

Department of Agriculture
State of Hawaii
Financial and Compliance Audit
Year Ended June 30, 2005

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII**

TABLE OF CONTENTS

	<u>PAGE</u>
Introduction	1
Independent Auditor's Report on Financial Statements	3
Required Supplementary Information Management's Discussion and Analysis	5
Government-wide Financial Statements	
Statement of Net Assets	12
Statement of Activities	13
Fund Financial Statements	
Balance Sheet – Governmental Funds	14
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	15
Reconciliation of Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds to the Statement of Activities	16
Statement of Fiduciary Net Assets	17
Statement of Changes in Fiduciary Net Assets	18
Notes to Financial Statements	19
Required Supplementary Information	
Statement of Revenues, Expenditures and Changes In Fund Balances (Budget and Actual) - General Fund	38
Statement of Revenues, Expenditures and Changes in Fund Balances (Budget and Actual) – Major Special Revenue Funds	39
Budgetary Comparison Schedule – Budget-to-GAAP Reconciliation	40
Schedule of Expenditures of Federal Awards	41
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	43
Report on Compliance With Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance With OMB Circular A-133	45
Schedule of Findings and Questioned Costs	47
Summary Schedule of Prior Year Findings and Questioned Costs	54
Response of the Department of Agriculture	

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Ms. Sandra Lee Kunimoto
Chairperson, Board of Agriculture
State of Hawaii

Dear Ms. Kunimoto:

This is our report on the financial and compliance audit of the Department of Agriculture of the State of Hawaii (Department) for the year ended June 30, 2005, including the accompanying notes to those financial statements, and the independent auditors' report thereon. Our audit was performed in accordance with the requirements of the Single Audit Act Amendments of 1996 and with terms of our contract with the Department.

AUDIT OBJECTIVES

The primary purpose of the audit was to form an opinion and issue an independent auditors' report on the fairness of the presentation of the Department's financial statements for the fiscal year ended June 30, 2005, to report on its internal control structure and to report on its compliance with applicable laws and regulations in accordance with the requirements established by the Single Audit Act Amendment of 1996, and the provisions of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The specified objectives of the audit were:

- 1) To satisfy the audit requirements of Circular A-133 issued by the United States Office of Management and Budget.
- 2) To provide a basis for an opinion on the fairness of the presentation of the Department's financial statements.
- 3) To determine whether expenditures have been made and all revenues and other receipts to which the Department is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and, where applicable, the Federal government.
- 4) To evaluate the adequacy of the Department's system of internal accounting control in assuring that there is effective control over and proper accounting of revenues, expenditures, assets and liabilities.
- 5) To determine whether the Department has materially complied with the fiscal provisions of grant agreements and applicable Federal laws, regulations and circulars with regard to Federal grant activities.

AUDIT SCOPE

Our audit was performed in conformity with auditing standards generally accepted in the United States of America, Governmental Auditing Standards issued by the Comptroller General of the United States, and the provisions of OMB Circular A-133 as they pertain to financial and compliance audits. Accordingly, the audit consisted of procedures to understand the Department and its operations, to test the Department's internal control structure and to test selected transactions and accounting records in order to formulate an opinion on its financial statements and schedule of expenditures of federal awards.

Hullari & Co., CPAs, Inc.

Honolulu, Hawaii
February 28, 2006

Financial Audit

INDEPENDENT AUDITOR'S REPORT

To The Board of Agriculture
State of Hawaii

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

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

As discussed in note 2, the financial statements of the department present the financial position and 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 department. They do not purport to, and do not, present the financial position of the State of Hawaii as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the government activities, each major fund, and the aggregate remaining fund information of the department as of June 30, 2005, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on page 5 to 11 and budgetary comparison information on page 38 to 40 are not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied 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.

INDEPENDENT AUDITOR'S REPORT, CONTINUED

In accordance with *Government Auditing Standards*, we have also issued a report dated February 10, 2006 on our consideration of the department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the department'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 also not a required part of the basic financial statements of the department. 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.

Hullari & Co., CPAs, Inc.

Honolulu, Hawaii
February 10, 2006

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

Our discussion and analysis of the Department of Agriculture of the State of Hawaii (Department)'s financial performance provides an overview of the Department's financial activities for the fiscal year ended June 30, 2005. We encourage the readers to read the information presented here in conjunction with the basic financial statements.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements comprising of three major components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. This report also contains other required supplementary information in addition to the basic financial statements themselves.

Government-Wide Financial Statements

The government-wide financial statements consist of the statement of net assets and the statement of activities. The statement of net assets and the statement of activities provide information about the activities of the Department as a whole and present a longer-term view of the Department's finances. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The statement of net assets and statement of activities report the Department's *net assets* and changes in them. The Department's net assets or the difference between assets and liabilities is one way to measure the Department's financial health, or *financial position*. Over time, *increases or decreases* in the Department's net assets are one indicator of whether its *financial health* is improving or deteriorating. Other non-financial factors such as changes in local, state and federal legislation and public policy may also have an affect on the Department's various programs and should also be considered in assessing the *overall health* of the Department.

We have reported the Department's governmental activities in the statement of net assets and the statement of activities. All of the Department's basic services are reported here, including the animal industry, agricultural loan, quality assurance, agricultural development, agricultural resource management and plant industry divisions, aquaculture development program, general administration, and the agribusiness development corporation. General fund appropriations, fees, agricultural loan interest, and state and federal grants finance most of these activities. The Department is not considered to have business-type activities and component units.

Fund Financial Statements

Fund financial statements tell how governmental activities and services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Department's operations in more detail than the government-wide statements by providing information about the Department's most significant funds.

Generally, the Department's funds are required to be established by State law. However, the Department establishes many other funds to show that it is meeting legal responsibilities for using certain taxes, grants, and other money (like grants received from the U.S. Department of Agriculture).

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department, like the State as whole and other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

requirements. All of the funds of the Department can be divided into two categories: (1) governmental funds, and (2) fiduciary funds.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. The Department's basic services are reported in governmental funds. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements are comprised of the balance sheet, and statement of revenues, expenditures, and changes in fund balances. The relationship (or differences) between *activities* (reported in the statement of net assets and the statement of activities) and governmental *funds* are reported on the reconciliation of the statement of revenues, expenditures, and changes in fund balances – governmental funds to the statement of activities.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the State. The Department is the trustee, or *fiduciary*, for private-purpose trust and agency funds. The fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's own programs. All of the Department's fiduciary activities are reported in a separate statement of fiduciary net assets. A statement of changes in fiduciary net assets is also included for the Department's private-purpose trust funds. The Department is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

Notes to Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Other Required Supplementary Information

In addition to the basic financial statements and accompanying notes, this report contains the statement of revenues, expenditures and changes in fund balances (budget and actual) for both general fund and major special revenue funds.

Government-Wide Financial Analysis

The Department's condensed financial information of its governmental activities for the year ended June 30, 2005 and June 30, 2004 is provided in Tables 1 and 2 below.

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

**Table 1
Net Assets
(in Millions)**

	<u>2005</u>	<u>2004</u>
Current and other assets	\$ 35.5	31.1
Loans receivable	18.2	20.7
Capital assets	<u>72.6</u>	<u>78.0</u>
Total assets	<u>126.3</u>	<u>129.8</u>
Long-term liabilities	10.1	10.5
Other liabilities	<u>2.9</u>	<u>3.6</u>
Total liabilities	<u>13.0</u>	<u>14.1</u>
Net assets:		
Invested in capital assets	72.6	78.0
Restricted	50.3	48.1
Unrestricted (deficit)	<u>(9.6)</u>	<u>(10.4)</u>
Total net assets	<u>113.3</u>	<u>115.7</u>
Total liabilities and net assets	\$ <u>126.3</u>	<u>129.8</u>

**Table 2
Changes in Net Assets
(in Millions)**

	<u>2005</u>	<u>2004</u>
Revenue		
Program revenues:		
Charges for services	\$ 8.9	6.7
Operating grants and contributions	9.1	2.5
Capital grants and contributions	6.0	4.1
State allotted appropriations	12.7	12.0
Non-imposed employee fringe benefit	3.2	2.9
Transfers	<u>(1.4)</u>	<u>(1.3)</u>
Total revenues	<u>\$ 38.5</u>	<u>26.9</u>
Program expenses		
Productivity improvement and management assistance	\$ 11.1	10.8
Product development and marketing	3.8	3.4
General support for agriculture	12.6	5.0
Agricultural water development and irrigation services	4.0	4.5
Pollution control	1.6	1.5
Protection of the consumer	0.9	0.8
Aquaculture development	0.6	0.6
Agriculture loans	<u>1.2</u>	<u>1.7</u>
Total expenses	<u>35.8</u>	<u>28.3</u>
(Decrease) Increase in net assets	\$ <u>2.7</u>	<u>(1.4)</u>

The Department's total assets exceed liabilities by \$113.3 million at the end of the fiscal year. Net assets of the Department's governmental activities decreased by 2% (\$113.3 million compared to \$115.7 million). The largest portion of the Department's net assets (\$72.6 million) reflects its investment in capital assets (e.g.,

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

land, infrastructure, buildings, and equipment) less any related debt used to acquire those assets that is still outstanding. The Department uses these assets to provide services to citizens; consequently, these assets are not available for future spending. A portion of the Department's net assets (\$50.3 million) represents resources that are subject to external restrictions, enabling legislation, or other legal requirements on how they may be used. The remaining unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints changed from a \$10.4 million deficit to a \$9.6 million deficit at the end of the fiscal year due to identification of the bond issuance in 2001. Net assets invested in capital assets decreased by approximately \$5 million generally due to an adjustment for an overstatement of fixed assets, primarily in "construction in progress" for the prior fiscal year.

The Department's total revenues increased by \$11.6 million primarily due to an increase in operating grants and contributions. The Department served as a pass-through agency for \$7.2 million in federal funds appropriated in the Military Construction Appropriation Emergency Hurricane Supplemental Appropriations Act of 2005, P.L. 108-324, and signed into law on October 3, 2004, to provide assistance for an agricultural transportation cooperative in the State of Hawaii. The funds were appropriated to assist members in the agricultural transportation cooperative that sustained economic losses due to reduced sugar yields as a result of extraordinary weather conditions. Upon ensuring that the cooperative members are eligible to participate in the Farm Service Agency administered Marketing Assistance Loan Program and that the cooperative did not have any past due owed to the federal government, the funds were transferred to the Hawaiian Sugar and Transportation Cooperative.

The Department's total expenses increased by \$7.5 million due to the transfer of \$7.2 million in federal funds to the Hawaiian Sugar and Transportation Cooperative.

Table 3 presents the cost of each of the Department's five largest programs as well as each program's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that was placed on Hawaii's taxpayers by each of these functions.

**Table 3
Governmental Activities
(in Millions)**

	<u>Total Cost of Services</u>		<u>Net Cost of Services</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Productivity improvement and management assistance	\$ 11.1	10.8	7.4	7.3
Product development and marketing	3.8	3.4	3.1	3.1
General support for agriculture	12.6	5.0	2.2	2.7
Agricultural water development and irrigation services	4.0	4.5	(2.9)	(0.5)
Pollution control	1.6	1.5	0.8	0.7
All others	<u>2.7</u>	<u>3.1</u>	<u>1.3</u>	<u>1.7</u>
Totals	<u>\$ 35.8</u>	<u>28.3</u>	<u>11.9</u>	<u>15.0</u>

The significant increase in total cost of services from FY 2004 to FY 2005 in the general support for agriculture is attributed to the \$7.2 million in federal funds transferred to the Hawaiian Sugar and Transportation Cooperative.

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

Financial Analysis of the Department's Funds

The Department's governmental funds reported a combined fund balance of \$51.4 million. In addition, these other changes in fund balances should be noted:

- The Department received \$17.5 million of allotted appropriations and spent \$3.9 million this year on irrigation and drainage system capital projects, increasing the fund balance in that capital projects fund by the same amount. The Department anticipates that these funds will be expended in the near future to complete the projects. Although such capital expenditures reduce available fund balances, they create new assets for the Department as reported in the Statement of Net Assets and as discussed in Note 2 to the financial statements.
- As stated previously, the Department served as a pass-through agency for \$7.2 million in federal funds intended for a agricultural transportation cooperative in Hawaii.
- The Department transferred a total of \$1.7 million in special funds (\$800,000 from the Animal Quarantine Special Fund and \$900,000 from the Agricultural Loan Reserve Fund) as authorized by the 2004 Legislature as a source of revenue to meet anticipated budget shortfalls and balance the State's budget.

Financial Analysis of Significant General Fund Budget Variations

The difference of \$87,590 between the original and final budgeted amounts in State allotted appropriation revenues for FY05 represents the addition of \$339,311 in collective bargaining augmentations and \$293,000 transferred from the Department of Land and Natural Resources from the funds appropriated to the Hawaii Invasive Species Council less \$544,721 in targeted restrictions.

The \$380,958 in excess revenues over expenditure represents \$240,400 transferred to the Irrigation System Revolving Fund pursuant to Section 6 of Act 200, SLH 2003, as amended by Act 41, SLH 2004, and \$140,558 of unrestricted funds transferred to the Hawaii Agricultural Development Revolving Fund pursuant to Section 7 of Act 200, SLH 2003, as amended by Act 41, SLH 2004.

The variance of \$265,802 between the final budgeted amount and the actual amount budgetary basis represents primarily personal savings generated from vacant positions the Department was unable to fill during the year.

General Fund Budgetary Highlights

The State began FY05 with the general condition of Hawaii's economy looking good with steady improvements in all areas. In comparison to a gloomy economic outlook predicted for FY04 by the Council on Revenues in June 2003, a moderate general fund tax revenue growth was projected. Projections of State expenditures, however, still showed significant growth as a result of appropriations made by the 2004 Legislative Session, including funding for collective bargaining requirements. Although the State projected a general fund balance of over \$100 million at the end of FY05 due largely to accumulated surpluses from previous years, it was projected that the surplus balances would disappear by FY06 because general fund expenditures have been greater than general fund revenues and will continue to erode the general fund balance. The Governor therefore imposed further spending reductions in FY05 and in the preparation of the FB 2005-07 budget. In FY05, the Department restricted and lapsed \$544,721 in general funds that were primarily appropriated for research and development projects. The Governor continued to request the Departments to exercise utmost care and prudence in all expenditure and hiring decisions. The hiring policy requiring the Departments to obtain the Governor's prior approval before filling vacancies continued in FY05 and into FY06 and continued to have an impact on the Department's ability to readily fill vacancies.

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

Capital Asset and Debt Administration

Capital Asset

At the end of June 30, 2005, the Department had \$72.6 million invested in a broad range of capital assets, including land, agricultural parks, buildings, equipment and motor vehicles (See Table 4 below.) This amount represents a net decrease (including additions and deductions) of \$5.4 million over last year.

**Table 4
Capital Assets at Year-end
(Net of Depreciation, in Millions)**

	<u>2005</u>	<u>2004</u>
Land	\$ 22.1	22.5
Buildings	20.2	20.2
Land improvements	17.2	17.5
Furniture and equipment	1.1	1.3
Motor vehicles	0.6	0.5
Construction in progress	<u>11.4</u>	<u>16.0</u>
Total	\$ <u>72.6</u>	<u>78.0</u>

The decrease in net capital assets occurred primarily due to an adjustment for an overstatement of fixed assets, primarily in "construction in progress" for the prior fiscal year.

Debt Administration

At the end of the current fiscal year, the Department had total bonded debt outstanding of \$8.3 million backed by the full faith and credit of the State. The changes to the general obligation bond as of June 30, 2004 are as follows:

Balance at July 1, 2004	\$8,335,100
Increase	-
Decrease	78,048
Balance at June 30, 2005	\$8,257,052

The State's total long-term debt decreased by \$0.08 million, or 1%, during the current fiscal year. The key factor in this increase was the repayment of \$0.08 million in general obligation bonds for financing public improvement projects.

Economic Factors and Next Year's Budgets and Rates

The State began FY06 with no general fund spending reductions and in the midst of a strong economy with expectations that the positive outlook for general fund revenues will continue for the near future. FY05 ended with a rare double-digit growth in general fund tax revenues. The economic indicators are strong, investment is robust, and people are optimistic about the future. The State's work force is growing and has one of the fastest growth rates in the nation and unemployment rate has decreased to below 3%, the lowest in the nation. Total personal income grew by 8%, the biggest increase since 1990, and the third largest increase in the nation. The Council of Revenues, however, cautions that the rapid increase was partly due to technical factors such as changes in the tax laws and fluctuations in payment patterns. General fund revenues are still projected to grow at a moderate pace for the duration of the six-year planning period spanning from FY06 through FY11. Although demands for program expansion have been unmet due to many years of budget constraints and the State's revenue picture looks rosy in FY06, the Governor cautioned department's to exercise restraint in spending and follow the Governor's budget objective that the State live within its means

**Department of Agriculture
State of Hawaii
Management Discussion and Analysis**

and plan for recurring and future expenses. The State's financial plan needs to include funds for the following: 1) a tax refund to meet a State Constitutional mandate to provide a tax refund to taxpayers when the general fund balance at the close of two successive fiscal years exceed five percent of general fund revenues; 2) collective bargaining negotiated agreements; and 3) increased costs for non-discretionary items such as court orders, Medicaid/QUEST, and debt service. Therefore in the FY07 Supplemental Budget, departments were instructed to limit requests for additional funding to address only four areas: 1) increases in certain unavoidable fixed costs and entitlements such as debt service, fringe benefits, Medicaid and financial assistance programs; 2) critical, unanticipated emergencies relating to public health and safety, or unforeseen, immediate requirements of court orders or federal mandates; 3) on-going critical programs, functions, or activities which were funded in FY06 but not funded in FY07; and 4) high priority program initiatives of the Governor.

Requests for Information

This financial report is designed to provide users of our report with a general overview of the Department's finances and to show the Department's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Department's Administrative Office at 1428 South King Street, Honolulu, Hawaii.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF NET ASSETS
JUNE 30, 2005**

Governmental Activities

ASSETS

Cash and cash equivalent	\$ 34,886,414
Receivables, net	611,292
Loans receivable, net	18,208,914
Capital assets	
Nondepreciable net assets	34,422,845
Other capital assets, net of depreciation	38,162,059

Total assets	\$ 126,291,524
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LIABILITIES

Accounts payable and accrued liabilities	\$ 1,345,162
Due to state general fund	5,539
Due to agency fund	3,832
Deferred revenues	305,685
Accrued vacation:	
Due within one year	1,127,229
Due in more than one year	1,986,650
Bond payable	
Due within one year	181,355
Due in more than one year	8,075,697

Total liabilities	13,031,149
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NET ASSETS (DEFICIT)

Investment in capital assets	72,584,904
Restricted for:	
Capital projects	16,103,326
Agricultural loan program	28,338,138
Other purpose	5,811,493
Unrestricted	(9,577,486)

Total net assets	113,260,375
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Total liabilities and net assets	\$ 126,291,524
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The accompanying notes are an integral part of these combined financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005**

		Charges For Services	Program Revenues Operating Grants and Contributions	Capital Grants and Contributions	Net Revenue (Expense) and Changes in Net Assets Governmental Activities
Functions/Programs	Expenses				
Departmental Activities:					
Productivity improvement and management assistance	\$ 11,111,339	2,683,296	1,048,327	-	\$ (7,379,716)
Product development and marketing	3,770,311	497,183	118,016	-	(3,155,112)
General support for agriculture	12,634,783	3,098,839	7,382,295	-	(2,153,649)
Agricultural water development and irrigation services	4,050,202	919,521	32,944	5,982,997	2,885,260
Pollution control	1,603,669	632,350	170,060	-	(801,259)
Protection of the consumer	868,424	-	-	-	(868,424)
Aquaculture development	594,573	-	30,391	-	(564,182)
Agricultural loans	1,222,781	1,028,760	324,694	-	130,673
Total departmental activities	\$ 35,856,082	8,859,949	9,106,727	5,982,997	(11,906,409) (a)
General Revenues					
					12,718,453
State allotted appropriations					3,233,304
Non-imposed employee fringe benefit					-
Intergovernmental revenues					(1,375,625)
Transfers					14,576,132 (a)
Total general revenues and special items					
Other Revenue (Loss)					
					(12,850) (a)
Loss on disposal of fixed assets					
Change in Net Assets [sum of (a)]					2,656,873
Net assets, June 30, 2004, as originally reported					115,703,879
Prior year adjustments					(5,100,377)
Net assets, June 30, 2004, as restated					110,603,502
Net Assets, June 30, 2005					\$ 113,260,375

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

DEPARTMENT OF AGRICULTURE, STATE OF HAWAII
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2005

	General Fund	Irrigation & Drainage System Capital Projects	Financial Assistance for Agriculture	Plant Pest & Disease Control	Agribusiness Development & Research	General Adminstration for Agriculture	Other Governmental Funds	Total Governmental Funds
ASSETS								
Cash	\$ 1,871,132	16,351,353	10,310,549	176,417	322,223	-	5,854,740	\$ 34,886,414
Loan Receivable	-	-	18,208,914	-	-	-	-	18,208,914
Total assets	\$ 1,871,132	16,351,353	28,519,463	176,417	322,223	-	5,854,740	53,095,328
LIABILITIES AND FUND BALANCES								
Liabilities:								
Vouchers Payable	\$ 194,643	248,028	4,104	29,856	1,215	-	130,997	\$ 608,843
Accrued Payroll	473,050	-	26,082	8,107	-	-	229,080	736,319
Due to State General Fund	5,539	-	-	-	-	-	-	5,539
Due to Agency Fund	-	-	3,832	-	-	-	-	3,832
Deferred Revenues	-	-	-	138,454	-	-	167,231	305,685
Total liabilities	673,232	248,028	34,018	176,417	1,215	-	527,308	1,660,218
Fund Balances(Deficit):								
Reserved for:								
Encumbrances	1,573,375	6,913,641	165,687	14,605	21,306	-	1,006,645	9,695,259
Continuing appropriation	-	9,189,684	11,602,958	(14,605)	299,702	-	4,320,787	25,398,526
Noncurrent assets	-	-	16,716,800	-	-	-	-	16,716,800
Unreserved	(375,475)	-	-	-	-	-	-	(375,475)
Total fund balances	1,197,900	16,103,325	28,485,445	-	321,008	-	5,327,432	51,435,110 (a)
Total liabilities and fund balances	\$ 1,871,132	16,351,353	28,519,463	176,417	322,223	-	5,854,740	\$ 53,095,328
Total governmental fund balances, above (a)								\$ 51,435,110
Capital assets used in governmental activities are not financial resources and therefore not reported in governmental funds								72,584,904
Receivables in the statement of activities that do not provide current financial resources are not reported in governmental funds								611,292
Some liabilities, such as compensated absences, are not due and payable in the current period and therefore not reported in governmental funds								(3,113,879)
Long term liabilities, such as bond payable, are not due and payable in the current period and therefore are not reported in governmental funds								(8,257,052)
Net assets of governmental activities								\$ 113,260,375

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

DEPARTMENT OF AGRICULTURE, STATE OF HAWAII
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2005

	General Fund	Irrigation & Drainage System Capital Projects	Financial Assistance for Agriculture	Plant Pest & Disease Control	Agribusiness Development & Research	General Administration for Agriculture	Other Governmental Funds	Total Governmental Funds
REVENUES								
Allotted appropriation	\$ 13,139,857	4,350,000	-	-	-	-	-	\$ 17,489,857
Intergovernmental revenues	-	1,641,810	-	828,700	-	7,334,870	489,106	10,294,486
Non-imposed employee fringe benefit	3,233,304	-	-	-	-	-	-	3,233,304
Interest on agricultural loans	-	-	991,240	-	-	-	-	991,240
Charges for services	-	-	37,520	-	2,092,486	-	5,939,678	8,069,684
Investment earnings	-	-	227,566	-	-	-	129,357	356,923
Total Revenues	16,373,161	5,991,810	1,256,326	828,700	2,092,486	7,334,870	6,558,141	40,435,494
EXPENDITURES								
Current:								
Productivity improvement and management assistance	7,215,386	-	-	828,700	-	-	2,957,847	11,001,933
Product development and marketing	3,340,171	-	-	-	-	-	507,904	3,848,075
General support for agriculture	2,207,153	-	-	-	1,771,478	7,334,870	1,269,453	12,582,954
Agricultural water development and irrigation services	171,653	-	-	-	-	-	1,247,643	1,419,296
Pollution control	910,727	-	-	-	-	-	687,958	1,598,685
Protection of the consumer	754,674	-	-	-	-	-	-	754,674
Aquaculture development	564,753	-	-	-	-	-	29,524	594,277
Agricultural loan administration	-	-	849,741	-	-	-	-	849,741
Capital outlay	-	3,917,556	-	-	-	-	-	3,917,556
Total Expenditures	15,164,517	3,917,556	849,741	828,700	1,771,478	7,334,870	6,700,329	36,567,191
Excess of revenue over(under) expenditure	1,208,644	2,074,254	406,585	-	321,008	-	(142,188)	3,868,303
Other financing sources:								
Lapsed appropriations	(421,404)	(8,812)	-	-	-	-	-	(430,216)
Operating transfers in	-	-	-	-	-	-	1,030,958	1,030,958
Operating transfers out	(380,958)	-	(900,000)	-	-	-	(800,000)	(2,080,958)
Sale of capital assets	-	-	97,128	-	-	-	-	97,128
	(802,362)	(8,812)	(802,872)	-	-	-	230,958	(1,383,088)
Excess of revenues and other sources over(under) expenditures and other uses	406,282	2,065,442	(396,287)	-	321,008	-	88,770	2,485,215
Fund Balances - Beginning	791,618	14,037,883	28,881,732	-	-	-	5,238,662	48,949,895
Fund Balances - Ending	\$ 1,197,900	16,103,325	28,485,445	-	321,008	-	5,327,432	51,435,110

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGE
IN FUND BALANCE - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2005**

Net change in fund balances - total governmental funds	\$ 2,485,215
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	(304,149)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	(200,975)
Some expenses reported in the statement of activities, such as compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	598,734
Long term liabilities, such as bond payable, are not due and payable in the current period and therefore are not reported in the governmental funds.	78,048
Change in net assets of governmental activities	\$ 2,656,873

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2005**

	Private- Purpose Trusts	Agency
ASSETS		
Cash and cash equivalents	\$ 39,441	\$ 45,756
Loans receivable, net	-	24,722
Due from special funds	-	3,832
Total Assets	\$ 39,441	\$ 74,310
LIABILITIES		
Vouchers payable	\$ 1,966	\$ 7,140
Accrued payroll	40,239	-
Due to others	-	25,630
Due to state general fund	-	41,540
Total Liabilities	42,205	74,310
NET ASSETS (Deficit)	(2,764)	-
	\$ 39,441	\$ 74,310

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2005**

	Private- Purpose Trust
REVENUES	
Other revenues	\$ 476,972
EXPENDITURES	
Expendable trust funds	504,430
Excess of revenues over(under) expenditures	(27,458)
Net assets (deficit) at July 1, 2004	24,694
Net assets (deficit) at June 30, 2005	\$ (2,764)

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(1) NATURE OF ORGANIZATION

The Department of Agriculture is a department of the State of Hawaii. The mission of the department is to stimulate growth in agriculture with programs that provide the foundation for agricultural enterprises to build successful businesses. The department administers and oversees programs that include plant quarantine, control of plant diseases and pests, livestock disease control, animal quarantine, agricultural park, aquaculture development, irrigation system, inspection and grading of commodities, monitoring the production and processing of milk, measurement standards, collection and dissemination of agricultural statistics and import and export statistics, granting agricultural loans, and market development and promotion of Hawaiian grown products.

The Board of Agriculture is responsible for the direction of the department's activities. The ten-member board is appointed by the governor, with the consent of the state senate, to serve a term of four years, with possible reappointed to an additional term.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity

The financial statements reflect only the activities of the department. The department 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 department are such that exclusion would cause the department's financial statements to be misleading or incomplete. The Government Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. The department has included in its financial statements the activities of the Agribusiness Development Corporation, a separate public instrumentality affiliated with the department for administrative purposes.

Basis of presentation

The accounting policies of the department utilized in the accompanying financial statements for the year ended June 30, 2005 conform to generally accepted accounting principles (GAAP) in the United States of America as prescribed by GASB. In June 1999, GASB issued Statement 34 - Basic Financial Statements - and Management's Discussions and Analysis - for State and Local Governments. The implementation of this statement created new major reporting requirements for state and local governments throughout the United States of America.

In conjunction with GASB Statement 34, other GASB statements are required to also be implemented. These include: Statement 33 - Accounting and Financial Reporting for Nonexchange Transactions, Statement 37 - Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus and Statement 38 - Certain Financial Statement Note Disclosures.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Government-wide financial statements

The statement of net assets and the statement of activities display information about the reporting entity (department or government as a whole). They include all funds of the reporting entity except for fiduciary funds.

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 function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are reported in three categories: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. 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 department's policy to use restricted resources first, then unrestricted resources as they are needed.

Fund financial statements

Fund financial statements of the department are organized on the basis of funds, each of which is considered to be a separate accounting entity. The department used fund accounting to report on its financial position and results of operations. 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 operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column.

Governmental fund types

Governmental fund types are those through which the acquisition, use and balances of the department's expendable available financial resources and the related liabilities are accounted for. The measurement focus is upon the availability and use of resources and of changes in financial position rather than upon net income determination. The following are the department's major governmental fund types:

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

General fund

The general fund is the general operating fund of the department. It is used to account for all financial activities except those required to be accounted for in another fund. The general fund presented is a part of the state's general fund and is limited only to those appropriations and obligations of the department.

Special revenue fund

Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trust funds and major capital projects) that are legally restricted to expenditure for specified purposes.

Capital projects fund

Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary funds

Trust and agency funds - Trust and agency funds are used to account for assets held by the department in a trustee or agency capacity. These include expendable trust funds that account for cash collected and expended by the department as trustee and agency funds that account for the cash collected and expended by the department in a custodial capacity.

Major funds

The following are the activities of the major funds accounted for in the fund financial statements:

- General fund
- Special revenue funds
- Financial assistance for agriculture - Accounts for revenues and expenditures of providing agricultural loans in the State of Hawaii.
- Plant pest and disease control - Accounts for revenues and expenditures of controlling plant pest and disease in the State of Hawaii.
- Agribusiness development and research - Accounts for revenues and expenditures of developing agricultural business and conducting agricultural research.
- Capital projects funds
- Irrigation and drainage systems - Accounts for resources restricted for the acquisition or construction or irrigation and drainage systems.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The governmental-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. With this measurement focus, all assets and liabilities associated with the operation of these activities are included on the statement of net assets. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when the related liability is incurred, regardless of the timing of the related cash flows. Grant and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The fund financial statements, which include governmental funds, expendable trust funds, and agency funds, are accounted and reported using the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and liabilities are generally included on the balance sheet. The revenues and expenditures represent increases and decreases in net current assets. Under 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. Expenditures are generally recognized when the related liability is incurred, except for vested but unpaid employee vacation and workers compensation benefits, which are recognized as expenditures when payable from expendable available resources.

In applying the susceptible to accrual concept to federal grant revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. Under most of the department's federal programs, moneys must be expended for a specific purpose or project; therefore, revenue is recognized to the extent that expenditures are recognized.

Appropriations

Appropriations are authorizations granted by the legislature of the State of Hawaii permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended or encumbered at the end of the fiscal year, except for allotted appropriations related to capital improvement projects.

Encumbrances

Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of resources are recorded to reserve that portion of the applicable appropriation. Encumbrances outstanding at fiscal year end are reported as reservations of fund balance since they do not constitute expenditures or liabilities.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fund balances

Reserved amounts in fund balances represent amounts that are not appropriable for expenditure or legally segregated for a specific future use. Portions of the fund balances are reserved for the following:

- Encumbrances for outstanding commitments that are generally liquidated in the subsequent fiscal year.
- Loan receivables, which are not currently available for expenditure at the balance sheet date.
- Expendable trust fund balances, which are restricted to the purpose of the account.
- Continuing appropriations for unencumbered allotment balances representing amounts that have been released and made available for encumbrance or expenditures, and are legally segregated for a specific use.

Cash and cash equivalents

Cash and cash equivalents include cash in the state treasury and cash in a Hawaii-based bank. The department's cash is held by the state treasury and pooled with funds from other state agencies and departments and deposited in approved financial institutions by the Director of Finance. At June 30, 2005, information related to the insurance and collateral of funds deposited into the state treasury was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits into the state treasury are either federally insured or collateralized with obligations of the state or United States government. 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 Hawaii Revised Statutes (HRS) authorizes the Director of Finance to invest any moneys of the state, which in the Director's judgment, are in excess of the amount necessary for meeting the immediate requirements of the state.

Accounts Receivables

Receivables in the Special Revenue Funds consist primarily of amounts due from individuals for services provided to those individuals for a fee. The amounts reported as net receivables were established based on management's estimate of accounts collectible.

Loan Receivables

The department grants credit in the form of loans to farmers, all located in the State of Hawaii. Loans are collateralized by real estate, equipment, crops and other assets of borrowers. Payments

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

received are first applied against interest balances. Management discontinues accruing interest on loans after the loans are 90 days delinquent as to principal or interest. The unsecured portion of a loan and its interest is reserved as an allowance if payment for the loan is 90 days delinquent.

Capital assets

Capital assets (primarily land, buildings, improvements, furniture and equipment) are reported in the government-wide financial statements. Capital assets are defined by the department as those assets with estimated useful lives greater than one year and with an acquisition cost greater than:

Land - all capitalized	
Infrastructure	\$100,000
Buildings	100,000
Land improvements	100,000
Furniture and equipment	5,000
Vehicles	5,000

Purchased and constructed capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements.

Depreciation is recorded in the government-wide statement of activities. Depreciation is computed using the straight-line method over the following estimated useful lives:

Buildings	30 years
Land improvements	15 years
Furniture and equipment	7 years
Vehicles	5 years

The department began to report and depreciate new infrastructure assets effective for the year ended June 30, 2002. Infrastructure assets include irrigation and drainage systems, etc. Prior to fiscal year ended June 30, 2002, neither their historical costs nor related depreciation has historically been reported in the financial statements.

The department has elected to utilize the infrastructure transition option in the implementation of GASB Statement No. 34, Basis Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, in fiscal year ending June 30, 2003 and began to implement the retroactive infrastructure provisions beginning that fiscal year.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Compensated Absence

It is the Department's policy to permit employees to accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since sick leave is not convertible to pay upon termination of employment. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the Governmental Funds only if they have matured, for example, as a result of employee resignations and retirements.

Long-Term Obligations

In the government-wide financial statements, long-term debt is reported as liabilities in the applicable governmental activities. Initial-issue bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective-interest method. The difference between the reacquisition price of refunding bonds and the net carrying amount of refunded debt (deferred amount on refunding) is amortized over the shorter of the life of the refunding debt or the remaining life of the refunded debt. Bonds payable are reported net of the unamortized portion of applicable premium, discount, or deferred amount on refunding. Bond issuance costs, including underwriters' discount, are reported as deferred bond issuance costs. Amortization of bond premiums or discounts, issuance costs, and deferred amounts on refunding is included in interest expense.

In the fund financial statements, Governmental Funds recognize bond premiums, discounts, and issuance costs during the period issued. The face amount of debt issued is reported as other financing sources. Premiums received are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Inter-fund Receivables/Payables

Reimbursements for expenditures paid by general fund on behalf of special revenue fund are classified as "due from other funds" and "due to other funds" on the governmental fund balance sheet.

Due to State of Hawaii

This account consists of reimbursements for expenditures paid by the State of Hawaii general fund on behalf of the special revenue funds.

Intra-fund and Inter-fund 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 financial statements.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Grant and Deferred Revenue

Grants are recorded as intergovernmental receivables and revenues when the related expenditures are incurred. Grant funds received in advance prior to the incurrence of expenditures are recorded as deferred revenue.

Risk Management

The Department is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

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 accompanying basic financial statements.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(3) BUDGETING AND BUDGETARY CONTROL

The budget of the department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues in the budgetary comparison statements are those estimates as compiled by the department. Budgeted

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(3) BUDGETING AND BUDGETARY CONTROL (continued)

expenditures are derived primarily from a biennial general appropriations act as amended by any supplemental or other specific appropriations acts. The department follows these procedures in establishing the budgetary data reflected in the financial statements:

The Budget - Not less than 30 days before the State Legislature convenes in every odd-numbered year, the governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendations of the governor for each succeeding biennium. The budget in general contains: the state program structure, statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of state receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress, and an estimate for the succeeding biennium.

Legislative Review - The State Legislature considers the governor's proposed program and financial plan and budget, evaluates alternatives to the governor's recommendation, adopts programs and determines the state budget. It may, from time to time, request the department of Budget and Finance and any agency to conduct such analyses of programs and finances in determining the state's programs and financial plan and budget.

Program Execution - Except as limited by policy decisions of the governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the state Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

A comparison of budgeted and actual (budgetary basis) revenues and expenditures of the general and major special revenue funds are presented in the budgetary comparison statement - general fund and special revenue funds. The final legally-adopted budget in the budgetary comparison statements represents the original appropriations, transfers, and other legally authorized legislative and executive changes.

The legal level of budgetary control is maintained at the appropriation line-item level by department, program, and source of funds as established in the appropriations acts. The Legislature has authorized the governor to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the department.

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 dates and any other contingencies that may terminate the authorizations for other appropriations.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(3) BUDGETING AND BUDGETARY CONTROL (continued)

Differences between revenues and expenditures reported on the budgetary basis and those reported in accordance with GAAP are mainly due to the different methods used to recognize resource uses. For budgeting purposes, revenues are recognized when cash is received and expenditures are recognized when cash disbursements are made or funds are encumbered. In the accompanying financial statements presented in accordance with GAAP, revenues are recognized when they become available and measurable and expenditures are recognized as incurred. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2005, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the notes to the Required Supplementary Information.

Funds for the department appropriated from the state's general revenues for the fiscal year ended June 30, 2005 were authorized under the following appropriations:

Act 200, Act 53, Act 24, and Act 149, Session Laws of Hawaii (SLH) of 2004 for the operating budget of the department:

Productivity improvement and management assistance	\$ 5,810,965
Product development and marketing	3,186,880
General support for agriculture	1,758,247
Agricultural water development and irrigation services	494,038
Pollution control	742,914
Protection of the consumer	653,658
Aquaculture development	493,155
<hr/>	
Budget total	\$13,139,857

(4) CASH AND CASH EQUIVALENTS

At June 30, 2005, the carrying amount of the department's cash and cash equivalents was \$34,886,414, which approximates the bank balance

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(5) LOANS RECEIVABLE

At June 30, 2005, loans receivable consisted of the following:

	Special Revenue	Agency
Hawaii Agriculture Loan Program	\$18,563,585	-
Hawaii Aquaculture Loan Program	997,621	-
Hawaii Agricultural Products Loan Program	76,214	
Independent Sugar Growers Loan Program	-	642
Emergency Loan Program	-	24,080
Accrued interest	581,180	-
	<hr/> 20,218,600	<hr/> -
Less allowance for doubtful receivables	2,009,686	-
	<hr/> \$18,208,914	<hr/> 24,722

Approximately \$3,595,000 of the total \$19,637,000 loan principal and \$523,000 of \$581,000 loan interest were over 90 days old.

(6) ACCOUNTS RECEIVABLE

At June 30, 2005, accounts receivable consisted of the following:

Waiahole Water System	\$ 63,754
Lease Rental of Public Land	147,936
Sale of Water	364,971
Quarantine Fee	848,865
	<hr/> 1,425,526
Less allowance for doubtful receivables	814,234
	<hr/> \$ 611,292

Approximately \$1,079,000 of the \$1,425,526 total receivable balance was over 90 days old.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(7) CAPITAL ASSETS

The changes to capital assets as of June 30, 2005 are as follows:

	Beginning Balance at July 1, 2004	Adjustments	Beginning Balance as Restated	Additions	Disposals and Transfers Out	Ending Balance June 30,2005
<i>Capital Assets Being Depreciated</i>						
Land improvements	\$ 49,098,283	1,046,492	50,144,775	1,125,310		51,270,085
Buildings	28,944,764	310,537	29,255,301	-	(771,639)	28,483,662
Vehicles	2,621,629	156,820	2,778,449	267,063	(116,251)	2,929,261
Furniture and Equipment	5,294,965	(868,525)	4,426,440	87,084	(338,552)	4,174,972
	85,959,641	645,324	86,604,965	1,479,457	(1,226,442)	86,857,980
Less accumulated depreciation						
Land improvements	33,820,071	(1,374,346)	32,445,725	2,582,774	-	35,028,499
Land improvements - not depreciable	409,083	(409,083)	-			-
Buildings	7,549,149	284,453	7,833,602	926,043	(450,122)	8,309,523
Vehicles	2,163,199	54,148	2,217,347	219,393	(116,251)	2,320,489
Furniture and Equipment	3,473,416	(273,580)	3,199,836	172,018	(334,444)	3,037,410
	47,414,918	(1,718,408)	45,696,510	3,900,228	(900,817)	48,695,921
Subtotal	38,544,723	2,363,732	40,908,455	(2,420,771)	(325,625)	38,162,059
<i>Capital Assets Not Being Depreciated</i>						
Land	22,497,464	1,478	22,498,942	-	(350,000)	22,148,942
Land improvements - not depreciable	911,262		911,262			911,262
Construction in progress	16,035,981	(7,465,586)	8,570,395	3,917,556	(1,125,310)	11,362,641
Subtotal	39,444,707	(7,464,108)	31,980,599	3,917,556	(1,475,310)	34,422,845
Total capital assets	\$ 77,989,430	(5,100,376)	72,889,054	1,496,785	(1,800,935)	72,584,904

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(7) CAPITAL ASSETS (continued)

Depreciation expense for the year ended June 30, 2005 was charged to governmental activities as follows:

Productivity improvement and management assistance	\$ 674,349
Product development and marketing	135,938
General support for agriculture	218,479
Agricultural water development and irrigation services	2,629,463
Pollution control	28,229
Protection of the consumer	165,833
Aquaculture development	12,520
Agricultural loans	35,416
	\$ 3,900,227

The department adopted a new capitalization policy effective July 01, 2001. Furniture and equipment purchases are capitalized when greater than \$5,000 and buildings and land improvements are capitalized when greater than \$100,000.

(8) GENERAL OBLIGATION BOND

Pursuant to Act 111, SLH 1998, reimbursable general obligation bonds of \$8,500,000 were issued in 2001 and \$91,988 in other years to fund the acquisition of the Waiahole Water System. Section 14, Part IV of ACT 111, SLH 1998, requires the Agribusiness Development Corporation (ADC) to reimburse the general fund in accordance with a schedule determined by the Director of Finance, with the approval of the governor. The term of the bonds is 34 years with an interest rate of 3.00%. The principal repayment is due annually and the accrued interest is due semi-annually. The interest expense for the year ended June 30, 2005 approximated to \$250,000.

The changes to the general obligation bond as of June 30, 2004 are as follows:

Balance at July 1, 2004	\$8,335,100
Increase	-
Decrease	78,048
	\$8,257,052

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(8) GENERAL OBLIGATION BOND (continued)

Future bond principal repayment and interest payment for fiscal year ending after June 30, 2005 are as follows:

	Principal	Interest
2006	\$ 181,355	\$ 249,925
2007	188,874	244,594
2008	194,742	238,719
2009	200,794	232,626
2010	208,184	226,310
Thereafter	7,283,103	3,087,693
	\$8,257,052	\$4,279,867

(9) NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs of the department's employees funded by general fund appropriations are assumed by the state and are not charged to the department's operating funds. These costs, totaling \$3,233,304, have been reported as revenues and expenditures in the department's financial statements for the fiscal year ended June 30, 2005.

Payroll fringe benefit costs related to federally funded salaries are not assumed by the state and are recorded as expenditures in the department's financial statements.

(10) LEASES

The department, as lessor, has non-cancelable lease agreements for parcels of land at agricultural parks located throughout the State of Hawaii. The lease agreements have minimum and, where applicable, additional rent based on a percentage of revenues and terms of up to 55 years.

Minimum future lease revenue for fiscal year ending after June 30, 2005 approximates as follows:

2006	\$ 430,200
2007	409,300
2008	408,000
2009	407,000
2010	407,000
Thereafter	10,182,000
	\$12,243,500

Rental income from leases at the agricultural parks for the fiscal year ended June 30, 2005 approximated \$395,000, including \$43,000 for additional rent based on percentage of revenues.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(11) FUND BALANCE DEFICITS

The general fund had a deficit in the unreserved fund balance at June 30, 2005, of 375,475. The deficit resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when the funds are measurable and available.

(12) VACATION

The changes to the compensated absences as of June 30, 2005 approximated the following:

Balance at July 1, 2004	\$3,712,600
Increase	-
Decrease	598,700
Balance at June 30, 2005	\$3,113,900

Compensated absences liabilities will be liquidated primarily by the general fund. In the past, approximately 80% has been paid by the general fund and the remainder by various other governmental funds.

(13) RETIREMENT BENEFITS

Retirement Plan Description

Substantially all eligible employees of the Department are required by Chapter 88 to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions.

All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(13) RETIREMENT BENEFITS (continued)

Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

Funding Policy

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 27 years from June 30, 2002.

The State's contribution requirements as of June 30, 2005, 2004, and 2003 were approximately \$251,685,000, \$181,614,000, and \$158,622,000, respectively. The State contributed 100% of its required contributions for those years. Changes in salary growth assumptions and investment earnings pursuant to Act 100, SLH of 1999, decreased the June 30, 2001 and 2000 required contributions. Act 233, SLH of 2002, increased the 2003 contribution by providing a one-time lump-sum pensioner bonus to retirees who were 70 years and older with at least 20 years of credited service as of June 30, 2002. Also Act 284, SLH of 2001, provided an increase in the pension benefits effective 2003 to retirees with military service. Covered payroll for the fiscal year ended June 30, 2005 was approximately \$ 2,079,054,000.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(13) RETIREMENT BENEFITS (continued)

There are currently approximately 25,000 state retirees receiving such benefits. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis. During fiscal 2005, expenditures of \$177,691,000 were recognized for post-retirement health care and life insurance benefits, approximately \$35,876,000 of which is attributable to the component units.

Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

(14) COMMITMENTS AND CONTINGENCIES

A. Commitments

General Obligation Bonds

The Department has issued general obligation bonds in which repayments, including interest, are reimbursed from specific revenue sources of the Waihole Water System Revolving Fund with terms corresponding to that of the related general obligation bonds (see note 8). At June 30, 2005, outstanding commitments to repay general obligation bonds approximated \$8,257,000.

Accumulated Sick Leave

Sick leave accumulates at the rate of one and three-quarters working days for each month service without limit. It can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a state employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employee's Retirement System. Accumulated sick leave at June 30, 2005 approximated \$11,494,100.

B. Contingencies

The Department has been named as defendant in a few lawsuits and claims arising in the normal course of operations. These claims may possibly result in adverse judgments against the Department. However, such claims amounts cannot be reasonably estimated at this time.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(15) Risk Management

The Department 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 retains the first \$25,000 per occurrence of property losses and the first \$4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$100 million for named hurricane, \$25 million for earthquake, and flood, \$50 million for terrorism, and the annual aggregate for general liability loss per occurrence is \$10 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$30 million per occurrence with no annual aggregate limit.

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses are administered by third-party administrators. The State administers its workers' compensation losses. A liability for workers' compensation and general liability claims is established if information indicates that a loss has been incurred as of June 30, 2005 and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported.

(16) TRANSFERS

For the year ended June 30, 2005, transfers by fund were as follows:

<u>Transfer From:</u>	<u>Transfer To:</u>	<u>Amount</u>
General fund	Irrigation System Revolving Fund	\$ 240,400
General fund	Hawaii Agriculture Development Revolving Fund	140,558
		<hr/> 380,958
 <u>Transfer From:</u>	 <u>Transfer To:</u>	
Agricultural Loan Revolving Fund	State general fund	900,000
Animal Quarantine Revolving Fund	State general fund	800,000
		<hr/> \$1,700,000

The general fund transferred \$240,400 to the Irrigation System Revolving Fund pursuant to Section 6 of Act 200, SLH 2003, as amended by Act 41, SLH 2004, and \$140,558 to the Hawaii Agricultural Development Revolving Fund pursuant to Section 7 of Act 200, SLH 2003, as amended by Act 41, SLH 2004; the remaining \$ 50,000 was restricted and lapsed. The Department of Land and Natural Resources transferred \$650,000 to the Hawaii Invasive Species Council Fund and the fixed assets transferred out approximated \$325,600.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2005

(17) PRIOR PERIOD ADJUSTMENTS

Adjustments were recorded to net assets in the government-wide financial statements as of June 30, 2004 to recognize the transfer of construction in progress to capital assets and resulting changes to depreciation. The following are the adjustments:

Cost of capital assets	\$(6,818,785)
Add accumulated depreciation	1,718,408
Net adjustment for capital assets	\$(5,100,377)

As a result of the restatement, the department's operating expenses presented in the statement of activities for the year ended June 30, 2004 increased by the net adjustment of \$5,100,377, increasing net decrease in net assets from \$1,346,143 to \$6,446,520.

Required Supplementary Information

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
(Budget and actual) - General Fund
For the Year Ended June 30, 2005

	Budgeted Amount		Actual Amount Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Budgetary fund balance at June 30, 2004	\$ -	\$ -	\$ -	\$ -
<i>Revenues</i>				
State allotted appropriation	13,052,267	13,139,857	13,139,857	-
Intergovernmental	-	-	-	-
Total Revenues	13,052,267	13,139,857	13,139,857	-
<i>Expenditures</i>				
Productivity improvement and management assistance	5,409,096	5,810,965	5,796,892	14,073
Product development and marketing	3,179,147	3,186,880	3,064,954	121,926
General support for agriculture	2,095,551	1,617,689	1,584,818	32,871
Agricultural water development and irrigation services	121,251	253,638	251,037	2,601
Pollution control	732,008	742,914	703,829	39,085
Protection of the consumer	643,260	653,658	622,501	31,157
Aquaculture development	490,996	493,155	469,066	24,089
Total Expenditures	12,671,309	12,758,899	12,493,097	265,802
Excess of revenue over(under) expenditure	380,958	380,958	646,760	265,802
<i>Other financing sources:</i>				
Operating transfers in				
Operating transfers out	(380,958)	(380,958)	(380,958)	-
Excess of revenues and other sources over(under) expenditures and other uses	-	-	265,802	265,802
Lapsed appropriations	-	-	(265,802)	(265,802)
Budgetary fund balance at June 30, 2005	\$ -	\$ -	\$ -	\$ -

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Budgetary Comparison Schedule
Special Revenue Funds
For the Year Ended June 30, 2005

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Financial Assistance for Agriculture				
<i>Revenues</i>				
Current-year appropriations	\$ 6,025,173	\$ 6,025,173	\$ 1,353,453	\$ (4,671,720)
<i>Expenditures</i>				
Agricultural Loans	6,025,173	6,025,173	905,649	5,119,524
Excess of revenues and other sources over (under) expenditures	-	-	447,804	447,804
<i>Other financing sources</i>				
Operating transfers in (out)	(900,000)	(900,000)	(900,000)	-
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ (900,000)	\$ (900,000)	\$ (452,196)	\$ 447,804
Plant and Pest Disease Control				
<i>Revenues</i>				
Current-year appropriations	\$ 265,349	\$ 324,581	\$ 218,976	\$ (105,605)
Current-year funds	1,942,251	1,934,851	414,647	(1,520,204)
<i>Expenditures</i>				
Productivity improvement and management	2,207,600	\$ 2,259,432	838,984	1,420,448
Excess of revenues and other sources over (under) expenditures and other uses	\$ -	\$ -	\$ (205,361)	\$ (205,361)
Agribusiness Development and Research				
<i>Revenues</i>				
Current-year funds	\$ 2,119,778	\$ 2,119,778	\$ 1,880,917	\$ (238,861)
<i>Expenditures</i>				
General support for agriculture	\$ 2,119,778	\$ 2,119,778	1,793,324	326,454
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ -	\$ -	\$ 87,593	\$ 87,593
General Administration for Agriculture				
<i>Revenues</i>				
Current-year funds	\$ 7,366,306	\$ 7,366,306	\$ 7,201,038	\$ (165,268)
<i>Expenditures</i>				
General support for agriculture	\$ 7,366,306	\$ 7,366,306	7,341,585	24,721
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ -	\$ -	\$ (140,547)	\$ (140,547)

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Budgetary Comparison Schedule
Budget to GAAP Reconciliation
For the Year Ended June 30, 2005

	General Fund	Financial Assistance for Agriculture	Plant Pest and Disease Control	Agribusiness Development and Research	General Administration for Agriculture
Excess of revenues and other sources over (under) expenditures and other uses - actual on budgetary basis	\$ 265,802	\$ (452,196)	\$ (205,361)	\$ 87,593	\$ (140,547)
Reserved for encumbrances at fiscal year-end	1,573,375	165,687	-	-	-
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	165,736	4,082	205,361	233,415	140,547
Lapsed appropriations	(421,404)	-	-	-	-
Expenditures for prior fiscal years' encumbrances	(1,177,227)	(113,860)	-	-	-
Excess of revenues and other sources over (under) expenditures and other uses - GAAP basis	\$ 406,282	\$ (396,287)	\$ -	\$ 321,008	\$ -

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

Compliance Audit

**Department of Agriculture
State of Hawaii
Schedule of Expenditures of Federal Awards
For Year Ended June 30, 2005**

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Grant Number	Expenditures
Department of Agriculture (USDA)			
Cooperative National Plant Pest Survey and Detection	10.025	04-8510-0586-CA	\$ 90,006
Red Imported Fire Ant Survey		03-8510-0666-CA	547
Homeland Security for Pest Detection Activity		02-8510-0586-CA	1,487
Survey and Detection of the Red Imported Fire Ant in Hawaii		04-8510-0666-CA	6,280
Detection Surveys for Papaya Mealybug in Hawaii		04-8510-0794-CA	9,192
Survey for Giant Salvinia and Fireweed in Hawaii		04-8510-0793-CA	20,195
Survey for Glassy-Winged Sharpshooter in Hawaii		04-8510-0874-CA	19,807
Seed Inspection Services		45-9417-6-9990	1,077
Homeland Security for Animal Disease Emergency Response		02-9715-0321-CA	6,899
Voluntary Scrapie Flock Certification		04-9715-1252-CA	8,624
Voluntary Johne's Disease Herd Status Program		04-9715-1215-CA	54,814
Foreign Animal Disease Surveillance, Bovine Spongiform Encephalopathy Surveillance, Animal Emergency Management		04-9715-1315-CA	70,236
Swine Health Protection		04-9715-1214-CA	63,115
HI Brown Tree Snake Detector Program		04-73-15-5388-GR	470,146
			<u>822,425</u>
Shell Egg Surveillance	10.162	12-25-A-3310	11,753
Meat Grading and Certification Service		12-25-A-3850	487
			<u>12,240</u>
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	10.156	12-25-G-0303	<u>17,524</u>
Cooperative Pesticide Recordkeeping	10.163	12-25-A-4407	6,082
National Organic Certification Service		12-25-A-4460	5,303
			<u>11,385</u>
Economic Assessment of Select HI Agricultural Exports		12-25-G-0383	<u>22,662</u>
Disease Management in Pacific Aquaculture	10.950	2002-38500-13092	<u>29,478</u>
Commodity Credit Corporation (USDA) - See note B	N/A	Public Law 108-324	<u>7,200,000</u>
Promote Specialty Crops	N/A	Public Law 107-27	<u>141,585</u>
Exploration for Biological Control of Melon Fly in Indo-Malayan Region	10.001	58-5320-1-530	<u>2,978</u>
Exploration for and Host Range Delineation of Potential Biological Control	10.664	58-3148-2-096	<u>1,022</u>
A Risk Management Education Program for Entrepreneurs in Hawaii	10.450	O3IEO8310110	<u>49,938</u>

**Department of Agriculture
State of Hawaii
Schedule of Expenditures of Federal Awards
For Year Ended June 30, 2005**

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Expenditures</u>
Upcountry Maui Watershed	10.904	68-9251-1-524	19,109
		68-9251-2-603	250,349
		65-9251-3-615	156,160
		65-9251-3-643	689,230
			<u>1,114,848</u>
Lower Hamakua Watershed, Hawaii	10.904	65-9251-1-514	18,359
		69-9251-1-562	57,165
		69-9251-1-563	32,976
		69-9251-1-584	7,588
		69-9251-2-602	135,131
		65-9251-3-617	1,425
		65-9251-3-625	368,139
			<u>620,783</u>
<u>Environmental Protection Agency (EPA)</u>			
Pesticide Enforcement	66.700	E-009159-02-2 / E-009159-04-0	110,274
Pesticide Certification		E-009419-02-2 / E-009419-04-0	26,031
Pesticide Environmental Stewardship			<u>14,014</u>
			<u>150,319</u>
<u>Department of Commerce</u>			
Voluntary Inspection Services for Fish and Fishery Products		45ABNMA0B1070	<u>3,643</u>
<u>Department of Interior</u>			
Research and Development for Brown Tree Snake	15.875	2004/2005 Interior Appropriation Act	<u>216,112</u>
Hawaii Water Resources Study	15.504	02-FG-30-0029	<u>7,501</u>
Total Expenditures of Federal Awards			<u><u>\$ 10,424,443</u></u>

Note:

- A** This Schedule of Expenditures of Federal Awards was prepared on accrual basis of accounting.
- B** The Department provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Amount Provided</u>
Military Construction & Appropriations & Emergency Hurricane Act of 2005 (Public Law 108-324)		
Subrecipient - Hawaiian Sugar & Transportation Cooperative	N/A	7,200,000

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Agriculture
State of Hawaii

We have audited the financial statements of the Department of Agriculture of the State of Hawaii, as of and for the year ended June 30, 2005, and have issued our report thereon dated February 10, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the department's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying schedule of findings and questioned costs as items 05-1 to 05-7.

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

Compliance

As part of obtaining reasonable assurance about whether the department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on

the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Agriculture, management, and 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.

Hattari & Co., CPAs, Inc.

Honolulu, Hawaii
February 10, 2006

Hattori & Co., CPAs, Inc.

1750 Kalakaua Avenue, Suite 1904 . Honolulu, Hawaii 96826 . (808) 949-2656 FAX (808) 949-8893

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH *OMB CIRCULAR A-133*

To the Board of Agriculture
State of Hawaii

Compliance

We have audited the compliance of Department of Agriculture with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. The department'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 department's management. Our responsibility is to express an opinion on the department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and *OMB Circular A-133* require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the department'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 department's compliance with those requirements.

In our opinion, the department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with *OMB Circular A-133* and which are described in the accompanying schedule of findings and questioned costs as items 05-8 and 05-9.

Internal Control Over Compliance

The management of the department 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 department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the

purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management of the State of Hawaii Department of Agriculture, 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.

Hattari & Co., CPAs, Inc.

Honolulu, Hawaii
February 10, 2006

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

A. SUMMARY OF AUDITORS' RESULTS

1. Financial Statements

- Unqualified opinion issued on the financial statements.
- No material weaknesses in internal control over financial reporting were disclosed.
- Reportable conditions in internal control over financial reporting were disclosed.
- No material noncompliance to the financial statements was disclosed.

2. Federal Awards

- No material weaknesses in internal control over major programs were disclosed.
- Reportable conditions in internal control over major programs are disclosed.
- Unqualified opinion issued on compliance for major programs.
- Audit finding required to be reported under OMB Circular A-133 Section 510 (a) was disclosed in this schedule.

Identification of major programs:

<u>CFDA Number</u>	<u>Federal Program</u>
10.025	U.S Department of Agriculture, APHIS, PPQ, VS, WS
N/A	Commodity Credit Corporation (USDA)
10.904	Watershed Protection and Flood Protection

- Threshold used to distinguish between Type A and Type B programs was \$300,000.
- The Department did not qualify as a low-risk auditee.

B. FINANCIAL STATEMENT FINDINGS

05-1 Loan files are not properly maintained.

Criteria: Adequate loan documentation provides evidence that loans exist and were analyzed for credit worthiness prior to loan approval. They also provide evidence that a loan has been properly made in accordance with policies, procedures and laws.

Condition: The loan files are not properly maintained.

Effect: Increases risk that errors and fraud could occur and not be detected in a timely manner because of inattention to proper documentation of the loan transaction and approvals. The condition could also result in wasted time in order to locate needed documents.

Recommendation: Management needs to be more diligent in obtaining required loan documents and ensure that those required documents are reviewed and signed off by appropriate personnel.

05-2 The status of delinquent accounts and history of collection attempts are not adequately documented.

Criteria: The loan division's policies and procedures manual requires that monthly delinquent loan reports are printed by an account clerk and distributed to the loan officers within the first ten business days of the current month for follow-up.

Condition: The delinquent loan reports are not distributed to the loan officers on a timely basis

Effect: Failure to monitor delinquent loans increases the risk of loan losses due to failure to follow-up on delinquencies from early occurrence.

Recommendation: All staff members responsible for the preparation and use of monthly delinquent loan reports should be reminded of the need to follow policies and procedures.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

05-3 Required inspections are not documented.

Criteria: According to the loan division's policies and procedures manual, initial on-farm visits should be performed within three months of loan disbursement and should be documented with a loan servicing report.

Condition: The department failed to maintain and document a loan servicing report for initial and subsequent on-farm visits of loan recipients.

Effect: Without a loan service report, the division exposes itself to questions regarding the efforts to protect state assets after a loan is disbursed, as no evidence exists that on farm visits were ever performed.

Recommendation: Perform and retain adequate documentation to provide the evidence that the on farm visits have been performed.

05-4 Internal records are not reconciled to FAMIS on a monthly basis.

Criteria: Subsidiary records supporting the FAMIS system account balances need to be reconciled on a periodic basis to insure that both the details of the subsidiary records and the FAMIS balances are accurate and reliable.

Condition: The department does not reconcile loan division master lists to FAMIS reports on a monthly basis.

Effect: Increases risk that errors or other discrepancies could occur and not be detected in a timely manner.

Recommendation: Establish policy to require monthly reconciliation of the loan master lists to the corresponding items in FAMIS. A simple reconciliation reflecting the master list balance, reconciling items (differences) to FAMIS balances, and the actual FAMIS balance should be documented each month, similar to reconciling a checkbook cash balance to a bank statement balance. The division should monitor and review the reconciliations to ensure monthly reconciliations are properly conducted according to the policy.

05-5 Participation loans are not adequately documented.

- Criteria: Participation agreements with private lenders stipulate that the participating institutions are responsible for administering the loans and ensuring compliance with statutes and rules.
- Condition: Although the loan files contained basic participation agreements, there was no other evidence that the division loan officers were monitoring the private lenders for compliance with applicable statutes.
- Effect: Private institutions may not be familiar with the intricacies of applicable state laws and regulations, and they may not follow the rules.
- Recommendation: Update the policies and procedures manual to include procedures on determining whether private lenders are in compliance with applicable laws regarding participation loans. Steps taken to determine compliance should be adequately documented within the loan files.

05-6 Interest on loans is accrued beyond its measurable and available period.

- Criteria: According to the "Methodology to Determine Allowance for Agricultural Loan Losses," the loan division should stop accruing interest on loans when payments have not been received for 90 days and certain other conditions exist.
- Condition: The department continued to accrue interest on loans with payments delinquent more than 90 days in its loan tracking system, but does not track interest accrued after the 90-day period.
- Effect: The loan system does not reflect the interest accrued on the 90-day past due loans that is needed for financial statement reporting under generally accepted accounting principles.
- Recommendation: With due consideration to the need to continually accrue interest on each loan for asset tracking and management purposes, a separate, manually prepared schedule should be maintained to also track the amount of interest accrued on the loans with interest past due more than 90 days.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

05-7 The agricultural resource management division do not adhere to collection policies and procedures, or did not adequately document efforts to do so.

Criteria: The department should enforce collection procedures and document the monitoring and collection efforts on delinquent accounts to preserve the state's right as well as to enable reasonable determination of potential losses due to uncollectible accounts.

Condition: The agricultural resource management division did not adhere to their policies regarding collection attempts except for sending past due notices, and did not document their collection efforts in the customer files.

Effect: Failure to properly manage accounts receivables might deprive the state of realizing revenue to which it is entitled and also prevents determination of a reasonable allowance for uncollectible accounts.

Recommendation: The department should perform review on delinquent accounts regularly and take proper collection efforts according to collection guidelines.

C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FEDERAL AWARDS - COMPLIANCE

DEPARTMENT OF AGRICULTURE (USDA)

**U.S. Department of Agriculture, APHIS, PPQ, VS, WS
CFDA 10.025**

05-8 Federal financial reports are untimely.

Criteria: Pursuant to the federal award agreement, quarterly financial reports should be filed on a timely basis. These reports are due no later than 30 days after the end of each Federal fiscal quarter.

Condition: Federal financial reports for grant 03-73-15-5388GR and 04-73-15-5388-GR for the period ending March 31, 2005 were due April 30, 2005 but not submitted until May 4, 2005. Federal financial reports for grant 03-73-15-5388-GR and 04-73-15-5388-GR for the period ending June 30, 2005 were due July 31, 2005 but not submitted until August 11, 2005.

Effect: The department did not comply with timely reporting requirements.

Recommendation: Procedures should be established to ensure timely submittal of required reports.

DEPARTMENT OF AGRICULTURE (USDA)

**U.S. Department of Agriculture, Commodity Credit Corporation
CFDA (not available)**

05-9 Management failed to obtain a written agreement with a subgrantee.

Criteria: The department received a grant under the United States Military Construction Appropriations & Emergency Hurricane Supplemental Appropriations Act of 2005 for assistance to an agricultural transportation cooperative in the State of Hawaii. The state's

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005

**05-9 Management failed to obtain a written agreement with a subgrantee
(continued).**

agreement with the federal grantor agency incorporates Title 7, CFR, Chapter 30, Part 3016, the Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.

Condition: The department did not execute a signed agreement with the grantee cooperative that incorporates the above referenced requirements.

Effect: The subgrantee was not informed of its obligation to meet the requirements Part 3016, specifically the requirement to have an audit conducted in accordance with the OMB Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations."

Recommendation: The department should take appropriate steps to rectify the problem by obtaining a written letter agreement retroactively. The agreement should incorporate the same laws and regulations contained in the department's letter agreement with the USDA. The department's policies should also be updated to require written agreements with all subgrantees.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII**

**Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended June 30, 2005**

A. FINANCIAL STATEMENT FINDINGS – NONE

B. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FISCAL YEAR JUNE 30, 2004

04-1 Interest earned on grant funds advanced was not submitted to Commodity Credit Corporation on a timely basis.

Condition: Interest of \$3,413.40 earned for the quarter ending Sept 30, 2003 from Promote Specialty Crops federal award program was not transferred to Commodity Credit Corporation until February 17, 2004.

Status: Resolved. No similar finding is reported for the current year.

Response of the Department of Agriculture

LINDA LINGLE
Governor



SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DUANE K. OKAMOTO
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 South King Street
Honolulu, Hawaii 96814-2512
Phone: (808) 973-9600 Fax: (808) 973-9613

March 24, 2006

Hattori & Co., CPAs, Inc.
1750 Kalakaua Avenue, Suite 1904
Honolulu, HI 96826

Gentlemen:

Thank you for the opportunity to review and provide comments on the draft report of the Financial and Compliance Audit of the Department of Agriculture for the fiscal year ended June 30, 2005.

We appreciate the cooperative and professional manner in which the Hattori & Co. staff conducted themselves during this audit.

Please feel free to call Elaine Abe of my staff at 973-9606 if there are any questions, or if additional information is needed.

Sincerely,

A handwritten signature in cursive script, appearing to read "Sandra Lee Kunimoto".

Sandra Lee Kunimoto, Chairperson
Board of Agriculture

Enclosure

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

B. FINANCIAL STATEMENT FINDINGS

05-1 Loan files are not properly maintained.

Criteria: Adequate loan documentation provides evidence that loans exist and were analyzed for credit worthiness prior to loan approval. They also provide evidence that a loan has been properly made in accordance with policies, procedures and laws.

Condition: The loan files are not properly maintained.

Effect: Increases risk that errors and fraud could occur and not be detected in a timely manner because of inattention to proper documentation of the loan transaction and approvals. The condition could also result in wasted time in order to locate needed documents.

Recommendation: Management needs to be more diligent in obtaining required loan documents and ensure that those required documents are reviewed and signed off by appropriate personnel.

Response: The division secretary and loan officers will be reminded in writing of the division's policy which requires them to conduct a final review and sign off on the Loan Document Checklist to ensure all of the required documents have been received and filed in the loan file. The loan officers will also be instructed in writing to follow-up and document attempts to obtain required loan documents from the borrower. The business loan supervisor will also be required to review existing loan files to ensure all the required documents have been received.

05-2 The status of delinquent accounts and history of collection attempts are not adequately documented.

Criteria: The loan division's policies and procedures manual requires that monthly delinquent loan reports are printed by an account clerk and distributed to the loan officers within the first ten business days of the current month for follow-up.

Condition: The delinquent loan reports are not distributed to the loan officers on a timely basis.

Effect: Failure to monitor delinquent loans increases the risk of loan losses due to failure to follow-up on delinquencies from early occurrence.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

05-2 The status of delinquent accounts and history of collection attempts are not adequately documented (cont'd).

Recommendation: All staff members responsible for the preparation and use of monthly delinquent loan reports should be reminded of the need to follow policies and procedures.

Response: On July 6, 2005 the division changed its procedures to require that monthly delinquent loan reports be printed by the account clerk and distributed to the loan officers by the 15th of each month. The account clerk will be instructed in writing to distribute delinquent loan reports by the 15th of each month. Staff will be instructed in writing that the division's loan delinquent procedures require loan officers to follow-up and document on their collection efforts on loans delinquent for 30, 60 and 90 days.

05-3 Required inspections are not documented.

Criteria: According to the loan division's policies and procedures manual, initial on-farm visits should be performed within three months of loan disbursement and should be documented with a loan servicing report.

Condition: The department failed to maintain and document a loan servicing report for initial and subsequent on-farm visits of loan recipients.

Effect: Without a loan service report, the division exposes itself to questions regarding the efforts to protect state assets after a loan is disbursed, as no evidence exists that on farm visits were ever performed.

Recommendation: Perform and retain adequate documentation to provide the evidence that the on-farm visits have been performed.

Response: The division will develop a tickler system/monitoring system for supervisors to ensure that initial and subsequent on-farm visits are completed on a timely basis. The Business Loan Supervisor will conduct periodic checks to monitor that the loan files contain a loan servicing report documenting initial and subsequent on-farm visits that have been conducted.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

05-4 Internal records are not reconciled to FAMIS on a monthly basis.

- Criteria: Subsidiary records supporting the FAMIS system account balances need to be reconciled on a periodic basis to insure that both the details of the subsidiary records and the FAMIS balances are accurate and reliable.
- Condition: The department does not reconcile loan division master lists to FAMIS reports on a monthly basis.
- Effect: Increases risk that errors or other discrepancies could occur and not be detected in a timely manner.
- Recommendation: Establish policy to require monthly reconciliation of the loan master lists to the corresponding items in FAMIS. A simple reconciliation reflecting the master list balance, reconciling items (differences) to FAMIS balances, and the actual FAMIS balance should be documented each month, similar to reconciling a checkbook cash balance to a bank statement balance. The division should monitor and review the reconciliations to ensure monthly reconciliations are properly conducted according to the policy.
- Response: The division will establish a policy to require monthly reconciliation of the loan master lists to the corresponding items in the FAMIS report. On a monthly basis, the account clerk will document the reconciliation by reflecting the master list balance, reconciling items (differences) to FAMIS balances, and the actual FAMIS balance and, as necessary, prepare journal vouchers to record reconciling items that need to be made in FAMIS. The division administrator will review the reconciliation documents to ensure that the monthly reconciliations are being conducted according to policy.

05-5 Participation loans are not adequately documented.

- Criteria: Participation agreements with private lenders stipulate that the participating institutions are responsible for administering the loans and ensuring compliance with statutes and rules.
- Condition: Although the loan files contained basic participation agreements, there was no other evidence that the division loan officers were monitoring the private lenders for compliance with applicable statutes.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

05-5 Participation loans are not adequately documented (cont'd).

Effect: Private institutions may not be familiar with the intricacies of applicable state laws and regulations, and they may not follow the rules.

Recommendation: Update the policies and procedures manual to include procedures on determining whether private lenders are in compliance with applicable laws regarding participation loans. Steps taken to determine compliance should be adequately documented within the loan files.

Response: In practice, the division reviews the application from the participating lender to ensure that all statutes and rules governing the program are met and discusses all requirements with the participating lender at loan closing. The division maintains regular contact with the borrowers to ensure the operation is in compliance with the terms of the agreement and division's statutes during the term of the loan and meets with the participating lender as required. The division will incorporate this practice into its policies and procedures manual to ensure that private lenders are in compliance with applicable laws regarding participation loans and require loan officers to document any review and contact with private lenders in the loan file.

05-6 Interest on loans is accrued beyond its measurable and available period.

Criteria: According to the "Methodology to Determine Allowance for Agricultural Loan Losses," the loan division should stop accruing interest on loans when payments have not been received for 90 days and certain other conditions exist.

Condition: The department continued to accrue interest on loans with payments delinquent more than 90 days in its loan tracking system, but does not track interest accrued after the 90-day period.

Effect: The loan system does not reflect the interest accrued on the 90-day past due loans that is needed for financial statement reporting under generally accepted accounting principles.

Recommendation: With due consideration to the need to continually accrue interest on each loan for asset tracking and management purposes, a separate, manually prepared schedule should be maintained to also track the amount of interest accrued on the loans with interest past due more than 90 days.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

05-6 Interest on loans is accrued beyond its measurable and available period (cont'd).

Response: The division will develop a separate spreadsheet to track the amount of interest accrued on loans with interest past due more than 90 days. The procedure and methodology for the spreadsheet will be incorporated into the division's policies and procedures manual.

05-7 The agricultural resource management division do not adhere to collection policies and procedures, or did not adequately document efforts to do so.

Criteria: The department should enforce collection procedures and document the monitoring and collection efforts on delinquent accounts to preserve the state's right as well as to enable reasonable determination of potential losses due to uncollectible accounts.

Condition: The agricultural resource management division did not adhere to their policies regarding collection attempts except for sending past due notices, and did not document their collection efforts in the customer files.

Effect: Failure to properly manage accounts receivables might deprive the state of realizing revenue to which it is entitled and also prevents determination of a reasonable allowance for uncollectible accounts.

Recommendation: The department should perform review on delinquent accounts regularly and take proper collection efforts according to collection guidelines.

Response: The division will comply with its written collection policies and procedures and document its collection efforts in the customer files. A review of all past due accounts will be made and appropriate collection action will be taken and documented in the customer files.

C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS – NONE

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

**FEDERAL AWARDS - COMPLIANCE
DEPARTMENT OF AGRICULTURE (USDA)
U.S. Department of Agriculture, APHIS, PPQ, VS, WS
CFDA 10.025**

05-8 Federal financial reports are untimely.

Criteria: Pursuant to the federal award agreement, quarterly financial reports should be filed on a timely basis. These reports are due no later than 30 days after the end of each Federal fiscal quarter.

Condition: Federal financial reports for grant 03-73-15-5388GR and 04-73-15-5388-GR for the period ending March 31, 2005 were due April 30, 2005 but not submitted until May 4, 2005. Federal financial reports for grant 03-73-15-5388-GR and 04-73-15-5388-GR for the period ending June 30, 2005 were due July 31, 2005 but not submitted until August 11, 2005.

Effect: The department did not comply with timely reporting requirements.

Recommendation: Procedures should be established to ensure timely submittal of required reports.

Response: Federal financial reports for the period ending March 31, 2005 and due April 30, 2005 were completed by the Fiscal Office on April 27, 2005. However, the program did not transmit the financial status report until May 4, 2005. In the future, when the completed federal financial reports are sent to the program, the Fiscal Office will by e-mail notify the program manager who will be responsible to ensure timely transmittal of the federal financial report to the federal agency.

On July 22, 2005, a request to extend the due date from July 31, 2005 to August 15, 2005 for the submittal of federal financial reports for the period ending June 30, 2005 was transmitted to the U.S. Wildlife Services, Honolulu Office. The extension was requested due to late distribution of state financial reports used to prepare the federal financial report. The department never received a response to its request from the U.S. Wildlife Services. On August 7, 2005, the department received the state financial reports enabling the submittal of the federal financial report on August 11, 2005. In the future, the department will follow-up on its extension request with written correspondences and telephone calls to the federal agency for a written response.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2005**

05-9 Management failed to obtain a written agreement with a subgrantee

- Criteria: The department received a grant under the United States Military Construction Appropriations & Emergency Hurricane Supplemental Appropriations Act of 2005 for assistance to an agricultural transportation cooperative in the State of Hawaii. The state's agreement with the federal grantor agency incorporates Title 7, CFR, Chapter 30, Part 3016, the Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.
- Condition: The department did not execute a signed agreement with the grantee cooperative that incorporates the above referenced requirements.
- Effect: The subgrantee was not informed of its obligation to meet the requirements of Part 3016, specifically the requirement to have an audit conducted in accordance with the OMB Circular A-133, "Audits of States, Local Governments and Non-Profit Organizations."
- Recommendation: The department should take appropriate steps to rectify the problem by obtaining a written letter agreement retroactively. The agreement should incorporate the same laws and regulations contained in the department's letter agreement with the USDA. The department's policies should also be updated to require written agreements with all subgrantees.
- Response: The department will initiate a retroactive letter of agreement notifying the subgrantee of its obligation to meet the requirements of the Commodity Credit Corporation including Title 7, CFR, Chapter 30, Part 3016, The Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments. The department will also establish policies to require written agreements with all subgrantees.