kaneohe Elementary School
Kauluwela Elementary School
Kaunakakai Elementary School
Kualapuu Elementary School
Likelike Elementary School
Makakilo Elementary School
Makalapa Elementary School
Momilani Elementary School
Nuuuanu Elementary School
Olomana School
Pope Elementary School
Royal Elementary School
Solomon Elementary School
Wahiawa Storefront School
Waiau Elementary School
Webling Elementary School

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 of Budget and Finance's budget. Interest payments and debt retired were \$152.1 million in FY 2009-10.

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Management's Discussion and Analysis

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Economic Factors and Next Year's Budget

Hawaii's economy has been periodically pummeled by economic downturns. Between 1980 and 2010, two of the worst U.S. recessions in the last century occurred. They were the most intense recessions since the Great Depression.

With the end of the Great Recession in June 2009, the Council on Revenues has been forecasting an economic recovery with growth in general fund tax revenues of 6% starting in FY 2011-12 and continuing through FY 2016-17.

The statewide seasonally adjusted unemployment rate for Hawaii was 6.3% for the month of December 2010, compared to the seasonally adjusted national unemployment rate of 9.4% for the same period. One year ago, the State's seasonally adjusted unemployment rate stood at 6.4%, while the seasonally adjusted national unemployment rate was 9.9%.

Cumulative Hawaii tax collections for the first five months of FY 2010-11 exceeds \$2.0 billion, but were \$9 million less than the corresponding period last year. This decrease was due to the release of accrued corporate refunds of \$1.3 million and accrued individual refunds of \$186.1 million. General excise and use taxes, which are the largest source of revenue and a good measure of economic growth, increased 0.04% in the same period.

In December 2010, the Council on Revenues raised its forecast for the State general fund tax revenue growth for FY 2010-11 from 2.0% to 3.0%. Actual State general fund tax collections declined in the first five months of FY 2010-11 over the corresponding FY 2009-10 period but only because of the timing of tax refunds.

Tourist arrivals for the first seven months of FY 2010-11 increased by 11.7% to 4.2 million visitors to the State. This trend is expected to continue for the rest of the year. However, more importantly, visitor expenditures were 24.0% higher than that in the prior year.

In response to the decline in general fund tax revenues in earlier years, both the Legislature and the Governor imposed budget cuts on the Department. For FY 2009-10, the Legislature approved mandatory reductions of \$40.1 million to the Department's appropriation. Upon execution of the budget, the Governor imposed further reductions using the Governor's power to restrict appropriations by withholding \$127.7 million of the Department's \$1.4 billion appropriation.

The Department managed the budget reductions with a combination of layoffs of personnel, program reductions, program eliminations, and labor savings achieved through furloughs. The Governor, Board of Education, and the Department successfully negotiated with all three unions to realize furlough savings. These furloughs resulted in significant public concern over the loss of instructional days. In response to public outcry, for FY 2010-11 the Legislature appropriated \$67 million to restore some of the negotiated furlough days.

Future Events that will Financially Impact the Department

Recovery from the global recession has been much slower in coming than anticipated. As of March 2011, the State experienced several months of positive growth in tourism arrivals and spending. Despite the improvements in the largest sector of the economy, growth in tax collections for the year have been negligible. As of March 2011, the Governor, Board of Education, and Department are currently in negotiations with all the unions.

**DEPARTMENT OF EDUCATION
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Management's Discussion and Analysis

June 30, 2010

The outcome of the negotiations will have a significant impact on the Department's budget. The debate over how to continue to manage the State's budget crisis has continued into the State Legislature's 2011 session.

The Department continues its implementation of the weighted student formula, giving schools increased budgetary decision-making flexibility, authority, and accountability. The Committee on Weights, established by Statute, reviews the weighted student formula annually, and makes recommendations to the Board of Education as to improvements or changes to the formula.

In accordance with the No Child Left Behind Act, the Hawaii DOE has made substantial progress in reading and mathematics proficiencies, at levels consistent with the State's plan to meet full proficiencies by FY 2013-14.

The Department's financial reporting goal is to provide its financial information to school-level personnel and the public in a transparent manner. There is a critical need for more financial reports that are easily understood by nonfiscal personnel, and more easily used for financial management. Accordingly, the Department has developed detailed specifications required to replace its aging financial systems, and has presented this information to the State Legislature for review and to explore funding options.

The American Recovery and Reinvestment Act (ARRA) of 2009 played a major role in maintaining education services during FY 2009-10. The Department received \$19.9 million in ARRA – Individuals with Disabilities Education Act funds; \$9.3 million in ARRA – School Improvement Grant funds; \$16.6 million in ARRA – Title I grant funds; and, was able to draw down \$44.2 million of ARRA – Part A State Fiscal Stabilization Fund.

The ARRA also provides the U.S. Department of Education with \$4.35 billion to be used for a competitive grant program, called "Race To The Top." More information is available at the U.S. Department of Education Website: www.ed.gov. This program is designed to encourage and reward states that are creating the conditions for education innovation and reform; achieving significant improvement in student outcomes, including making substantial gains in student achievement; closing achievement gaps; improving high school graduation rates, and ensuring student preparation for success in college and careers; and implementing ambitious plans in four (4) core education reform areas:

- Adopting standards and assessments that prepare students to succeed in college and the workplace and to compete in the global economy
- Building data systems that measure student growth and success, and inform teachers and principals about how they can improve instruction
- Recruiting, developing, rewarding and retaining effective teachers and principals, especially where they are needed the most
- Turning around our lowest-achieving schools

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Management's Discussion and Analysis

June 30, 2010

On August 24, 2010, U.S. Secretary Arne Duncan announced that Hawaii was a Race to the Top Phase 2 winner. The federal government pledged to invest \$75 million in Hawaii over four years and secured its investment with the commitment of educators and stakeholders to execute Hawaii's blueprint for education reform.

With the unprecedented collective support of educators, legislators, policy makers, and community partners, Hawaii continues to move forward with its plan to ensure that every child graduates college-and career-ready.

Hawaii's comprehensive five-point plan is focused on:

1. Tying high-quality college – and career-ready standards and assessments to a statewide curriculum;
2. Improving longitudinal data collection and use;
3. Cultivating, rewarding, and leveraging effective teaching and leading;
4. Providing targeted support to struggling schools and students; and
5. Aligning organizational functions to support reform outcomes.

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 Fiscal Services, Department of Education, P.O. Box 2360, Honolulu, Hawaii 96804. For general information about the Department, please refer to the Department's Website at doe.k12.hi.us.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Net Assets

June 30, 2010

Assets	<u>Governmental activities</u>
Current assets:	
Cash	\$ 328,820,101
Receivables:	
Due from federal government	22,391,216
Due from other agencies	2,084,423
Accounts receivable	<u>530,464</u>
Total current assets	353,826,204
Capital assets, net of accumulated depreciation	<u>1,121,218,092</u>
Total assets	<u><u>\$ 1,475,044,296</u></u>
Liabilities and Net Assets	
Current liabilities:	
Vouchers and contracts payable	\$ 68,627,240
Accrued wages and employee benefits	119,528,321
Accrued compensated absences	13,678,274
Workers' compensation claims reserve	9,671,125
Due to State of Hawaii General Fund	<u>5,000,000</u>
Total current liabilities	216,504,960
Accrued compensated absences, less current portion	52,541,395
Workers' compensation claims reserve, less current portion	<u>43,330,386</u>
Total liabilities	<u>312,376,741</u>
Net assets:	
Invested in capital assets	1,121,218,092
Unrestricted	<u>41,449,463</u>
Total net assets	<u>1,162,667,555</u>
Total liabilities and net assets	<u><u>\$ 1,475,044,296</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Activities

Year ended June 30, 2010

Functions/programs	Expenses	Program revenues		Net revenue (expenses) and change in net assets Governmental activities
		Charges for services	Operating grants and contributions	
Governmental activities:				
School-related	\$ 2,051,678,368	36,188,611	308,280,863	(1,707,208,894)
State and complex area administration	56,507,028	709,597	473,169	(55,324,262)
Public libraries	43,275,828	2,868,827	1,987,470	(38,419,531)
Capital outlay	80,761,150	—	—	(80,761,150)
Total governmental activities	<u>\$ 2,232,222,374</u>	<u>39,767,035</u>	<u>310,741,502</u>	<u>(1,881,713,837)</u>
General revenues:				
State allotted appropriations, net of lapses				1,542,071,851
Unrestricted investment earnings				<u>2,814,476</u>
Total general revenues				<u>1,544,886,327</u>
Other financing sources (uses):				
Transfers in				585,891,229
Transfers out				<u>(195,238,528)</u>
Net transfers				<u>390,652,701</u>
Change in net assets				53,825,191
Net assets at July 1, 2009				<u>1,108,842,364</u>
Net assets at June 30, 2010				<u>\$ 1,162,667,555</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Balance Sheet – Governmental Funds

June 30, 2010

Assets	General	Federal	Capital projects	Other	Total
Cash	\$ 168,794,668	45,866,218	48,510,982	65,648,233	328,820,101
Receivables:					
Due from federal government	—	22,391,216	—	—	22,391,216
Due from other agencies	—	—	—	2,084,423	2,084,423
Accounts receivable	—	—	—	530,464	530,464
Total assets	<u>\$ 168,794,668</u>	<u>68,257,434</u>	<u>48,510,982</u>	<u>68,263,120</u>	<u>353,826,204</u>
Liabilities and Fund Balances					
Liabilities:					
Vouchers and contracts payable	\$ 32,813,760	9,542,482	23,145,511	3,125,487	68,627,240
Accrued wages and employee benefits payable	109,605,880	7,776,817	214,049	1,931,575	119,528,321
Due to State of Hawaii General Fund	<u>5,000,000</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>5,000,000</u>
Total liabilities	<u>147,419,640</u>	<u>17,319,299</u>	<u>23,359,560</u>	<u>5,057,062</u>	<u>193,155,561</u>
Fund balances:					
Reserved for encumbrances	99,392,689	20,134,495	454,676,708	5,271,575	579,475,467
Reserved for continuing appropriations	22,182,407	—	—	(2,367,817)	19,814,590
Unreserved	<u>(100,200,068)</u>	<u>30,803,640</u>	<u>(429,525,286)</u>	<u>60,302,300</u>	<u>(438,619,414)</u>
Total fund balances	<u>21,375,028</u>	<u>50,938,135</u>	<u>25,151,422</u>	<u>63,206,058</u>	<u>160,670,643</u>
Total liabilities and fund balances	<u>\$ 168,794,668</u>	<u>68,257,434</u>	<u>48,510,982</u>	<u>68,263,120</u>	<u>353,826,204</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets

June 30, 2010

Total fund balances – governmental funds	\$ 160,670,643
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 funds:	
Capital assets	2,284,468,775
Less accumulated depreciation	<u>(1,163,250,683)</u>
	<u>1,121,218,092</u>
Accrued compensated absences liability is not due in the current period and, therefore, is not reported in the funds.	(66,219,669)
Accrued workers' compensation liability is not due in the current period and, therefore, is not reported in the funds.	<u>(53,001,511)</u>
Net assets of governmental activities	<u><u>\$ 1,162,667,555</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Revenues, Expenditures,
and Changes in Fund Balances –
Governmental Funds

Year ended June 30, 2010

	<u>General</u>	<u>Federal</u>	<u>Capital projects</u>	<u>Other</u>	<u>Total</u>
Revenues:					
State allotments, net	\$ 1,341,250,062	—	200,821,789	—	1,542,071,851
Intergovernmental revenues	—	294,775,577	—	7,938,367	302,713,944
Other revenues	—	—	—	50,609,069	50,609,069
	<u>1,341,250,062</u>	<u>294,775,577</u>	<u>200,821,789</u>	<u>58,547,436</u>	<u>1,895,394,864</u>
Expenditures:					
School-related	1,612,645,395	309,406,926	—	48,822,085	1,970,874,406
State and complex area administration	54,606,866	236,790	—	634,613	55,478,269
Public libraries	33,355,263	1,120,694	—	1,550,790	36,026,747
Capital outlay	—	—	197,344,745	—	197,344,745
	<u>1,700,607,524</u>	<u>310,764,410</u>	<u>197,344,745</u>	<u>51,007,488</u>	<u>2,259,724,167</u>
Excess (deficiency) of revenues over expenditures	<u>(359,357,462)</u>	<u>(15,988,833)</u>	<u>3,477,044</u>	<u>7,539,948</u>	<u>(364,329,303)</u>
Other financing sources (uses):					
Transfers in	585,671,729	—	—	219,500	585,891,229
Transfers out	<u>(194,793,118)</u>	<u>(219,500)</u>	<u>(225,910)</u>	<u>—</u>	<u>(195,238,528)</u>
Net transfers	<u>390,878,611</u>	<u>(219,500)</u>	<u>(225,910)</u>	<u>219,500</u>	<u>390,652,701</u>
Net changes in fund balances	31,521,149	(16,208,333)	3,251,134	7,759,448	26,323,398
Fund balances at July 1, 2009	<u>(10,146,121)</u>	<u>67,146,468</u>	<u>21,900,288</u>	<u>55,446,610</u>	<u>134,347,245</u>
Fund balances at June 30, 2010	<u>\$ 21,375,028</u>	<u>50,938,135</u>	<u>25,151,422</u>	<u>63,206,058</u>	<u>160,670,643</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Reconciliation of the Change in Fund Balances
of Governmental Funds to the Statement of Activities

Year ended June 30, 2010

Net change in fund balances – total governmental funds	\$ 26,323,398
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.	
Capital assets recorded in the current period	117,804,196
Loss on disposal of capital assets	(1,220,601)
Less current fiscal year depreciation	<u>(74,087,542)</u>
	42,496,053
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.	(10,105,363)
Change in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.	<u>(4,888,897)</u>
Change in net assets of governmental activities	\$ <u><u>53,825,191</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Revenues and Expenditures –
Budget and Actual (Budgetary Basis) – General Fund

Year ended June 30, 2010

	Budgeted amounts		Actual on budgetary basis	Variance favorable (unfavorable)
	Original	Final		
Revenues:				
State allotments	\$ 1,477,676,788	1,343,400,962	1,343,399,358	(1,604)
Expenditures:				
School-related	1,397,397,435	1,263,799,976	1,245,335,998	18,463,978
State and complex area administration	51,432,190	53,534,811	51,759,812	1,774,999
Public libraries	28,847,163	26,066,175	26,064,569	1,606
	<u>1,477,676,788</u>	<u>1,343,400,962</u>	<u>1,323,160,379</u>	<u>20,240,583</u>
Excess of revenues over expenditures	\$ <u>—</u>	<u>—</u>	<u>20,238,979</u>	<u>20,238,979</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Revenues and Expenditures –
Budget and Actual (Budgetary Basis) – Federal Fund

Year ended June 30, 2010

	Budgeted amounts		Actual on budgetary basis	Variance favorable (unfavorable)
	Original	Final		
Revenues:				
Federal grants	\$ 380,445,027	512,728,963	283,828,328	(228,900,635)
Expenditures:				
School-related	379,044,781	510,189,873	305,709,101	204,480,772
State and complex area administration	35,001	1,173,846	459,728	714,118
Public libraries	1,365,245	1,365,244	1,365,244	—
	<u>380,445,027</u>	<u>512,728,963</u>	<u>307,534,073</u>	<u>205,194,890</u>
Deficiency of revenues over expenditures	\$ <u>—</u>	<u>—</u>	<u>(23,705,745)</u>	<u>(23,705,745)</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Statement of Assets and Liabilities – Agency Funds

June 30, 2010

Assets

Cash and cash equivalents	\$ 20,829,125
Investments	<u>1,304,279</u>
Total assets	<u><u>\$ 22,133,404</u></u>

Liabilities

Due to student group and others	<u>\$ 22,133,404</u>
Total liabilities	<u><u>\$ 22,133,404</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

(1) Financial Reporting Entity

(a) Introduction

The Department of Education of the State of Hawaii (the 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 noncollege 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 (the State). The financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State 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 as of June 30, 2010, and the changes in its financial position for the year then ended, in conformity with U.S. generally accepted accounting principles (GAAP). 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.

(b) Reporting Entity

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.

(2) Significant Accounting Policies

The accompanying financial statements of the DOE have been prepared in conformity with GAAP as prescribed by the GASB.

(a) Government-Wide and Fund Financial Statements

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. Governmental activities are primarily supported by State allotments and intergovernmental revenues.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

function. State allotments are reported as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the DOE's policy to use restricted resources first, then unrestricted as they are needed.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds are reported as separate columns in the fund financial statements. Nonmajor funds are summarized into a single column.

(b) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

Government-Wide Financial Statements

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

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the DOE considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end.

Principal revenue sources considered susceptible to accrual include federal grants. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with GAAP since they have been earned and are expected to be collected within sixty days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the DOE.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation and workers' compensation claims, which are recorded as an expenditure when utilized or paid. The amount of accumulated vacation and reserve for workers' compensation claims at June 30, 2010 has been reported only in the government-wide financial statements.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

Fiduciary Funds

The financial statement of fiduciary funds is reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

(c) Fund Accounting

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. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and nonmajor 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.

Governmental Funds

General Fund – The general fund is the main operating fund of the DOE. 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 for.

Federal Fund – The federal fund is used to account for federally funded programs for the DOE's major activities. This fund is made up entirely by special revenue funds which account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. In this case, the expenditures are for activities authorized by the federal agency grantor.

Capital Projects Fund – The capital projects fund includes all amounts related to the DOE's capital improvement program. It is used to account for financial resources used for the acquisition or construction of major capital facilities.

Other Fund – The other fund is used to account for all financial activities not required to be accounted for in another fund. It includes special revenue and trust funds which account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

Fiduciary Fund Type

Agency Funds – Agency funds are used to account for assets held by the DOE on behalf of outside parties, or on behalf of individuals. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

(d) Cash

Cash include certificates of deposit with original maturities of three months or less. It also includes amounts held in the State Treasury. The Director is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). The Director may invest any monies of the State, which in the Director's judgment are in excess of the amounts necessary for meeting the immediate requirements of the State. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool system. Cash accounts that participate in the investment pool accrue interest based on the weighted average cash balances of each account.

The State's investment pool as of June 30, 2010 included auction rates securities collateralized by student loans. During 2008, a number of the auctions failed and companies without the ability to hold such securities until maturity have taken significant losses. As of June 30, 2010, the State recorded an adjustment for the increase in fair value of these investments. The DOE's allocated share of the adjustment was approximately \$2,243,000. This amount was recorded in the government-wide financial statements as an increase in cash in the statement of net assets and unrestricted investment earnings in the statement of activities. In the governmental funds, this amount was recorded as an increase in cash in the balance sheet and other revenues in the statement of revenues, expenditures and changes in fund balances – other funds.

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

(e) Capital Assets

Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible 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.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

Depreciation expense is recorded in the government-wide financial statements. The DOE utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. 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
Vehicles	5,000	5 years
Public library materials	All	5 years

(f) 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.

(g) 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 generally allotted annually. General fund allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, unless the DOE receives permission to carryover such funds. The law permits the DOE to carryover up to five percent of general fund appropriations, for school-level instruction and comprehensive school support services, from one fiscal year to the next.

(h) Program Revenues

Program revenues are derived 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.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

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.

(i) *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.

(j) *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.

(k) *Use of Estimates*

The preparation of the basic financial statements in conformity with GAAP 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.

(3) *Budgeting and Budgetary Control*

Revenue estimates are provided to the State Legislature at the time of budget consideration, and 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 federal 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 federal funds.

However, Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to five percent each of any appropriation at the end of the fiscal year except for appropriations to fund certain financing agreements. These carryover funds, to the extent not expended or encumbered, lapse at June 30 of the first fiscal year of the next fiscal biennium. As of June 30, 2010, general funds carried over amounted to approximately \$20,239,000, representing less than 1.5% of appropriations.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2010

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 GAAP. The DOE's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrances of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grants 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, 2010:

	<u>General</u>	<u>Federal</u>
Excess (deficiency) of revenues over expenditures – actual on a budgetary basis	\$ 20,238,979	(23,705,745)
Reserved for encumbrances at fiscal year end	119,997,716	35,328,127
Expenditures for liquidation of prior fiscal year encumbrances	(105,106,460)	(23,512,898)
Net accrued revenues and expenditures	<u>(3,609,086)</u>	<u>(4,317,817)</u>
Excess (deficiency) of revenues over (under) expenditures – GAAP basis	<u>\$ 31,521,149</u>	<u>(16,208,333)</u>

(4) Cash

Cash at June 30, 2010 consisted of amounts held in State Treasury of \$328,820,101.

(a) Custodial Credit Risk

Cash and deposits with financial institutions are collateralized in accordance with State statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

The DOE also maintains cash in banks, which is held separately from cash in the State Treasury. As of June 30, 2010, the carrying amount of total bank deposits was approximately \$11,388,000 and the corresponding bank balances were approximately \$11,916,000. Of this amount, the entire balance is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by the DOE's agent.

(b) Interest Rate Risk

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

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(c) Credit Risk

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

(d) Custodial Risk

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

(e) Concentration of Credit Risk

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

(f) Amounts Held in State Treasury

The State has an established policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Section 36-21, Hawaii Revised Statutes, authorizes the State to invest in obligations of the State, the U.S. Treasury, agencies and instrumentalities, certificates of deposit, and bank repurchase agreements. At June 30, 2010, the amount reported as amounts held in State Treasury reflects the DOE's relative position in the State's investment pool and amounted to \$328,820,101. The DOE recorded an increase in its amounts held in State Treasury by approximately \$2,243,000 during the year ended June 30, 2010.

The State Director of Finance is responsible for the safekeeping of all moneys paid into the State Treasury (investment pool). The State Director of Finance may invest any moneys of the State, which, in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions.

Information relating to individual bank balances, insurance, and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions. Information regarding the carrying amount and corresponding bank balances of the State's investment pool and collateralization of those balances is included in the comprehensive annual financial report of the State. A portion of the bank balances is covered by federal deposit insurance, or by collateral held by the State Treasury, or by the State's fiscal agents in the name of the State. Other bank balances are

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held by fiscal agents in the State's name for the purpose of satisfying outstanding bond obligations. Accordingly, these deposits are exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being undercollateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

The DOE's share of the State's investment pool, as summarized in the table below, is 35.1% at June 30, 2009 (amounts in thousands):

		Maturity (in years)		
	Fair value	Less than 1	1 – 5	>5
Investments – primary government:				
Student loan auction rate securities	\$ 509,467	—	—	509,467
Certificates of deposit	32,869	31,883	986	—
U.S. government securities	262,951	—	205,102	57,849
Repurchase agreements	16,434	8,217	8,217	—
	<u>\$ 821,721</u>	<u>40,100</u>	<u>214,305</u>	<u>567,316</u>
Investments – fiduciary funds:				
Student loan auction rate securities	\$ 58,599	—	—	58,599
Certificates of deposit	3,781	3,667	114	—
U.S. government securities	30,244	—	23,590	6,654
Repurchase agreements	1,890	945	945	—
	<u>\$ 94,514</u>	<u>4,612</u>	<u>24,649</u>	<u>65,253</u>

Information relating to the State's investment pool at June 30, 2010 will be included in the comprehensive annual financial report of the State when issued.

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(5) Capital Assets

The changes in capital assets were as follows:

	Balance, June 30, 2009	Additions	Deductions	Balance, June 30, 2010
Governmental activities:				
Capital asset, not being depreciated:				
Land	\$ 84,248,409	—	—	84,248,409
Land improvements	6,014,060	—	(6,014,060)	—
Construction in progress	67,038,296	106,297,623	(63,263,012)	110,072,907
Total capital assets not being depreciated	<u>157,300,765</u>	<u>106,297,623</u>	<u>(69,277,072)</u>	<u>194,321,316</u>
Capital assets, being depreciated:				
Land improvements	150,188,526	38,779,361	—	188,967,887
Buildings and improvements	1,716,077,428	30,834,855	—	1,746,912,283
Furniture and equipment	71,459,191	7,514,111	(3,578,622)	75,394,680
Vehicles	10,687,630	15,650	(404,187)	10,299,093
Public library materials	69,399,761	3,639,668	(4,465,913)	68,573,516
Total capital assets being depreciated	<u>2,017,812,536</u>	<u>80,783,645</u>	<u>(8,448,722)</u>	<u>2,090,147,459</u>
Less accumulated depreciation for:				
Land improvements	(68,688,476)	(14,153,516)	—	(82,841,992)
Buildings and improvements	(914,231,337)	(46,960,635)	—	(961,191,972)
Furniture and equipment	(50,784,563)	(5,932,942)	2,378,459	(54,339,046)
Vehicles	(8,188,167)	(679,076)	383,673	(8,483,570)
Public library materials	(54,498,719)	(6,361,373)	4,465,989	(56,394,103)
Total accumulated depreciation	<u>(1,096,391,262)</u>	<u>(74,087,542)</u>	<u>7,228,121</u>	<u>(1,163,250,683)</u>
Governmental activities, net	<u>\$ 1,078,722,039</u>	<u>112,993,726</u>	<u>(70,497,673)</u>	<u>1,121,218,092</u>

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Depreciation expense was charged to functions as follows:

	Governmental activities
School-related	\$ 65,952,596
State and complex area administration	741,903
Public libraries	<u>7,393,043</u>
Total additions to accumulated depreciation	<u>\$ 74,087,542</u>

(6) Long-Term Liabilities

The change in the long-term liabilities during the fiscal year ended June 30, 2010 was as follows:

	Accrued compensated absences	Workers' compensation claims
Balance at June 30, 2009	\$ 56,114,306	48,112,614
Additions	27,475,284	12,996,085
Reductions	<u>(17,369,921)</u>	<u>(8,107,188)</u>
Balance at June 30, 2010	<u>\$ 66,219,669</u>	<u>53,001,511</u>
Due within one year	\$ 13,678,274	9,671,125

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

(7) Fund Balance

(a) Reserved for Encumbrances

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

(b) Reserved for Continuing Appropriations

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

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(8) Lease Commitments

The DOE leases equipment from third party lessors under various operating leases expiring through 2019. Future minimum lease rentals under noncancelable operating leases with terms of one year or more at June 30, 2010 were as follows:

	<u>Amounts</u>
Year ending June 30:	
2011	\$ 7,548,000
2012	4,676,000
2013	3,161,000
2014	1,884,000
2015	899,000
2016 – 2020	<u>1,366,000</u>
	<u>\$ 19,534,000</u>

Total rent expense related to the above leases for the year ended June 30, 2010 amounted to approximately \$7,114,000.

(9) Retirement Benefits

(a) *Employees' Retirement System*

Substantially all eligible employees of the DOE are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the ERS of the State, a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement, survivor, and disability with multiple benefit structures known as the contributory, hybrid, and noncontributory plans. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984 and before July 1, 2006, who are covered by Social Security, were generally required to join the noncontributory plan. Qualified employees in the contributory and noncontributory plan were given the option of joining the hybrid plan effective July 1, 2006, or remaining in their existing plan. Starting July 1, 2006, all new employees covered by Social Security are required to join the hybrid plan.

The three plans provide a monthly retirement allowance equal to the benefit multiplier percentage (1.25% or 2.00%) multiplied by the average final compensation (AFC) multiplied by years of credited service. The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, or three highest paid years of service, excluding the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service, excluding the payment of salary in lieu of vacation.

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For postretirement increases, every retiree's original retirement allowance is increased by 2.5% on each July 1 following the calendar year of retirement. This cumulative benefit is not compounded and increases each year by 2.5% of the original retirement allowance without a ceiling (2.5% of the original retirement allowance the first year, 5% the second year, 7.5% the third year, etc.).

The following summarizes the three plan provisions relevant to the general employees of the respective plan:

Contributory Plan

Employees in the contributory plan are required to contribute 7.8% of their salary and are fully vested for benefits upon receiving five years of credited service. The DOE may also make contributions for these members. Under the contributory plan, employees may retire with full benefits at age 55 and 5 years credited service, or may retire early at any age with at least 25 years of credited service and reduced benefits. The benefit multiplier is 2.00% for employees covered by Social Security.

Hybrid Plan

Employees in the hybrid plan are required to contribute 6.0% of their salary and are fully vested for benefits upon receiving five years of credited service. The DOE may also make contributions for these members. Employees may retire with full benefits at age 62 and 5 years of credited service or at age 55 and 30 years of credited service, or may retire at age 55 and 20 years service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 2.0%.

Noncontributory Plan

Employees in the noncontributory plan are fully vested upon receiving 10 years of credited service. The DOE is required to make all contributions for these members. Employees may retire with full benefits at age 62 years and 10 years of credited service or age 55 and 30 years of credited service or age 55 years and 20 years of credited service with reduced benefits. The benefit multiplier used to calculate retirement benefits is 1.25%.

The ERS funding policy provides for periodic employer contributions at actuarially determined rates, expressed as a percentage of annual covered payroll, such that the employer contributions, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate sufficient assets to pay benefits when due. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability. Employers contribute 15.75% for police officers and firefighters, and 13.75% for all other employees. These rates increase, as of July 1, 2008, to 19.700% for police officers and firefighters, and 15.00% for all other employees. Employer rates are set by statute based on the recommendation of the ERS actuary resulting from an experience study conducted every five years.

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The pension contributions made by the DOE for the years ended June 30, 2010, 2009, and 2008 of \$174,290,000, \$187,907,000, and \$166,507,000, respectively, were equal to the required contributions for each year. The contribution rates for the fiscal year ended June 30, 2010 was 15.00%, and for the fiscal years ended June 30, 2009, and 2008 was 15% and 13.75%, respectively. Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the DOE.

The ERS issues a comprehensive annual financial report that includes financial statements and required supplementary information, which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, HI 96813

(b) *Post-Retirement Health Care and Life Insurance Benefits*

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87A, is a participating employer in a cost-sharing, multiple-employer defined benefit plan providing certain healthcare and life insurance benefits to all qualified employees and retirees. The Employer-Union Health Benefits Trust Fund (EUTF) was established on July 1, 2003 to design, provide, and administer medical, prescription, drug, dental, vision, chiropractic, dual-coverage medical and prescription, and group life benefits.

For employees hired before July 1, 1996, the State pays the entire monthly healthcare premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium. For those retiring with over 25 years of service, the State pays the entire healthcare premium.

For employees hired after June 30, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For employees hired after June 30, 2001, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium, for those retiring with over 25 years of service, the State pays the entire healthcare premium.

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Measurement of the actuarial valuation and the annual required contribution (ARC) are made for the State as a whole and are not separately computed for the individual state departments and agencies such as the Airports Division. The State allocates the ARC to the State component units and proprietary funds based upon a systematic methodology.

For active employees, the employee's contributions are based upon negotiated collective bargaining agreements. Employer contributions for employees not covered by collective bargaining agreements and for retirees are prescribed by the HRS.

The DOE's general fund and special federal fund share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2010 were approximately \$87,424,000 and \$5,414,000, respectively. The total expense of approximately \$92,838,000, which was paid by the DOE, is included in the basic financial statements.

The DOE's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2009 and 2008 were approximately \$74,537,000 and \$107,291,000, respectively.

The EUTF issues a financial report that includes financial statements and required supplementary information, which may be obtained from the following address:

Hawaii Employer-Union Health Benefits Trust Fund
P.O. Box 2121
Honolulu, HI 96805-2121

(c) *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 the DOE's basic financial statements.

(10) 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 the 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 (\$40 million for earthquake and flood) and the annual aggregate for general liability losses per occurrence is \$10 million. The State also has an insurance policy to cover

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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 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 are 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 reasonable estimable.

(11) Commitments and Contingencies

(a) Construction Contracts

The DOE is committed under contracts awarded and orders placed for construction, repairs and maintenance, expenses, supplies, etc. These commitments amounted to approximately \$158,451,000 as of June 30, 2010.

(b) 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 the legislative appropriation of the State General Fund and not by the DOE.

(12) Food Distribution Program

U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS), has delegated to the Office of Hawaii Child Nutrition Programs (OHCNP) the administrative responsibility of the Food Distribution Program. OHCNP is the State Agency that distributes USDA foods to schools (public, private and charter), institutions and organizations that participate in the National School Lunch Program (NSLP) and Summer Food Service Program (SFSP). Hawaii's entitlement is determined in part by the number of lunches served under the NSLP and meals in SFSP of each year. The amount charged to the DOE entitlement is based upon the FNS estimated cost to purchase the commodities. The estimated commodity prices can be found by referring to: <http://www.fns.usda.gov/fdd/pcims/Nov15CommodityFiles.htm> – FNS November 15 Commodity File Report for the SY 2010 Prices. Bonus commodities are USDA foods that are additional to Hawaii's entitlement balance.

The DOE received \$4,554,005 under this program to purchase commodities for the fiscal year ended June 30, 2010. No bonus commodities were received for the fiscal year ended June 30, 2010.

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(13) Transfers for Debt Service

Act 180, SLH 2010, Section 3 provides a general fund appropriation to pay for debt service on general obligation bonds issued for the DOE for the fiscal years ended June 30, 2010 and 2011. The payments are budgeted directly to the Department of Budget and Finance for the DOE's share of debt service. The total amount of the debt service appropriated for the fiscal years 2010 and 2011 are \$194,793,118 and \$194,855,477, respectively.

SUPPLEMENTARY INFORMATION

**DEPARTMENT OF EDUCATION
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Schedule of Expenditures of Federal Awards
Year ended June 30, 2010

Federal grantor/pass-through grantor/program title	CFDA number¹	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
U.S. Department of Agriculture:				
Child Nutrition:				
School Breakfast Program	10.553	—	\$ 7,920,723	509,206
National School Lunch Program:	10.555			
Cash assistance		—	30,344,143	1,798,652
Cash assistance (commodities)		—	4,554,005	—
Total National School Lunch Program			34,898,148	1,798,652
Special Milk Program for Children	10.556	—	2,133	2,133
Summer Food Service Program for Children:	10.559			
Cash assistance		—	989,211	363,634
State Administrative Expense for Child Nutrition		—	25,336	—
Total Summer Food Service Program for Children			1,014,547	363,634
Total Child Nutrition Cluster			43,835,551	2,673,625
Child and Adult Care Food Program:	10.558			
Cash assistance		—	6,188,318	5,835,403
State Administrative Expense for Child Nutrition		—	48,697	—
Total Child and Adult Care Food Program			6,237,015	5,835,403
State Administrative Expense for Child Nutrition	10.560	—	782,320	—
Fresh Fruit and Vegetable Program	10.582	—	446,228	—
CNP – NSLP Equipment Assistance Grant – ARRA	10.579	—	73,965	73,965
Total U.S. Department of Agriculture			51,375,079	8,582,993
U.S. Department of Defense:				
National Defense Authorization Act P.L. 110-417	650009	—	5,087,993	—
Joint Venture Education Forum	000913	—	2,566,297	—
Thinking Through Science	12.030	—	73,399	—
Bridging the Mathematical Continuum	650109	—	174,595	—
Total U.S. Department of Defense			7,902,284	—
U.S. Department of Commerce:				
Kauai Watershed Project	11.473	—	10,699	—
Total U.S. Department of Commerce			10,699	—
U.S. Department of Interior:				
Passed-through State Governor's Office Economic, Social and Economic, Social and Political Development of the Territories	15.875	GR 270 094	7,887	—
Total U.S. Department of the Interior			7,887	—
U.S. Department of Education:				
Adult Education – State Grant Program	84.002	—	2,088,159	—
Title I – Grants to Local Educational Agencies	84.010	—	41,870,948	—
Title I – Grants to Local Educational Agencies – ARRA	84.389	—	5,851,710	—
Total Title I, Part A Cluster			49,810,817	—
Migrant Education – State Grant Program	84.011	—	961,547	—
Title I – Program for Neglected and Delinquent Children	84.013	—	324,683	—
Special Education:				
Grants to States	84.027	—	42,508,278	—
Preschool Grants	84.173	—	927,936	—
Total Special Education Cluster			43,436,214	—
Impact Aid	84.041	—	72,946,202	—
MEP Consortium	84.144	—	246,514	—
NCLB – SDFSC – Readiness and Emergency Management	84.184	—	409,577	—
Byrd Honors Scholarships	84.185	—	148,500	—
Safe and Drug-Free School and Communities – State Grants	84.186	—	889,486	—
Education for Homeless Children and Youth	84.196	—	263,073	—
Even Start – State Educational Agencies	84.213	—	316,173	—
Even Start – Migrant Education	84.214	—	36,652	—

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Schedule of Expenditures of Federal Awards
Year ended June 30, 2010

Federal grantor/pass-through grantor/program title	CFDA number¹	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Fund for the Improvement of Education	84.215	—	\$ 3,383,703	—
Twenty-First Century Community Learning Centers	84.287	—	5,127,035	—
Foreign Language Assistance	84.293	—	185,149	—
State Grants for Innovative Programs	84.298	—	85,569	—
Education Technology State Grants	84.318	—	1,681,645	—
State Program Improvement Grants	84.323	—	217,072	—
Advanced Placement Program	84.330	—	43,880	—
Reading First State Grants	84.357	—	420,113	—
Native Hawaiian Education	84.362	—	1,765,781	—
Expanding Pathways to Hawaii's Leadership	84.363	—	136,522	—
English Language Acquisition Grants	84.365	—	1,859,548	—
Mathematics and Science Partnerships	84.366	—	1,002,251	—
Improving Teacher Quality State Grants	84.367	—	13,848,307	—
Grants for State Assessments and Related Activities	84.369	—	2,112,539	—
Statewide Longitudinal Data Systems	84.372	—	363,401	—
Temporary Assistance for Needy Families	84.377	—	1,366,158	—
Education Technology State Grants – ARRA	84.386	—	685,863	—
Education for Homeless Children and Youth – ARRA	84.387	—	71,087	—
State Fiscal Stabilization Fund, Part A – ARRA	84.394	—	44,180,359	—
Common Core of Data Survey Project	500000	—	6,754	—
NAEP State Coordinator	650140	—	151,570	—
			248,483,744	—
Passed-through Office of the State Director for Vocational Education:				
Career and Technical Education – Basic Grants to States	84.048	V048A040011	230	—
		V048A050011	263	—
		V048A060011	856	—
		V048A070011	7,946	—
		V048A080011	1,002,633	—
		V048A090011	1,695,148	—
			2,707,076	—
Passed-through Alu Like, Inc.:				
Native Hawaiian Career and Technical Education	84.259	VE07-08	404	—
		VE08-09	173,172	—
		VE09-10	66,195	—
			239,771	—
Passed-through University of Hawaii:				
Gear Up Hawaii	84.334	P334S050013	934,120	—
		P334A080046	5,026	—
			939,146	—
Native Hawaiian Special Education	490001	C010147-mod#5	1,002,004	—
		S362A090050	42,885	—
			1,044,889	—
Passed-through Research Corporation of Hawaii:				
Ulu Pono – McKinley CSA-KCC FY 09	650740	CB-18240-09-60-A-15	87,487	—
Passed-through National Center of Education, University of Minnesota:				
General Supervision Enhancement Grant	84.373	H373X070021	78,763	—
Total U.S. Department of Education			253,580,876	—
U.S. Department of Health and Human Services:				
Passed-through State Department of Health:				
Peer Education Counselors PEP	650720-09	ASO 09-128	40,407	—
Nutrition Education Program	650650	MOA-DOH 08-003	(61,000)	—
FSNE Snap Education	497000	MOA-DOH	5,766	—
FSNE Program – Waimanalo DOH FY 09	650651	MOA-DOH	39,951	—
FSNE Program – Waimanalo DOH FY 10	497001	MOA-DOH	49,589	—
Mental Health Transformation State Incentive Grant	650830	MOA-Hawaii DOH	9,922	—
			84,635	—

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**
Schedule of Expenditures of Federal Awards
Year ended June 30, 2010

Federal grantor/pass-through grantor/program title	CFDA number¹	Pass-through entity identifying number	Federal expenditures	Amount provided to subrecipient
Cooperative Agreements to Support: Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	—	\$ 300,318	—
Passed-through State Department of Human Services: Child Care and Development Block Grant	93.575	G0100HICCD2 G0100HICCDF	9,711 319,963	— —
			<u>329,674</u>	<u>—</u>
Parent Project Fences FY 08	93.590	G-0201HIFRPG	31,308	—
Temporary Assistance for Needy Families	650715	DHS-06-BESSD-3117 DHS-10-ETPO-156	1,137,179 1,500,041	— —
			<u>2,637,220</u>	<u>—</u>
Teen Pregnancy Prevention Training – DHS FY 10	650703	DHS-10-ETPO-145	43,692	—
Rehabilitation Services – Basic Support Work Study	84.126	MOA	53,403	—
DHS A+ Subsidy	93.558	MOA	4,509,760	—
Corporation for National and Community Service: Passed-through State Department of Labor: Learn and Serve America – School and Community Based Programs	94.004	06KSPHI001 09KSPHI001 09KSPHI002	70,070 5,647 3,111	— — —
			<u>78,828</u>	<u>—</u>
Total Corporation for National and Community Service			<u>78,828</u>	<u>—</u>
Total U.S. Department of Health and Human Services			<u>8,068,838</u>	<u>—</u>
Total federal grant fund expenditures			<u>\$ 320,945,663</u>	<u>8,582,993</u>

¹ Other identifying number used if no CFDA number available.

See accompanying independent auditors' report and note to schedule of expenditures of federal awards.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Note to Schedule of Expenditures of Federal Awards

June 30, 2010

Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Education, State of Hawaii, and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirement of U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts may differ from amounts presented in, or used in the preparation of, the basic financial statements.

PART II

Auditors' Report on Internal Control over Financial
Reporting and on Compliance and Other Matters



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

**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***

The Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education:

We have audited the 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 (the DOE), as of and for the fiscal year ended June 30, 2010, which collectively comprise the DOE's basic financial statements, and have issued our report thereon dated March 31, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the DOE's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in items 2010-01 to 2010-02 in the accompanying schedule of findings and questioned costs to be material weaknesses.

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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2010-08, 2010-09, and 2010-12.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, the Office of the Auditor, 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.

KPMG LLP

March 31, 2011

PART III

Auditors' Report on Compliance with
Requirements That Could Have a Direct and Material Effect on
Each Major Program and on Internal Control over Compliance



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education:

Compliance

We have audited the Department of Education of the State of Hawaii's (the DOE) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct or material effect on each of the DOE's major federal programs for the year ended June 30, 2010. The DOE's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the 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*,³ 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 of the DOE's compliance with those requirements.

As described in items 2010-08, 2010-09, and 2010-12 in the accompanying schedule of findings and questioned costs, the DOE did not comply with requirements regarding the Equipment and Real Property Management and Procurement, Suspension, and Debarment compliance requirements that are applicable to its Child Nutrition Cluster Title I – Grants to Local Educational Agencies, Special Education Cluster, Fund for the Improvement of Education, Twenty-First Century Community Learning Centers, Education Technology State Grants, Improving Teacher Quality State Grants, and National Defense Authorization Act, P.L. 110-417 programs. 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 compliance requirements referred to above that could have a direct or material effect on each of its major federal programs for the year ended June 30, 2010. 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 2010-03 to 2010-07, 2010-10, 2010-11, 2010-13, and 2010-14.

Internal Control Over Compliance

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 the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2010-08, 2010-09, and 2010-12 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2010-03 to 2010-06 and 2010-13 to be significant deficiencies.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, the Office of the Auditor, 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.

KPMG LLP

March 31, 2011

PART IV

Schedule of Findings and Questioned Costs

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

(1) Summary of Auditors' Results

- (a) The type of report issued on the financial statements: **Qualified opinion**
- (b) Significant deficiencies in internal control were disclosed by the audit of the financial statements: **None noted**

Material weaknesses: **Yes, see Findings 2010-01 and 2010-02**

- (e) Noncompliance, which is material to the financial statements: **Yes, see Findings 2010-08, 2010-09, and 2010-12**
- (d) Significant deficiencies in internal control over major programs: **Yes, see Findings 2010-03 to 2010-06 and 2010-13**

Material weaknesses: **Yes, see Findings 2010-08, 2010-09, and 2010-12**

- (e) The type of report issued on compliance for major programs: **Qualified opinion**
- (f) Audit findings that are required to be reported under Section 510(a) of OMB Circular A-133: **Yes, see Findings 2010-03 to 2010-14**
- (g) Major programs:

U.S. Department of Agriculture:

Child Nutrition Cluster:

School Breakfast Program – CFDA No. 10.553

National School Lunch Program – CFDA No. 10.555

Special Milk Program for Children – CFDA No. 10.556

Summer Food Service Program for Children – CFDA No. 10.559

Child and Adult Care Food Program – CFDA No. 10.558

U.S. Department of Defense:

National Defense Authorization Act P.L. 110-417 – #650009

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

U.S. Department of Education:

Title I – Grants to Local Educational Agencies – CFDA No. 84.010

Title I – Grants to Local Educational Agencies – ARRA – CFDA No. 84.389

Special Education Cluster:

Grants to States – CFDA No. 84.027

Preschool Grants – CFDA No. 84.173

Fund for the Improvement of Education – CFDA No. 84.215

Twenty-First Century Community Learning Center – CFDA No. 84.287

Education Technology State Grants – CFDA No. 84.318

Education Technology State Grants – ARRA – CFDA No. 84.386

Improving Teacher Quality State Grants – CFDA No. 84.367

State Fiscal Stabilization Fund, Part A – ARRA – CFDA No. 84.394

U.S. Department of Health and Human Services:

Passed through State of Hawaii Department of Human Services

DHS A+ Program Subsidiary – CFDA No. 93.558

- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$3,000,000**
- (i) Auditee qualified as a low-risk auditee under Section 530 of OMB Circular A-133: **No**

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

(2) Financial Statement Findings

Finding 2010-01 – Agency Fund – Local Schools Funds

Specific Requirements/Criteria

Agency funds are used to account for assets held by the DOE on behalf of outside parties or on behalf of individuals. These funds are also known as local school funds.

Processing Disbursements

According to the Financial Management System (FMS) User Policy and Process Flow Guide, purchase orders shall be used as a document that authorizes the purchase of materials, supplies, and services. The purchase order shall be submitted to the principal for review and approval prior to the purchase. Reimbursements of local school funds may be made to individuals who receive prior approval from the principal or designee to make the purchase.

The FMS User Policy and Process Flow Guide further states that the following procedures should be performed when processing invoices for payment:

1. All goods received must be checked immediately by authorized personnel for quantity of items ordered, serviceability, and damage.
2. Affix approval to pay stamp of the original invoice.
3. Enter date invoice received and date goods/services received.
4. Check unit prices/extensions and totals.
5. Check off items as received on the school's copy of purchase order.

Processing Receipts

According to the FMS User Policy and Process Flow Guide, a cash receipt book must be maintained by each school that receives monies. An official receipt must be completed including information as to date, name of payee, purpose of collection, amount, method of payment, and reference to organization.

Section 296-32 of the Hawaii Revised Statutes (HRS) allows the DOE to receive and manage appropriate gifts, grants, and bequests for the purpose of public education. The FMS User Policy and Process Flow Guide requires that the schools maintain a report of all gifts, grants, and bequests by date, name of donor, description, purpose, and amount for which it is to be used. The revised Form 434, Rev. 9/94 is used for this purpose. In addition, any such amounts greater than \$500 must be presented to and accepted by the Superintendent. The schools are required to maintain a file of letters, memorandums, or copies of checks for all gifts, grants, and bequests by the school.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Condition

Processing Disbursements

During our testing of a sample of 70 local school fund disbursements, we noted the following:

- Twenty-seven (27) instances where the date of the purchase order was not prior to the check date.
- Seven (7) instances where there was no invoice.
- Seven (7) instances where there was no approval-to-pay form.
- Four (4) instances where there was no purchase order.

Processing Receipts

During our testing of a sample of 70 local school fund receipts, we noted the following:

- Ten (10) instances where there was no support for the receipt.
- Eight (8) instances where the deposit date was prior to the posting date.
- Two (2) instances where the recorded deposit date was different from the date on the deposit slip.

Cause

The above findings were caused primarily by a lack of management oversight. The decentralized nature of processing these transactions and turnover of personnel may also contribute to these findings.

Effect

One of the purposes of the FMS User Policy and Process Flow Guide is to establish standard guidelines in the processing of disbursements and receipts of the local school funds. Inconsistencies in the reporting of these transactions could result in inaccurate reporting and increases the probability of funds being lost, unrecorded, or misused.

Recommendation

We recommend that all disbursements and receipts be properly processed and approved and that all required documentation be maintained in accordance with the FMS User Policy and Process Flow Guide.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-02 – Public Charter Schools

Specific Requirements/Criteria

The financial statements of the DOE should reflect the State-wide system of public schools, including the public charter schools.

Condition

The financial statements of the DOE do not completely reflect the activity of the DOE's 31 public charter schools. As of June 30, 2010, the following amounts representing the total charter schools' balances are excluded from the DOE's financial statements (amounts include unaudited information):

- Assets – \$52.4 million
- Liabilities – \$6.2 million
- Revenues – \$22.1 million
- Expenses – \$24.4 million

Cause

The financial information of the public charter schools are not recorded on the DOE's FMS, but is instead recorded individually by the different schools. There is no formal process in place to accumulate the financial information of these public charter schools and to record them to the DOE's financial statements. In April 2010, a requirement was made by the Charter School Review Panel for each of the public charter schools to have an annual financial statement audit completed by January 31, 2011, however, 10 of these schools have yet to comply.

Effect

The effect of the exclusion of the public charter schools' financial information is that the DOE's financial statements do not completely reflect the financial activity of all its public schools.

Recommendation

We recommend that DOE management put a process in place to accumulate the audited financial statements of the public charter schools in a timely manner in order to incorporate their financial activity into the DOE's financial statements.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

(3) Federal Award Findings and Questioned Costs

Finding 2010-03 – Activities Allowed/Allowable Costs – Payroll Certifications

Information on Federal Programs

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Education Technology State Grants – CFDA No. 84.318, Federal Award No. S318X090011; Award Year: July 1, 2009 to September 30, 2010. Education Technology State Grants, Recovery Act – CFDA No. 84.386, Federal Award No. S386A090011; Award Year: February 17, 2009 to September 30, 2010.

Specific Requirements/Criteria

In accordance with OMB Circular No. A-87, Section 8(h), “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 and 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 firsthand knowledge of the work performed by the employee.”

Condition

We noted certain internal control and compliance issues related to payroll costs as follows:

- Out of a sample of nine that was tested for the Special Education Cluster, we identified three instances where the employee and the supervisor both approved the payroll certification prior to the end of the certification period. Further, we noted a fourth instance where the payroll certification was approved over six months after the end of the certification period.
- Out of a sample of 31 that was tested for the Education Technology State Grants, we noted four instances where the payroll certification was approved over 30 days after the end of the certification period. Further, we noted four instances where the payroll certification was coded to the incorrect program ID.

Cause

Management believes that the current practice of semi-annual certifications may need to be performed more frequently.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Effect

The documentation required for personnel costs charged to federal programs is in place to help ensure proper oversight and expenditure of federal funds for personnel costs. Failure to comply with this requirement prevents these controls from operating effectively. Additionally, the costs may be deemed unallowable which may result in the DOE being required to reimburse the federal government.

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend management be more diligent in completing the required payroll certifications in a timely manner. Management should consider adopting a more frequent certification period policy to help ensure compliance with federal requirements.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-04 – Activities Allowed/Allowable Costs – Payroll Costs Allowability

Information on Federal Programs

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Fund for the Improvement of Education – CFDA No. 84.215, Federal Award Nos. V215L052307 and S215L080728; Award Years: July 1, 2005 to June 30, 2010 and July 10, 2008 to July 9, 2013, respectively.

Specific Requirements/Criteria

In accordance with OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, “To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the provisions of this Circular.
- c. Be authorized or not prohibited under State or local laws or regulations.
- d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of costs items.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.
- f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost of any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- g. Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.
- h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
- i. Be the net of all applicable credits.
- j. Be adequately documented.”

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Condition

We noted certain internal control and compliance issues related to payroll costs as follows:

- Out of a sample of 13 that was tested for the Fund for the Improvement of Education program, we identified two instances where the payroll expense should have been recorded to a different program. The sum of these sampled expenses was \$5,720.
- Out of a sample of 34 that was tested for the Special Education Cluster, we identified one instance where the payroll expense should have been recorded to a different program. This sampled expense totaled \$673.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

Failure to record the appropriate expenses to the proper program could result in the misstatement of the federal expenditure amounts by program or the total federal expenditures in the schedule of expenditures of federal awards. This could also impact the determination of the major programs.

Questioned Costs

\$8,931, which is based on the total payroll expense recorded to the Fund for the Improvement of Education and Special Education Cluster programs for the identified individuals in the current fiscal year.

Systemic or Isolated

Systemic

Recommendation

We recommend that management be more diligent in reviewing the program that the payroll expenses are being recorded to. Management should also ensure that the programs documented on the payroll certifications are consistent with where the expenses are recorded in the DOE's FMS.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-05 – Activities Allowed/Allowable Costs – Internal Controls over Payroll

Information on Federal Programs

U.S. Department of Agriculture, Child Nutrition Cluster – School Breakfast Program, National School Lunch Program, Special Milk Program, and Summer Food Services Program – CFDA Nos. 10.553, 10.555, 10.556, and 10.559, respectively; Federal Award No. 7HI300HI3; Award Years: October 1, 2008 to September 30, 2009, October 1, 2009 to September 30, 2010.

Specific Requirements/Criteria

In accordance with OMB Circular A-133, Subpart C – Auditees, §__.300, *Auditee responsibilities*, the auditee shall “Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.”

Condition

During our testwork over the Child Nutrition Cluster program, we did not identify any internal controls over the timesheets that were prepared for the employees that were being paid with funds from this program. The timesheets included the appropriate information, however, we were not able to identify an internal control over the review of these timesheets to ensure that a supervisor was ensuring that the time reported was accurate and that the amounts were recorded to the proper program.

Despite the absence of internal controls at the timesheet level, we did identify internal controls at a broader level, which included a review of the payroll information that is received by the State of Hawaii Department of Accounting and General Services prior to its recordation into the DOE’s FMS.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

The purpose of having internal controls over the timesheet process is to ensure that the amounts reported as worked are accurate and that the correct amounts are paid out and recorded. The absence of these internal controls makes it possible for the submission of inaccurate information and the recordation of this information to the DOE’s FMS.

Questioned Costs

None

Systemic or Isolated

Systemic

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Recommendation

We recommend that management of the Child Nutrition Cluster program review the payroll process and implement internal controls to ensure that the timesheets are being reviewed and that they are recorded to the proper program.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-06 – Cash Management

Information on Federal Programs

U.S. Department of Education, Fund for the Improvement of Education – CFDA No. 84.215, Federal Award Nos. V215L052307 and S215L080728; Award Years: July 1, 2005 to June 30, 2010 and July 1, 2008 to July 9, 2013, respectively.

Specific Requirements/Criteria

In accordance with 34 CFR Part 74.22, drawdowns should not exceed federal expenditures, except in the following instances:

- “(1) Recipients are paid in advance, provided they maintain or demonstrate the willingness to maintain (i) written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient; and (ii) Financial management systems that meet the standards for fund control and accountability as established in §74.21.
- (2) Cash advances to a recipient organization are limited to the minimum amounts needed and be timed to be in accordance with the actual, immediate case requirements of the recipient organization in carrying out the purpose of the approved program or project.
- (3) The timing and amount of cash advances are as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.”

Condition

During our testwork over cash management for the Fund for the Improvement of Education program, we noted three instances where a miscalculation in the federal expenditures resulted in the drawdown exceeding the related expenditures.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

Failure to comply with federal regulations may impact the amount of federal funding received. In addition, the DOE could incur an interest liability during periods where the drawdowns are in excess of the related federal expenditures.

Questioned Costs

None

Systemic or Isolated

Systemic

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Recommendation

We recommend that DOE management reinforce the internal controls over the cash management process to ensure that the federal expenditure amounts are properly calculated and that the drawdowns do not exceed these amounts.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-07 – Eligibility

Information on Federal Programs

U.S. Department of Health and Human Services, Passed-through State of Hawaii Department of Human Services, A+ Program Subsidy – CFDA No. 93.558, Federal Award No. DHS-08-BESSD-5026; Award Year: July 1, 2009 to June 30, 2010.

Specific Requirements/Criteria

In accordance with the A+ Program agreement (DHS-08-BESSD-5026), Exhibit E, the DOE is responsible for retaining all records related to their performance of services under this agreement for at least three years after the date of submission of the DOE's final expenditure report. Further, per Exhibit A, the DOE is also responsible for determining which children in the school can qualify for free and reduced status. This determination is made based on the parents' income levels.

Condition

Out of a sample of 25 student applications, we identified the following:

- Five instances where the application documents for the 2009-2010 school year were not retained.
- Three instances where the incorrect income amount was used on the Application for Reduced Monthly Fee form, which is one of the required student application documents.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

The absence of the application documents results in a lack of evidence to support the eligibility of the students enrolled in the A+ Program. The risk of using the incorrect income amounts is that the student could qualify for the incorrect status, resulting in benefits that should, or should not, be received.

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend that the A+ Program site coordinators ensure that records are retained in accordance with the guidance stated in the A+ Program agreement. Further, site coordinators should ensure that the proper income amounts are included and calculated in the student application documents.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-08 – Equipment and Real Property Management – Annual Certification of Inventory

Information on Federal Programs

U.S. Department of Education, Title I – Grants to Local Educational Agencies – CFDA No. 84.010, Federal Award Nos. S010A080011A, S010A0901A; Award Years: July 1, 2008 to September 30, 2009 and July 1, 2009 to September 30, 2010, respectively. Title I – Grants to Local Educational Agencies-ARRA – CFDA No. 84.389, Federal Award No. S389090011A; Award Year: February 17, 2009 to September 30, 2010.

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Twenty-First Century Community Learning Centers – CFDA No. 84.287, Federal Award Nos. S287C070011, S287C080011, S287C090011; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Education Technology State Grants – CFDA No. 84.318, Federal Award No. S318X090011; Award Year: July 1, 2009 to September 30, 2010. Education Technology State Grants, Recovery Act – CFDA No. 84.386, Federal Award No. S386A090011; Award Year: February 17, 2009 to September 30, 2010.

U.S. Department of Education, Improving Teacher Quality State Grants – CFDA No. 84.367, Federal Award Nos. S367A070010, S367A080010, S367A090010; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

Specific Requirements/Criteria

In accordance with the Hawaii Administrative Rules (HAR) §3-130-6, *Physical inventory*, “(a) Each designated property custodian or governmental unit shall conduct an annual inventory, to be verified by physical count of all state property in their possession, custody, control, or use. (b) If there is a change in the designated property custodian, the chief procurement officer or the custodial department’s fiscal office shall take action to have a physical inventory taken at that time. (c) Immediately upon the completion or termination of any agency or property account, for whatever reason, a complete physical inventory shall be taken pursuant to the direction of the chief procurement officer or the custodial department’s fiscal office.”

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Condition

To ensure that the schools are performing annual physical inventory counts, each school is required to complete an Annual Certification of Inventory, which is approved by the school's principal. However, the Annual Certification of Inventory merely states that the inventory has been performed; it does not provide evidence of the items counted in connection with the inventory. Further, we noted that 12 schools did not submit the Annual Certification of Inventory for the fiscal year ending June 30, 2010.

Cause

Management believes that the Annual Certification of Inventory is an adequate process to ensure that the inventories are being performed at the schools. Further, the non-submission of the Certifications was due to a lack of management oversight.

Effect

The ineffective design of the Annual Certification of Inventory process results in inadequate evidence to support that inventories are being performed at the schools. Insufficient evidence of the inventory results, coupled with the numerous inventories that were not performed could lead to inaccurate reporting of capital assets and violation of the HAR.

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend that the DOE make revisions to the annual inventory process to require the schools to submit the results of the inventory count (i.e., a listing of the items counted, discrepancies noted, etc.) along with the Annual Certification of Inventory. Further, the DOE should continue to be diligent in following up with the non-responsive schools.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-09 – Equipment and Real Property Management – Inventory Records

Information on Federal Programs

U.S. Department of Education, Title I – Grants to Local Educational Agencies – CFDA No. 84.010, Federal Award Nos. S010A080011A, S010A0901A; Award Years: July 1, 2008 to September 30, 2009 and July 1, 2009 to September 30, 2010, respectively. Title I – Grants to Local Educational Agencies-ARRA – CFDA No. 84.389, Federal Award No. S389090011A; Award Year: February 17, 2009 to September 30, 2010.

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Twenty-First Century Community Learning Centers – CFDA No. 84.287, Federal Award Nos. S287C070011, S287C080011, S287C090011; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Education Technology State Grants – CFDA No. 84.318, Federal Award No. S318X090011; Award Year: July 1, 2009 to September 30, 2010. Education Technology State Grants, Recovery Act – CFDA No. 84.386, Federal Award No. S386A090011; Award Year: February 17, 2009 to September 30, 2010.

Specific Requirements/Criteria

In accordance with the HAR §3-130-5, *Property Inventory Record File*, all State agencies are required to ensure that their chief procurement officer “establish, manage, and maintain a centralized property inventory record file for all equipment, real property, weapon, and controlled items of state property in possession, custody, control, or use of the jurisdiction which the officer presides.”

Condition

Out of a sample of 65 equipment purchases, we identified the following:

- Of the sample of 65 equipment purchases that were tested for the Special Education Cluster, we noted 21 instances where the equipment purchased was not recorded to the property inventory record file as of June 30, 2010.
- Out of a sample of 65 equipment purchases that were tested for the Title I program, we noted three instances where the equipment purchased was not properly recorded to the property inventory record file as of June 30, 2010. Further, we noted that there is an inconsistent methodology of accounting for taxes and shipping costs for the equipment recorded to the property inventory record file.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

- Out of a sample of 40 equipment purchases that were tested for the Education Technology for State Grants program, we noted one instance where the equipment purchased was not recorded to the property inventory record file as of June 30, 2010.
- Out of a sample of 65 equipment purchases that were tested for the Twenty-First Century Community Learning Centers, we noted one instance where the equipment purchase was not properly recorded to the property inventory record file as of June 30, 2010.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

Failure to properly record equipment purchases on inventory records prevents officials from monitoring the DOE's assets and does not provide a complete total of inventory on hand. This may also lead to the potential for misappropriation of assets since it may be less risky for an individual to steal an asset that has not been reported on the inventory records.

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend that the DOE enforces procedures to ensure that inventory is properly recorded on property inventory record files. Further, the DOE should ensure that controls over the reconciliation of the FMS expenditures to the property inventory record files are in place and operating effectively.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-10 – Earmarking – Special Education Cluster

Information on Federal Programs

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

Specific Requirements/Criteria

In accordance with 34 CFR 300.133 and the “Guidance Funds for Part B of the Individuals with Disabilities Education Act Made Available Under The American Recovery and Reinvestment Act of 2009,” a provision of services for parentally placed private school children with disabilities must be made for all Special Education grant awards.

Condition

During the fiscal year ending June 30, 2010, the DOE did not set aside funds for the provision of services for parentally placed private school children with disabilities for the Preschool Grant awards (Federal Award No. H173A090083). Also for the fiscal year ending June 30, 2010, there was no evidence documenting that the earmark provision for the Grants to States award (Federal Award No. H027090026) was made.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

By not making the required provision, the Special Education funding is potentially not being allocated to the appropriate recipients under this program.

Questioned Costs

None

Systemic or Isolated

Isolated

Recommendation

We recommend that the DOE should calculate the proportionate share in accordance with 34 CFR 300.133 and the “Guidance Funds for Part B of the individuals with Disabilities Education Act Made Available Under The American Recovery and Reinvestment Act of 2009.” In addition, we recommend that the DOE should maintain a separate program ID in their system specifically for these grants to properly track the earmark provision.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-11 – Earmarking – Education Technology State Grants

Information on Federal Programs

U.S. Department of Education, Education Technology State Grants – CFDA No. 84.318, Federal Award No. S318X090011; Award Year: July 1, 2009 to September 30, 2010. Education Technology State Grants, Recovery Act – CFDA No. 84.386, Federal Award No. S386A090011; Award Year February 17, 2009 to September 30, 2010.

Specific Requirements/Criteria

Office of Management and Budget (OMB) Circular A-133 Compliance Supplement, Part 4 – Department of Education CFDA 84.318, G. *Matching, Level of Effort, Earmarking*, states that the DOE “may retain no more than five percent of its annual allocation for state-level activities. Of the amount retained for State-level activities, no more than 60% may be used for administrative purposes.”

Condition

Based on our testwork over the earmarking compliance requirement for the Education Technology State Grants program, we noted that \$130,584 was allocated for state-level and administrative activities, which exceeded five percent of the total annual allocation of \$1,305,843.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

Failure to comply with federal regulations may impact the amount of federal funding received. Further, adhering to the required allocation ensures that the proper amount of funding is spent towards the program activities, as opposed to administrative expenses.

Questioned Costs

None

Systemic or Isolated

Isolated

Recommendation

We recommend that DOE management reinforce the internal controls over the earmarking process to ensure that the allocations are properly calculated.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-12 – Procurement, Suspension, and Debarment

Information on Federal Programs

U.S. Department of Agriculture, Child Nutrition Cluster – School Breakfast Program, National School Lunch Program, Special Milk Program, and Summer Food Services Program – CFDA Nos. 10.553, 10.555, 10.556, and 10.559, respectively; Federal Award No. 7HI300HI3; Award Years: October 1, 2008 to September 30, 2009, October 1, 2009 to September 30, 2010.

U.S. Department of Education, Title I – Grants to Local Educational Agencies – CFDA No. 84.010, Federal Award Nos. S010A080011A, S010A0901A; Award Years: July 1, 2008 to September 30, 2009 and July 1, 2009 to September 30, 2010, respectively. Title I – Grants to Local Educational Agencies-ARRA – CFDA No. 84.389, Federal Award No. S389090011A; Award Year: February 17, 2009 to September 30, 2010.

U.S. Department of Education, Special Education Cluster, Grants to States – CFDA No. 84.027, Federal Award Nos. H027A070026, H027A080026, H027090026; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively. Preschool Grants – CFDA No. 84.173, Federal Awards Nos. H173A070083, H173A080083, H173A090083; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Fund for the Improvement of Education – CFDA No. 84.215, Federal Award Nos. V215L052307 and S215L080728; Award Years: July 1, 2005 to June 30, 2010 and July 10, 2008 to July 9, 2013, respectively.

U.S. Department of Education, Twenty-First Century Community Learning Centers – CFDA No. 84.287, Federal Award Nos. S287C070011, S287C080011, S287C090011; Award Years: July 1, 2007 to September 30, 2009, July 1, 2008 to September 30, 2010, July 1, 2009 to September 30, 2011, respectively.

U.S. Department of Education, Education Technology State Grants – CFDA No. 84.318, Federal Award No. S318X090011; Award Year: July 1, 2009 to September 30, 2010. Education Technology State Grants, Recovery Act – CFDA No. 84.386, Federal Award No. S386A090011; Award Year: February 17, 2009 to September 30, 2010.

U.S. Department of Defense, National Defense Authorization Act, P.L. 110-417

Specific Requirements/Criteria

In accordance with 34 CFR 80.46 “When procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-Federal funds.” HRS 103D; HAR 3-120-4 and 3-122-75.

Pursuant to HRS and HAR, the DOE is required to obtain no less than three quotes for purchases between \$5,000 to \$15,000; for purchases between \$15,000 and \$50,000, the three quotes must be written.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Pursuant to the HAR 3-120-4 and 3-120-5, when a procurement is made that is exempt to the procurement code, the request for the exemption must be approved by the chief procurement officer.

Condition

We noted certain internal control and compliance issues related to the procurement process as follows:

- Out of a sample of 65 that was tested for the Special Education Cluster, we noted seven instances where there was no documentation supporting that quotations were solicited for these goods and services.
- Out of a sample of 40 that was tested for the Child Nutrition Cluster, we noted six instances where there was no documentation supporting that quotations were solicited for these goods and services.
- Out of a sample of 40 that was tested for the Education Technology State Grants, we noted four instances where there was no documentation supporting that quotations were solicited.
- Out of a sample of 40 that was tested for the Title I program, we noted two instances where the procurement was classified as sole source, however, there was no documentation to support the sole source classification. Further, we noted a third instance where there was no documentation supporting that quotations were solicited for these goods and services.
- Out of a sample of 65 that was tested for the Twenty-First Century Community Learning Centers, we noted two instances where there was no documentation supporting that quotations were solicited for these goods and services.
- Out of a sample of 40 that was tested for the Fund for the Improvement of Education program, we noted one instance where there was no documentation supporting that quotations were solicited and another instance where a procurement was classified as exempt, however, there was no documentation to support the exempt classification.
- Out of a sample of 40 that was tested for the National Defense Authorization Act, we noted one instance where there was no documentation supporting that quotations were solicited for these goods and services.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

The Hawaii Procurement Code, HRS 103D, was developed in part to ensure that public money is expended in the best interests of the public and that funds are expended in an equitable manner. The conditions noted above resulted in noncompliance with HRS 103D.

Questioned Costs

None

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Systemic or Isolated

Systemic

Recommendation

We recommend that the DOE be more diligent in complying with applicable procurement requirements. This may include additional training and workshops where necessary. Also, school-level administrators where purchases originate should ensure that all required documents are obtained and included in the procurement file prior to authorizing the purchase. All exceptions to HRS 103D and applicable HAR should be clearly noted on the applicable purchase orders.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-13 – Subrecipient Monitoring

Information on Federal Programs

U.S. Department of Agriculture, Child Nutrition Cluster – School Breakfast Program, National School Lunch Program, Special Milk Program, and Summer Food Services Program – CFDA Nos. 10.553, 10.555, 10.556, and 10.559, respectively; Federal Award No. 7HI300HI3; Award Years: October 1, 2008 to September 30, 2009, October 1, 2009 to September 30, 2010.

U.S. Department of Agriculture, Child and Adult Care Food Program – CFDA No. 10.558; Federal Award No. 7HI300HI3; Award Years: October 1, 2008 to September 30, 2009, October 1, 2009 to September 30, 2010.

Specific Requirements/Criteria

Office of Management and Budget (OMB) Circular A-133 Compliance Supplement, Part 3 M. *Subrecipient Monitoring* states that, “A pass-through entity is responsible for *Subrecipient Audits* – (1) Ensuring that subrecipients expending \$500,000 or more in Federal awards during the subrecipient’s fiscal year for fiscal years ending after December 31, 2003 as provided in OMB Circular A-133 have met the audit requirements of OMB Circular A-133, and that the required audits are completed within 9 months of the end of the subrecipient’s audit period; (2) issuing a management decision on audit findings within 6 months after receipt of the subrecipient’s audit report; and (3) ensuring that the subrecipient takes timely and appropriate corrective action on all audit findings. In cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity shall take appropriate action using sanctions.”

Condition

Based on our testwork over the subrecipient monitoring compliance requirement for the Child Nutrition Cluster (CNC) and Child and Adult Care Food Program (CACFP) programs, we noted the following:

- For the CNC program, out of the five subrecipients that had federal expenditures in excess of \$500,000, three did not submit audit reports during the current year and for the two that did, there was no documentation of the date of receipt.
- For the CACFP, out of the 14 subrecipients that had federal expenditures in excess of \$500,000, five did not submit audit reports during the current year and out of the nine that did, seven were submitted after the respective submission deadline.

Cause

The above conditions were primarily caused by a lack of management oversight.

Effect

Management is unable to ensure that its subrecipients are in compliance with federal regulations if it does not obtain and review the required audit reports pursuant to OMB Circular A-133.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend that management ensure that audit reports are obtained from its subrecipients and reviewed for compliance on a timely basis. We also recommend that management obtain corrective action plans on a timely basis. Management should also promptly withhold future subrecipient payments if an imposed deadline is not met.

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Finding 2010-14 – Special Tests and Provisions

Information on Federal Programs

U.S. Department of Education, Title I – Grants to Local Educational Agencies – CFDA No. 84.010, Federal Award Nos. S010A080011A, S010A901A; Award Years: July 1, 2008 to September 30, 2009 and July 1, 2009 to September 30, 2010, respectively. Title I – Grants to Local Educational Agencies-ARRA – CFDA No. 84.389, Federal Award No. S38909011A; Award Year: February 17, 2009 to September 30, 2010.

Specific Requirements/Criteria

In accordance with the Title II A Highly Qualified Teacher Guidelines (updated May 2010), the principal or designee must submit highly qualified documentation annually to the Highly Qualified Teachers (HQT) Office for each non-highly qualified teacher, maintain all records used to support the HQ Documentation Form, and forward the HQ Documentation Form to the receiving school for any teacher transferring within the Hawaii public school system.

Condition

Based on our testwork over the highly qualified teachers and paraprofessionals compliance requirement for the Title I program, we noted the following:

- For the highly qualified teachers, out of the nine teachers selected for testing, there were two instances where sufficient supporting documentation was not maintained.
- For the non-highly qualified teachers, out of the eight teachers selected for testwork, there were two instances where sufficient supporting documentation was not maintained.

Cause

The above conditions were primarily caused by a lack of oversight by the school principals.

Effect

Failure to maintain adequate documentation for highly qualified and non-highly qualified teachers may increase the risk that teachers who do not meet the required criteria are hired at Title I schools.

Questioned Costs

None

Systemic or Isolated

Systemic

Recommendation

We recommend that the school principals ensure that documentation is properly retained for highly qualified and non-highly qualified teachers.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Views of Responsible Officials and Planned Corrective Action

Refer to the Response of Affected Agency

PART V

Corrective Action Plan

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



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

OFFICE OF THE SUPERINTENDENT

March 30, 2011

KPMG LLP
Pauahi Tower, Suite 2100
1003 Bishop Street
Honolulu, HI 96813-3421

Ladies and Gentlemen:

The Single Audit of the State of Hawaii Department of Education (HIDOE) for the fiscal year ended June 30, 2010 was completed by the March 31, 2011 Federal deadline. The number of repeat audit findings has decreased tremendously in spite of the massive budget cuts and staff reductions during the downturn in the economy. This result displays the diligent efforts of HIDOE's personnel to improve and strengthen the areas noted by the external auditors.

However, HIDOE did receive a qualified opinion on the financial statements due to the financial records of the public charter schools. The Charter School Review Panel requires annual financial audits from all charter schools and will impose budgetary penalties if the audits are not completed timely.

We have reviewed your audit findings and recommendations and corrective action plans have been prepared. In accordance with OMB Circular A-133, the following pages contain the **Corrective Action Plan** for the year ended June 30, 2010 and the **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2009.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Kathryn S. Matayoshi".

Kathryn S. Matayoshi
Superintendent

KSM:dy

Attachments

c: Internal Audit Office

**STATE OF HAWAII DEPARTMENT OF EDUCATION
CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2010**

FINANCIAL STATEMENT FINDINGS

2010-01 Agency Fund – Local Schools Funds

(Pages 51 to 52)

Corrective Action Plan

Beginning with school year 2007-08, the Department's Internal Audit Office (IA) implemented an Annual Checklist for Compliance of Local School Fund Procedures for all schools as part of its monitoring efforts. Each school is required to certify that specific steps have been completed, such as:

- Bank reconciliations completed;
- Annual Principal Financial Report completed and signed;
- Administrator's Checklist completed and signed;
- Money Raising and Donations are summarized and accounted for;
- Training sessions attended;
- Cash receipts and disbursements are accounted for;
- Petty cash accounted for; and
- Fixed assets inventory updated.

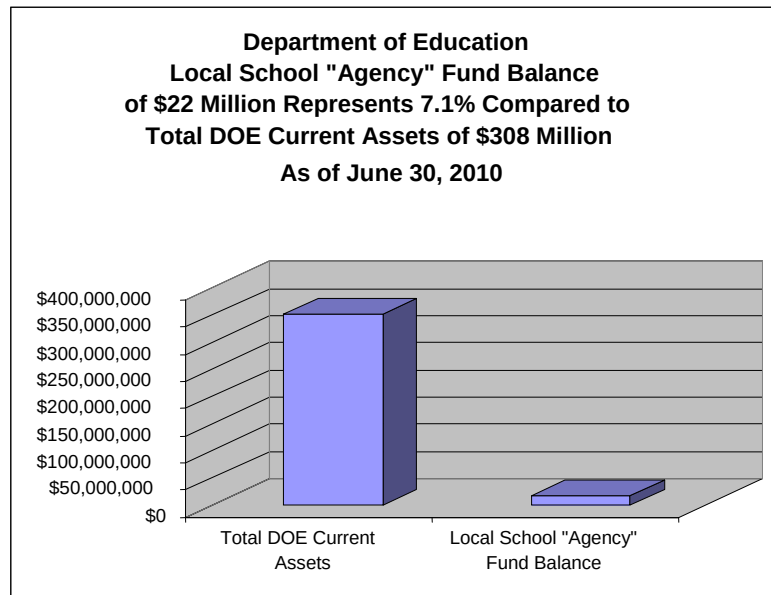
This Checklist is required to be submitted to the DOEIA by August 15 of every year. Schools that do not submit copies of the completed Checklists are placed on a site visit list. IA visits those schools to determine the reasons for the non-response and performs a local school fund audit at that time. IA also performs random site visits of other schools to assess compliance (post-audit), as well as to review corrective action plans from prior audits. These procedures have resulted in strengthened internal controls, and have resulted in substantial reductions in the occurrences of these local school fund audit findings.

In addition, the Department now has Complex Area Business Managers (CABMs) in each of the fifteen (15) complex areas. The CABMs assist the Complex Area Superintendents in monitoring all 257 schools across the State of Hawaii, and they assist schools to comply with fiscal procedures, including local school "agency" funds.

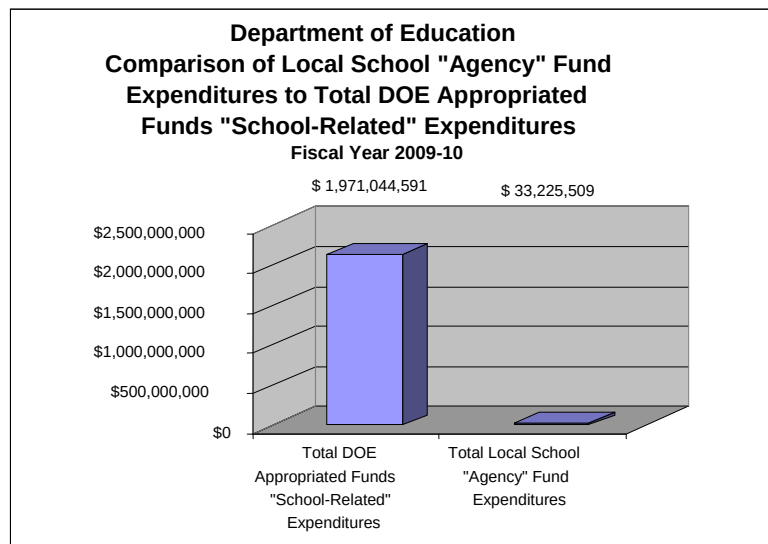
Contextual information

The Department appreciates the auditor's findings pertaining to local school "agency" funds. Since those are "liquid" assets, they are of "high risk" and the findings must be given urgent attention. In addition, since these "agency" funds are held by schools on behalf of student activity transactions, the Department recognizes that it has a fiduciary responsibility to account for these transactions properly. Concurrently, however, we also believe the findings should be considered in appropriate context, in comparison to the total Department current assets, and expenditures under its purview.

The Department's local school "agency" fund balance of \$22 million represents 7.1 percent compared to the total Department current assets of \$308 million as follows:



In addition, the Department's local school "agency" fund expenditures of \$33 million represents 1.7 percent compared to the total Department appropriated fund "school-related" expenditures of \$1.97 billion, as follows:



Please see **Attachment A** for details of each Complex Area Business Manager as contact persons, for the specifics of additional corrective action plans for each of the 15 complex areas across the state, with anticipated completion dates.

Contact Persons: Please refer to **Attachment A**.

Anticipated Completion Dates: Please refer to **Attachment A**.

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Farrington-Kaiser-Kalani	May K. Price	Kaiser High School – Contact: Candy Lii Disbursements: 1. Notify all teachers and staff about purchase order procedures - All purchases must be pre-approved by the principal. Account clerk will not issue purchase order without proper approval. - Purchaser requesting for a reimbursement, must still have a pre-approval by the principal before purchase is made. Receipts from purchase will be collected for documentation. - Original invoices must be provided for all purchases. Receipts: - Account clerk will prepare and date deposit slips on date of courier pick up. Receipts are kept in safe until courier pick up. - Account clerk will ensure supporting documentation on all receipts including those for use of facilities. Kalani High School – Contact: Lisia Uyema Disbursements: 1. Notify all teachers and staff about purchase order procedures a) All purchases must be pre-approved by the principal with the use of a requisition form. Account clerk will not issue purchase order without proper approval. b) Purchaser requesting for a reimbursement, must still have a pre-approval by the principal before purchase is made. Receipts from purchase will be collected for documentation. c) Original invoices must be provided for all purchases. 2. Account clerk will use the “approval to pay” stamp on all invoices in order to process payment. Receipts: a) Account clerk will ensure there is supporting documentation (copy of checks) for each donation receipt that is received.	3/18/11 3/18/11 3/14/2011 3/14/2011

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
		b) Account clerk will ensure supporting documentation on all receipts - Copy of checks from donations - Copy of invoices from robotics team with a copy of the check for sales of Bristlebot kits. Notify teachers and staff to obtain collections forms and fill it out accordingly before submitting money to account clerk.	
Kaimuki-McKinley-Roosevelt	Elden Nakamura	Complex Area School Principals and Office Staff will review the established guidelines for processing the disbursements and receipts of local school funds. The Principals will be informed at the Complex Area Principals Meeting scheduled for March or April. The Office Staff will be informed when the Complex Area Business Manager reviews the local school account at the schools.	June 30, 2011
Aiea-Moanalua-Radford	Adrienne Freitas	Fiscal guidance and training are provided to schools periodically and as requested. Principals ensure compliance with local school procedures by completing Administrative Checklist.	Ongoing
Leilehua-Mililani-Waialua	Lynn Kitaoka (T/A)	The ASA's and I (as a team) are going out to do mini Local School audits at our complex schools – we review, cash receipts, disbursements, fund-raising forms, donation file, bank reconciliation, journal vouchers, administration checklist, cash collection procedures and disbursement procedures. Make recommendations to correct identified problems to Principal, SASA/Account Clerk. The ASA's and I will provide any additional training that is requested / needed by the schools. Linda Ho and I will work with Mililani High – to ensure that proper procedures are in place so that they will be in compliance.	Ongoing
Campbell-Kapolei	Michael N. Tanaka	Complex area had no findings. CABM will continue periodic review of schools' disbursements and receipt processes.	Ongoing
Pearl City-Waipahu	Lawrence Suan	Complex area had no findings. Continuing onsite reviews, testing and staff debriefings will be done to ensure that complex area schools' disbursement and receipt processes, documentation and internal controls are compliance with the FMS User Policy and Process Flow Guide.	Ongoing

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Nanakuli-Waianae	Earlyne Harada	The Complex Area Business Manager will continue to conduct periodic, random reviews of the complex schools' disbursements and receipts for adherence to all applicable DOE policies and procedures as outlined in the FMS User Policy and Process Flow Guide- The Nanakuli Waianae CA did not have any known findings for the current review.	Ongoing
Caste-Kahuku	Cindi Ahuna	Did not have findings. ☐ Held training for principals on the following: - o Completing each section of Administrators Checklist - o Filling out the Administrator's Checklist - o Importance of completing the Checklist ☐ For schools that have requested assistance and for schools that we identify as needing assistance we will complete the following administrative checklist sections as designees: - o Daily Cash Deposit - o Disbursement Documentation - o Journal Vouchers - o Upon completion of reviewing the sections we provide/discuss summary of findings and provide recommendations to correct/prevent findings. ☐ Created Local School Account binders for each school. Each binder includes the entire local school section. ☐ Train new administrative staff or as requested by administrative staff on the following: - o Processing Disbursements - o Processing Receipts - o Administrative Checklist (management oversight) - o During training we review all FMS policies and procedures and also make recommendations on how to implement those policies and procedures. - o Once revised policies and procedures are adopted we offer to provide training to school staff (principal, SASA, clerk and teacher) on new policies and procedures.	December 2008 Ongoing February 2009 Ongoing

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Kailua-Kalaheo	Cindi Ahuna	Did not have findings. ☐ Held training for principals on the following: ○ Completing each section of Administrators Checklist ○ Filling out the Administrator's Checklist ○ Importance of completing the Checklist ☐ For schools that have requested assistance and for schools that we identify as needing assistance we will complete the following administrative checklist sections as designees: ○ Daily Cash Deposit ○ Disbursement Documentation ○ Journal Vouchers ○ Upon completion of reviewing the sections we provide/discuss summary of findings and provide recommendations to correct/prevent findings. ☐ Created Local School Account binders for each school. Each binder includes the entire local school section. ☐ Train new administrative staff or as requested by administrative staff on the following: ○ Processing Disbursements ○ Processing Receipts ○ Administrative Checklist (management oversight) ○ During training we review all FMS policies and procedures and also make recommendations on how to implement those policies and procedures. ○ Once revised policies and procedures are adopted we offer to provide training to school staff (principal, SASA, clerk and teacher) on new policies and procedures.	December 2008 Ongoing February 2009 Ongoing
Hilo-Laupahoehoe-Waiakea	Adri Wilson	No Findings: Complex area will continue providing support to schools through local school reviews and technical assistance	

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Kau-Keaau-Pahoa	Karie Klein	No findings. The complex area is in the process of having each school come up with a clear plan of who is responsible for each local school procedure and related due date (to include primary and backup assigned).	N/A
Honokaa-Kealakehe-Kohala-Konawaena	Scott Jeffrey	School office staffs will be instructed to continue following FMS requirements for LSA as has been the norm. The CABM and ASAs will continue to review the monthly bank reconciliations and conduct ad hoc reviews of LSA transaction files when visiting schools.	3/10/11
Baldwin-Kekaulike-Maui	Kevin Drake	Even though are no findings in the Complex Area, there is ongoing reviews of certain documentation submitted by the schools throughout the year in addition to site visits by the complex area business manager. Local School Fund workshops are conducted periodically as requested for new personnel and regularly for all personnel to ensure that standard practices are followed in all schools.	12/31/2011
Lahainaluna-Lanai-Molokai	Frances Pitzer	Even though are no findings in the Complex Area, there is ongoing reviews of certain documentation submitted by the schools throughout the year in addition to site visits by the complex area business manager. Local School Fund workshops are conducted periodically as requested for new personnel and regularly for all personnel to ensure that standard practices are followed in all schools.	12/31/2011
Kauai-Waimea	Gail Nakaahiki	Did not have any findings. ASAs and CABM have been doing mini reviews. 7 of Kauai schools were audited by IA office during the week of February 28 – March 4, 2011. Upon receiving audit reports, plan to compile and review findings from our mini reviews, IA audits, and KPMG audits with all SASAs and Account Clerks. Continue to do mini reviews.	12/31/11

Corrective Action Plan

The Charter School Review Panel (CSRP) requires (motion adopted April 2010) all charter schools to undergo an annual financial audit, the first of FY 2009-10 due no later than January 31, 2011.

To date, the CSRP and DOE have received copies of 21 of 31 audit reports plus a required assurance letter from the school's governing body, the local school board (LSB). Each LSB was required to assure the CSRP that it had read and discussed the report and that specific corrective action was taken to remedy any findings and recommendations.

The Panel has instructed the Charter School Administrative Office to withhold the third per-pupil allotment (10% of the charter school budget allocation for 2010-11) for the ten schools that have not yet submitted their required audit reports. We expect all remaining schools to submit their reports shortly, but no later than May, 2011.

On an on-going basis, the Panel will review this process to improve the timeliness of completion of these financial audits by charter schools.

*Contact Person: Ms. Ruth Tschumy, Chair
Charter School Review Panel*

Anticipated Completion Date: June 30, 2011

FEDERAL AWARD FINDINGS

2010-03 Activities Allowed/Allowable Costs - Payroll Certifications

(Pages 54 to 55)

Corrective Action Plan

The Department of Education's Federal Compliance and Project Management Office has developed a Standard of Practice (SP 0404), that requires all federally paid employees to complete payroll certifications as per the requirement outlined in paragraph 8h(3) of the Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local and Indian Tribal Governments.

The Department monitors to ensure program managers of federally funded programs:

- 1. Include as part of their regular program monitoring and evaluation activities, verification of fund recipient adherence to the payroll certification requirement.*
- 2. Ensure that fund recipient training includes information regarding this requirement.*

Due to the continued challenges experienced in complying with this payroll certification procedure, the Department is in the process of expanding federally-funded compliance monitoring resources. We have also assigned state-funded staff to monitor for proper and timely federal payroll certifications. Our plans include more frequent tracking of federally-funded personnel, and more frequent payroll certifications.

*Contact Person: Debra Farmer, Educational Specialist
Special Education Section
Office of Curriculum, Instruction and Student Support*

*Christina Tydeman, Acting Director
Federal Compliance and Project Management Office
Office of the Superintendent*

*Edwin Koyama, Accounting Director
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: June 30, 2011

Corrective Action Plan

Special Education Cluster, Grants to States – CFDA No. 87-027

This error occurred at a school and has already been corrected on December 1, 2010.

The Special Education Section (SES) will be initiating a fiscal monitoring process beginning March 2011. The monitoring will include reviews of the payroll certifications, fixed asset management, and allowable costs based on district and complex area project write-ups for PROG ID 17040, Special Education Preschool, and PROG ID 17929, Special Education. The monitoring will occur in all districts statewide.

*Contact Person: Debra Farmer, Educational Specialist
Special Education Section
Curriculum and Instruction Branch
Office of Curriculum, Instruction and Student Support*

Anticipated Completion Date: Completed – March 2011

Fund for the Improvement of Education – CFDA No. 84-215

The payroll cost for a state office teacher was inadvertently charged to the Program ID 17970 rather than Program ID 12667. This was corrected on March 16, 2011. Documentation is on file.

To ensure that this type of error does not re-occur, the program administrator will work with clerical staff to complete payroll forms accurately when a state office teacher is promoted or transferred to another position.

*Contact person: Ms. Katherine Sakuda, Administrator
School Literacy Improvement and Innovation Section
Curriculum and Instruction Branch
Office of Curriculum, Instruction and Student Support*

Anticipated Completion Date: March 31, 2011

Corrective Action Plan

Food Service Plan:

School Food Services Branch acknowledges the finding and will implement the following school level standards:

- A standardized time and attendance template (sign-in sheet) will have two signature and date lines at the bottom (one for the School Food Service Manager, one for the Principal) acknowledging the recorded times are correct. Signatures will be required on the last day of the payroll period.*
- The original sign-in sheet will be filed with the SASA. School level payroll is a SASA responsibility, these signed attendance records will serve as support documents, as well as confirmation that sick or vacation time was entered correctly.*
- A copy of the sign-in sheet will be kept on file in the School Food Service Manager's office.*
- As part of the annual, federally required, On-Site Review, School Food Service will add timesheet review to the checklist. District supervisors will examine managers' timesheet copies; checking that signature lines have been signed.*

For kitchens with a time clock, the School Food Service Manager will:

- Make copies of the timecards.*
- Submit the original timecards with original standardized sign-in sheet to the SASA to obtain principal's signature. SASA will provide manager with copy of the signed form. (SASA to retain originals.)*
- Attach copy of signed standardized sign-in sheet to copies of the corresponding timecards and file in manager's office.*

Systemic Plan:

The Department is planning to implement an automated time recording system via KRONOS Time and Attendance.

The new system will involve a combination of time clocks, computer access, and telephone access, to time recording of attendance, and requests for leaves of absence. The system will have internal controls in place for electronic review and supervisor approvals of time as well as review of accounts charged. Subject to union

consultation, the roll-out of the project will begin in 2012, and will extend to 2013 for all schools and offices.

*Contact Person: Glenna Owens, Director
School Food Services Branch
Office of School Facilities and Support Services*

*Edwin Koyama, Accounting Director
Accounting Services Branch
Office of Fiscal Services*

*Anticipated Completion Dates: Food Service procedures: July 2011
KRONOS project - Full implementation: 2013*

Corrective Action Plan

The finding noted three instances where a miscalculation in the Federal expenditures resulted in the drawdown exceeding the related expenditures.

The Department's Office of Fiscal Services, Accounting Section is responsible for calculating and performing the drawdowns for the majority of the Federal grants. There are currently written policies & procedures in place which were last updated August 9, 2010. The drawdown worksheet is prepared by an Accountant and reviewed by the Fiscal Specialist, the Accountant's supervisor, prior to the Accountant performing the drawdown on the related Federal drawdown system.

The three instances noted in the findings were all due to the same error which was created by the preparer and not caught by the supervisor during the review process. This error was an inappropriate manual adjustment to the system-generated download of expenditures.

In order to improve current procedures, the following actions will be taken:

- 1. The policies & procedures document, Letter of Credit Drawdown Procedure for Federal Grants" will be updated to include the following addition to Section 4. Supervisory Review:*

The supervisor shall perform a thorough review of all manual adjustments made to the system-generated download of expenditures. The supervisor shall document this review by placing an initial on the top of all manual adjustment columns, as applicable.

*Contact Person: Edwin Koyama, Accounting Director
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: June 30, 2011

Corrective Action Plan

The finding noted three instances where the incorrect income amount was used on the Application for Reduced Monthly Fee form, which is one of the student application documents.

Kealakehe Elementary School will be more careful in screening fee status, using a month's worth of recent pay stubs from each family requesting reduced tuition. They will also have the Coordinator's Aide review the school's determination of fee status for accuracy.

Contact Person: Monica Chong, Site Coordinator
A+ Program
Kealakehe Elementary School

Anticipated Completion Date: March 30, 2011

The finding noted five instances where the application documents for the 2009-2010 school year were not retained.

Pearl City Elementary School could not provide the auditors with the student applications as requested for the 2009-2010 school year due to a misunderstanding between A+ coordinator and the A+ staff. This ultimately led to the shredding of the entire box of 2009-2010 student applications.

The school will take the following actions to prevent this from occurring again:

- 1. At the end of each school year, the A+ coordinator will place all A+ student applications in a box and will seal and label the box "PCES A+, 2010-2011 SY, Confidential, Do Not Discard".*
- 2. The school will then store the box in the administration office for 2 years. After the 2nd year, the school will shred the student applications.*

Contact Person: Renee Morikawa, Site Coordinator
A+ Program
Pearl City Elementary School

Anticipated Completion Date: March 22, 2011

Corrective Action Plan

The finding noted that the Department's current equipment and real property management procedures lack evidence to support that inventory counts are being performed at schools and offices. In addition, the finding noted non-submission of a number of Certification of Annual Inventory Reports.

The Department currently requires each school and office to perform an annual physical inventory count. Each School Principal or Office Administrator must also complete and sign-off on a 'Certification of Annual Inventory Report' which must be submitted to the Office of Fiscal Services, Accounting Section–Inventory Unit. Schools and offices are notified of this requirement shortly after the fiscal year end via a memo from the Assistant Superintendent and CFO. Along with the memo, schools and offices are provided with several inventory reports to aid them in the physical inventory count.

In order to improve current procedures, the following actions will be taken:

- 1. The Office of Fiscal Services, Accounting Section – Inventory Unit will monitor completion and submission of all Certification of Annual Inventory Reports. A list of all schools and offices that did not submit the Certification by the stated deadline will receive a first and second reminder; subsequently, the list will go to the Assistant Superintendent and CFO for action.*
- 2. The Department will require schools and offices to maintain on file, documentation that an annual physical inventory was performed. Documentation may include inventory reports, count sheets, etc. that should have manual markings evidencing a physical inventory count was taken.*
- 3. On a test-basis, the Department will request certain schools and offices make available the documentation evidencing that an annual physical inventory was performed.*
- 4. The above changes to procedures will be communicated and emphasized in the Annual Certification of Fixed Assets Inventory memo from the Assistant Superintendent and CFO.*

*Contact Person: Edwin Koyama, Accounting Director
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: The Department will implement the corrective action plan for the fiscal year-end June 30, 2011 inventory count and certification.

Corrective Action Plan

The finding noted instances where equipment purchased was not properly recorded to the property inventory record file. In addition, the finding noted inconsistent methodology of accounting for taxes and shipping costs for the equipment recorded to the property inventory record file.

The Department currently has a financial management system that routes all purchases flagged to an inventory-type object (expenditure) code directly to a property “hold” file when paid. School and offices subsequently move items from the “hold” file to the “property” file when the items are placed in its final location. Approved and trained users are allowed access to the inventory system to split bulk purchases into separate items, assign decal numbers, change location codes, etc. The ability to remove items from the inventory records, however, is limited to the Office of Fiscal Services, Accounting Section – Inventory Unit. Schools and offices must make a formal request using Form FA3 – Request to Dispose in order to process such a transaction.

In all instances of the findings, the equipment was recorded as an item on the property inventory record file. In certain instances, however, the item cost was inaccurate. This inaccuracy resulted from manual changes that were done improperly, resulting in an inappropriate change to the item cost. In other instances, the item was received prior to fiscal year end June 30, 2010, however was not recorded to the property inventory record file until after the fiscal year end June 30, 2010. This inaccuracy resulted from a somewhat significant lag between when the item was received and when the item was paid for.

The inconsistent methodology of accounting for taxes and shipping costs for equipment recorded to the property inventory record file is due to lack of properly communicated guidance.

In order to improve current procedures, the following actions will be taken:

- 1. A memo will be sent to schools and offices from the Assistant Superintendent and CFO covering the following:*
 - a. Details of the three findings and the related causes. In addition, measures schools and offices should take to prevent future occurrences.*
 - b. Communication of the Department’s methodology for accounting for taxes and shipping costs for equipment recorded to the property inventory record file.*
- 2. The Office of Fiscal Services, Accounting Section, with the help of the Department’s Information Systems Services Branch, will create an exception report targeted at catching instances of transactions such as those that resulted in the three findings.*

In addition to the actions to be implemented noted above, please also note that the Department currently has a request to the State Legislature for funding to purchase a new Enterprise Resource Planning (ERP) system, that will replace and integrate existing financial, budget and human resource systems. This ERP system will include a module for equipment and property management.

*Contact Person: Edwin Koyama, Accounting Director
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: June 30, 2011

Corrective Action Plan

The Special Education Section (SES) has implemented corrective actions to address 34 CFR 300.133 requirements to set aside funds for the provision of services for parentally-placed private school children with disabilities for the Preschool Grant awards.

- On January 31, 2011, a proportionate share of ARRA IDEA Preschool funds was calculated and set aside in accordance with 34 CFR 300.133 and the “Guidance Funds for Part B of the Individuals with Disabilities Education Act Made Available Under the American Recovery and Reinvestment Act of 2009.” A total of \$8,170.00 was allocated under a unique program ID, 38635, to the complex areas to implement the Private School Participation Project (PSPP).

The screenshot shows a software window titled "DOE Budget Alloc. Details..." with a sidebar on the left containing menu items: "Alloc. Details", "Alloc. Summary", "Alloc. by Program", "Alloc. by Title", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary". The main area displays a list of allocations:

Allocation Number	Date	Program	T	Total
38631		ARRA SFSF PART B-HI-EST		
38632		ARRA SFSF PART B-INTER-EST		
38634		ARRA TITLE I-FARRINGTON COMPLEX		
38635		ARRA IDEA PRESCHOOL PVT SCH PART		
Allocation Number 511 Date 01/31/2011				
CA-AIEA-MOANALUA-RADFORD		ARRA IDEA PRESCHOOL PVT SCH PART	T:\$ 2,403.00	Total: \$ 2,403.00
CA-BALDWIN-KEKAULIKE-MAUI		ARRA IDEA PRESCHOOL PVT SCH PART	T:\$ 1,922.00	Total: \$ 1,922.00
CA-KAILUA-KALAHED		ARRA IDEA PRESCHOOL PVT SCH PART	T:\$ 1,442.00	Total: \$ 1,442.00
CA-KAIMUKI-MCKINLEY-ROOSEVELT		ARRA IDEA PRESCHOOL PVT SCH PART	T:\$ 961.00	Total: \$ 961.00
CA-NANAKULI-WAIANAE		ARRA IDEA PRESCHOOL PVT SCH PART	T:\$ 1,442.00	Total: \$ 1,442.00
42100		WEIGHTED STUDENT FORMULA		

- On January 31, 2011, a proportionate share of IDEA Preschool funds was calculated and set aside in accordance with 34 CFR 300.133 and the “Guidance Funds for Part B of the Individuals with Disabilities Education Act Made Available Under the American Recovery and Reinvestment Act of 2009.” A total of \$15,070.00 was allocated under a unique program ID, 17041, to the complex areas to implement the Private School Participation Project (PSPP).

The screenshot shows a software window titled "DOE Budget Alloc. Details..." with a sidebar on the left containing menu items: "Alloc. Details", "Alloc. Summary", "Alloc. by Program", "Alloc. by Title", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary", "Alloc. Summary". The main area displays a list of allocations:

Allocation Number	Date	Program	T	Total
16807		HAWAIIAN STUDIES		
17040		SPECIAL ED PRE-SCHOOL GRANT		
17041		SPECIAL ED PRE-SCHOOL PVT SCH PART		
Allocation Number 510 Date 01/31/2011				
CA-AIEA-MOANALUA-RADFORD		SPECIAL ED PRE-SCHOOL PVT SCH PART	T:\$ 4,432.00	Total: \$ 4,432.00
CA-BALDWIN-KEKAULIKE-MAUI		SPECIAL ED PRE-SCHOOL PVT SCH PART	T:\$ 3,546.00	Total: \$ 3,546.00
CA-KAILUA-KALAHED		SPECIAL ED PRE-SCHOOL PVT SCH PART	T:\$ 2,659.00	Total: \$ 2,659.00
CA-KAIMUKI-MCKINLEY-ROOSEVELT		SPECIAL ED PRE-SCHOOL PVT SCH PART	T:\$ 1,773.00	Total: \$ 1,773.00
CA-NANAKULI-WAIANAE		SPECIAL ED PRE-SCHOOL PVT SCH PART	T:\$ 2,660.00	Total: \$ 2,660.00
17131		SPECIAL EDUCATION IN REGULAR SCHOOLS		

Annually, the SES will set aside funds from the Preschool Grant Award for the PSPP at the same time funds are set aside for the regular Special Education grant award.

*Contact Person: Debra Farmer, Educational Specialist
Special Education Section
Curriculum and Instruction Branch
Office of Curriculum, Instruction and Student Support*

Anticipated Completion Date: Completed – January 31, 2011

Corrective Action Plan

The Department recognizes the finding and agrees that management oversight was the cause for an allocation in excess of five percent of the annual allocation award. This corrective action will require the following:

- 1. The Department will ensure that the appropriate portion of funds under federal award S386A090011 will be used for state-level activities and administration. This will be accomplished by:
 - A. Transferring charges, where appropriate, to the Local Education Agency (LEA) program and*
 - B. Transferring the requisite amount of funds which remain in balance to the LEA program.**
- 2. Ensure that all new program managers attend and understand the newly created Program Manager training.*

*Contact Person: Robert Campbell, Ph.D., Executive Assistant for Strategic Reform
Office of the Superintendent*

Anticipated Completion Date: June 30, 2011

Corrective Action Plan

The Department of Education, Office of Fiscal Services, Procurement and Contracts Branch (PCB) acknowledges room for improvement in our procurement processes.

PCB continues to provide training workshops on procurement and contracts issues throughout the year. The workshops and training are provided to a target audience of school/program administrators, school administrative services assistants (SASAs), account clerks, administrative services assistants (ASAs), and complex area business managers (CABMs). The training by PCB has been provided as stand-alone workshops or as requested by complex area superintendents, program managers, and state offices.

The training covers the various procurement methods, including price lists, vendor lists, small purchase and exempt procurement for goods and services (\$0 - \$24,999), exempt, sole source, IFB, RFP, professional services, emergency procurement, and MOA/MOU procurements (\$25,000 and above). PCB also maintains a database of procurement and contracting flowcharts, checklists, forms, and instructions/guidelines and is available to all DOE employees as necessary for review and reference. DOE employees are also encouraged to contact PCB if there are further questions that may arise or to seek additional assistance.

PCB will continue to provide training via workshops and through an "opening of school/office" memo to remind all administrators and support staff of procurement and contracts requirements. In addition, PCB has instituted its own internal documentation review process for projects/contracts of \$25,000 and more. The Office of Fiscal Services will work with the CABMs to perform reviews of school level procurement transactions to ensure on-going compliance. A working team of CABMs, with consultation by PCB, has developed an audit program for the schools and offices to ensure that monitoring is part of the review of the schools procurement transactions. Federal program managers will also notify their program participants of compliance to the procurement code, whether for federal or general fund procurement transactions. Finally, school level administrators and support staff must be more diligent in complying with applicable procurement requirements, as outlined in training and notifications to the federal program participants.

Contact Person: Andrell Beppu Aoki, Director
 Procurement and Contracts Branch
 Office of Fiscal Services

Anticipated Completion Date: June 30, 2011

Corrective Action Plan

Due to a shortage of staff and a high number of furlough days, the Office of Hawaii Child Nutrition Programs (OHCNP) has been challenged to fulfill its subrecipient monitoring duties. OHCNP is understaffed by five positions (i.e. the Assistant Director, two Program Specialist Vs, one Program Specialist IV, and one Account Clerk IV) despite ongoing recruitment efforts. HIDOE has incurred 18 furlough days in 2009-2010 and is slated for 13 in 2010-2011 to balance the State of Hawaii budget.

The following steps have been taken to comply including the establishment of a timeline and work plan for various stages of compliance including:

- Developing an internal knowledge base
- Training staff
- Revising appropriate forms
- Conducting a review of audit reports
- Completing follow up

We pilot tested the revised forms in School Year 2010 to 2011 to address our compliance needs for the present year due to limited staffing and when possible, shall follow up on past year reports.

As of 3/1/2011, we have completed the following steps:

- Developed a knowledge base through study, review of resources and collaboration with USDA and other subject matter experts.
- Completed initial staff training.
- Revised the audit survey form completed by the subrecipient
- Revised the OHCNP monitoring logs used to document the State Agency's follow up
- Completed the initial review of all sponsors requiring A-133 audits including the review of audits on file, requesting missing audits, requesting Corrective Action Plans as appropriate and documentation of the overall review and follow up on the A-133 log.

OHCNP will apply for automation funds through a USDA grant opportunity known as the Administrative Review Training Grant in April 2011. These funds will enable OHCNP to work smarter to achieve program compliance outcomes with limited internal resources.

The A-133 Compliance Plan is moving forward and is on target for completion of all required A-133 audit reports and follow up by December 2011.

Contact Person: Sue Uyehara RD, MPH, Director
Office of Hawaii Child Nutrition Programs
Federal Compliance and Project Management Office
Office of the Superintendent

Anticipated Completion Date: August 2011

Corrective Action Plan

The Office of Human Resources (OHR) provides current highly qualified (HQ) status of teachers, and also whether a non-HQ teacher has an approved professional development plan on the PDE3 system. Principals have access to this system to determine whether a teacher is highly qualified or not, and whether a non-HQ teacher has an approved professional development plan (PDP) in place. The two NHQ teachers listed did not have professional development plans on file with our office. PDP are the responsibility of the school as is noted in the Principals HQT Handbook; HQT Guidelines; Item 29, 34C, 34D.

However, the HQ office does create a report to complex areas detailing those teachers who are not highly qualified, and the need to provide an appropriate professional development plan. In its next HQ training session, OHR plans to re-emphasize to school administrators that they do have access to the PDE3 system to check the highly qualified status of teachers and also whether or not they have an approved professional development plan, if needed.

Contact Person: Kerry Tom, Acting Assistant Superintendent
Office of Human Resources

Anticipated Completion Date: June 2011

PART VI

Summary Schedule of Prior Audit Findings

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

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Prior Fiscal Year Ended June 30, 2009

SECTION II - FINANCIAL STATEMENT FINDINGS

2009-01 Error Corrections

(Pages 61 to 62 of the Prior Year June 30, 2009 Report)

(Pages 60 to 62 of the June 30, 2008 Report)

(Pages 65 to 67 of the June 30, 2007 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

2009-02 Accounting for Compensated Absences

(Page 63 of the Prior Year June 30, 2009 Report)

(Page 63 of the June 30, 2008 Report)

(Pages 67 to 68 of the June 30, 2007 Report)

(Pages 55 to 56 of the June 30, 2006 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

2009-03 Improve Compensating Controls For Inadequate Segregation of Duties over Agency Funds

(Pages 64 to 67 of the Prior Year June 30, 2009 Report)

(Pages 64 to 66 of the June 30, 2008 Report)

(Pages 68 to 69 of the June 30, 2007 Report)

(Pages 57 to 58 of the June 30, 2006 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2010-01.*

2009-04 Agency Fund Bank Reconciliations

(Pages 68 to 69 of the Prior Year June 30, 2009 Report)

(Pages 67 to 68 of the June 30, 2008 Report)

(Pages 69 to 70 of the June 30, 2007 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

SECTION II - FINANCIAL STATEMENT FINDINGS - continued

2009-05 Procurement

(Page 70 of the Prior Year June 30, 2009 Report)

(Page 71 of the June 30, 2008 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2009-06 Period of Availability

(Page 71 of the Prior Year June 30, 2009 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

2009-07 Reporting

(Pages 72 to 73 of the Prior Year June 30, 2009 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Financial Statement Findings.*

2009-08 Allowable Costs and Cost Principles - Payroll Certifications

(Pages 74 to 75 of the Prior Year June 30, 2009 Report)

(Pages 72 to 73 of the June 30, 2008 Report)

(Pages 74 to 75 of the June 30, 2007 Report)

(Pages 61 to 62 of June 30, 2006 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2010-03.*

2009-09 Cash Management

(Pages 76 to 77 of the Prior Year June 30, 2009 Report)

(Pages 74 to 76 of the June 30, 2008 Report)

(Pages 71 to 73 of the June 30, 2007 Report)

(Page 69 of the June 30, 2006 Report)

Status -- *Corrective action has been taken with respect to the Twenty-First Century Community Learning Centers. However, corrective action and monitoring is still in progress for the Fund for the Improvement of Education in the current year. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2010-06.*

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS - continued

2009-10 Oversight of Charter Schools

(Pages 78 to 79 of the Prior Year June 30, 2009 Report)

(Pages 77 to 78 of the June 30, 2008 Report)

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

2009-11 Earmarking

(Pages 80 to 81 of the Prior Year June 30, 2009 Report)

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

2009-12 Earmarking

(Page 82 of the Prior Year June 30, 2009 Report)

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

2009-13 Equipment and Real Property Management

(Page 83 of the Prior Year June 30, 2009 Report)

(Page 81 of the June 30, 2008 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2010-09.

2009-14 Procurement, Suspension, and Debarment

(Pages 84 to 85 of the Prior Year June 30, 2009 Report)

(Pages 84 to 85 of the June 30, 2008 Report)

(Pages 78 to 80 of the June 30, 2007 Report)

Status -- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2010-12.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS - continued

2009-15 Period of Availability

(Page 86 of the Prior Year June 30, 2009 Report)

(Page 86 of the June 30, 2008 Report)

(Pages 75 to 76 of the June 30, 2007 Report)

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

2009-16 Eligibility

(Pages 87 to 88 of the Prior Year June 30, 2009 Report)

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

2009-17 Eligibility

(Pages 89 to 90 of the Prior Year June 30, 2009 Report)

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

2009-18 Eligibility

(Page 91 of the Prior Year June 30, 2009 Report)

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

2009-19 Eligibility

(Page 92 of the Prior Year June 30, 2009 Report)

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

2009-20 Subrecipient Monitoring

(Pages 93 to 95 of the Prior Year June 30, 2009 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2010-13.*

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS - continued

2009-21 Reporting

(Page 96 of the Prior Year June 30, 2009 Report)

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

2009-22 Allowable Activities and Allowable Costs

(Pages 97 to 98 of the Prior Year June 30, 2009 Report)

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