

Department of Agriculture
State of Hawaii
Financial and Compliance Audit
Year Ended June 30, 2006

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII

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Hattori & Co., CPAs, Inc.



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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, 2006, 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, 2006, 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.

Kittari & Co., CPAs, Inc.

Honolulu, Hawaii
February 28, 2007

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, 2006, 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, 2006, 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, 2006, 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 10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 1, 2007 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

INDEPENDENT AUDITOR'S REPORT, CONTINUED

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.

Arthur & Co., CPAs, Inc.

Honolulu, Hawaii
February 1, 2007

**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, 2006. 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, 2006 and June 30, 2005 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>2006</u>	<u>2005</u>
Current and other assets	\$ 36.1	35.5
Loans receivable	16.4	18.2
Capital assets	<u>74.3</u>	<u>72.6</u>
Total assets	<u>126.8</u>	<u>126.3</u>
Long-term liabilities	10.1	10.1
Other liabilities	<u>3.0</u>	<u>2.9</u>
Total liabilities	<u>13.1</u>	<u>13.0</u>
Net assets:		
Invested in capital assets	74.3	72.6
Restricted	47.5	50.3
Unrestricted (deficit)	<u>(8.1)</u>	<u>(9.6)</u>
Total net assets	<u>113.7</u>	<u>113.3</u>
Total liabilities and net assets	\$ <u>126.8</u>	<u>126.3</u>

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

	<u>2006</u>	<u>2005</u>
Revenue		
Program revenues:		
Charges for services	\$ 8.0	8.9
Operating grants and contributions	2.0	9.1
Capital grants and contributions	0.8	6.0
State allotted appropriations	15.0	12.7
Non-imposed employee fringe benefit	3.9	3.2
Transfers	<u>1.2</u>	<u>(1.4)</u>
Total revenues	<u>\$ 30.9</u>	<u>38.5</u>
Program expenses		
Productivity improvement and management assistance	\$ 12.7	11.1
Product development and marketing	4.7	3.8
General support for agriculture	3.9	12.6
Agricultural water development and irrigation services	4.3	4.0
Pollution control	2.2	1.6
Protection of the consumer	1.0	0.8
Aquaculture development	0.8	0.6
Agriculture loans	<u>0.9</u>	<u>1.3</u>
Total expenses	<u>30.5</u>	<u>35.8</u>
Increase in net assets	\$ <u>0.4</u>	<u>2.7</u>

The Department's total assets exceed liabilities by \$113.7 million at the end of the fiscal year. Net assets of the Department's governmental activities increased by 0.4% (\$113.7 million compared to \$113.3 million). The largest portion of the Department's net assets (\$74.3 million) reflects its investment in capital assets

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

(e.g., 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 (\$47.5 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, reflects a deficiency of \$8.1 million, the result of the identification of bond issuance in fiscal year 2001. The deficiency decreased by \$1.5 million due to the excess of revenues over expenses for the year.

The Department's total revenues decreased by \$7.6 million primarily due to a decrease in operating grants and contributions. In FY05, 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. This was a one-time appropriation and is not expected to continue.

The Department's total expenses decreased by \$5.3 million again primarily due to the one-time appropriation of \$7.2 million in federal funds in FY05 which did not continue in FY06.

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>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Productivity improvement and management assistance	\$ 12.7	11.1	8.7	7.4
Product development and marketing	4.7	3.8	4.1	3.1
General support for agriculture	3.9	12.6	2.2	2.2
Agricultural water development and irrigation services	4.3	4.0	2.2	(2.9)
Pollution control	2.2	1.6	1.0	.8
All others	<u>2.7</u>	<u>2.7</u>	<u>1.4</u>	<u>1.3</u>
Totals	<u>\$ 30.5</u>	<u>35.8</u>	<u>19.6</u>	<u>11.9</u>

The significant decrease in total cost of services from FY05 to FY06 in the general support for agriculture is again attributed to the one-time appropriation of \$7.2 million in federal funds in FY05 which did not continue in FY06. The increase in total net cost of services from FY05 to FY06 in the agricultural water development and irrigation services is attributed to a decrease in capital grants and contributions.

Financial Analysis of the Department's Funds

The Department's governmental funds reported a combined fund balance of \$49.9 million. In addition, these other changes in fund balances should be noted:

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Management Discussion and Analysis**

- The Department received \$16.7 million of allotted appropriations and spent \$4.9 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 a one-time appropriation of \$7.2 million in federal funds in FY05 which did not continue in FY06 and accounts for the significant decrease in revenues and expenditures from FY05 to FY06.

Financial Analysis of Significant General Fund Budget Variations

The difference of \$1,477,316 between the original and final budgeted amounts in State allotted appropriation revenues for FY06 represents the addition of \$277,316 in collective bargaining augmentations and \$1,200,000 in debt services expenses savings transferred from the Department of Budget and Finance to perform work necessary to mitigate health and safety hazard at the Kailua Reservoir.

The \$565,558 in excess revenues over expenditure represents \$425,000 transferred to the Irrigation System Revolving Fund pursuant to Section 5 of Act 178, SLH 2005, and \$140,558 transferred to the Hawaii Agricultural Development Revolving Fund pursuant to Section 7 of Act 178, SLH 2005.

The variance of \$27,131 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. Closer monitoring of program expenditures and balances resulted in a reduction in the variance in FY06.

General Fund Budgetary Highlights

The State continued to show strong economic gains in FY06 which produced positive results for both residents and businesses. In the first half of 2006, total wages grew by 7.3% and personal income rose by 6.4%. Hawaii's unemployment rate was below 3% for most of the year and remained among the lowest in the nation. Hawaii's economy is expected to continue its expansion into FY07 but at a more moderate pace. State general fund revenue collections showed a healthy growth of 10.9% for FY06 with increases projected by the Council on Revenues for FY07 as well as in the next biennium and planning period. The State ended FY 2006 with a \$732 million balance in general fund. With a strong economy and health revenue growth, the Governor provided departments with greater expenditure authority and authorized a full year allocation of general funds without restrictions. Although the State continues to strengthen, the governor continued to emphasize maintaining fiscal prudence in managing resources because projections of State expenditures continue to show significant growth due to collective bargaining and fringe benefit obligations, including post-employment benefits. Departments were encouraged to practice sound management principles by reviewing expenditures, ensuring expenditures are within anticipated revenue projections, and building reserves to cope with unforeseen emergencies. The hiring policy requiring the Departments to obtain the Governor's prior approval before filling vacancies into FY06 and continued to have an impact on the Department's ability to readily fill vacancies.

Capital Asset and Debt Administration

Capital Asset

At the end of June 30, 2006, the Department had \$74.3 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 increase (including additions and deductions) of \$1.7 million over last year.

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State of Hawaii
Management Discussion and Analysis**

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

	<u>2006</u>	<u>2005</u>
Land	\$ 22.2	22.1
Buildings	19.9	20.2
Land improvements	15.2	17.2
Furniture and equipment	0.8	1.1
Motor vehicles	.6	.6
Construction in progress	<u>15.6</u>	<u>11.4</u>
Total	<u>\$ 74.3</u>	<u>72.6</u>

The increase in net capital assets occurred primarily due to an increase in "construction in progress" fixed assets.

Debt Administration

At the end of the current fiscal year, the Department had total bonded debt outstanding of \$8.1 million backed by the full faith and credit of the State. The changes to the general obligation bond as of June 30, 2006 are as follows:

Balance at July 1, 2005	\$8,257,052
Increase	-
Decrease	181,355
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Balance at June 30, 2006	\$8,075,697

The State's total long-term debt decreased by \$0.2 million, or 2%, during the current fiscal year. The key factor in this increase was the repayment of \$0.2 million in general obligation bonds for financing public improvement projects.

Economic Factors and Next Year's Budgets and Rates

The State began FY07 with no general fund spending reductions and with general fund revenues still projected to grow at a healthy pace for the duration of the next six-year planning period spanning from FY08 through FY13. The double digit rates of 16.0 % and 10.9% in general fund tax revenues for FY05 and FY06, respectively, are not expected to continue in FY07. The leveling off of the economy has had an impact on State tax collections. At their September 2006 meeting, the Council on Revenues estimated a 6.0% grow for general fund tax revenues in FY07 and projected a growth of 6.0% in FY08 and 4.4% in FY09. A healthy balance at the end of FY06 is expected to decrease to about \$200 million at the end of FY07 as a result of increased program appropriations by the 2006 Legislature. Previous years of fiscal constraints and imposed budget restrictions have resulted in many unmet needs and areas where catching up activities are necessary. Many equipment and motor vehicles were not replaced on a regular basis and programs were forced to operate with existing resources in the midst of increasing demands for services. With a healthy balance, the Governor stressed the need to plan ahead for the next economic and budget cycle that would soften the upswings and downswings in economic activities and budgetary actions that we experienced in the past two decades. Concerns over high energy prices, rising interest rates and inflation, and employee collective bargaining costs and fringe benefit obligations warrants a cautious approach in formulating the budget in the future. In preparation for the FB 2007-2009, departments were requested to review their program structure and performance measures in an effort to develop meaningful objective statements and performance measures for all programs. The Department will be proposing to consolidate ten programs in the Economic Development program structure area into one to provide an objective that focuses on maintaining the agricultural sector of the State's economy in a strong and competitive condition through our various program

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Management Discussion and Analysis**

activities and services. For the FB 2007-2009 Executive Budget, departments were instructed to limit requests for additional funding to address the following areas: 1) increases in certain unavoidable non-discretionary expenses such as debt service, employee fringe benefits, entitlements, court orders, consent decrees, or federal mandates, risk management requirements, and costs of fuel and utilities; 2) recurring costs from specific appropriation acts of 2005 and 2006 Legislature; 3) critical activities/services for public health and safety; 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, 2006**

Governmental Activities

ASSETS

Cash and cash equivalent	\$ 35,273,031
Receivables, net	795,331
Loans receivable, net	16,480,148
Capital assets	
Nondepreciable net assets	38,674,527
Other capital assets, net of depreciation	35,638,082

Total assets	\$ 126,861,119
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LIABILITIES

Accounts payable and accrued liabilities	\$ 1,523,975
Due to state general fund	7,105
Deferred revenues	280,723
Accrued vacation:	
Due within one year	1,078,443
Due in more than one year	2,218,367
Bond payable	
Due within one year	188,874
Due in more than one year	7,886,823

Total liabilities	13,184,310
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NET ASSETS (DEFICIT)

Investment in capital assets	74,312,609
Restricted for:	
Capital projects	11,945,613
Agricultural loan program	28,707,335
Other purpose	6,851,146
Unrestricted	(8,139,894)

Total net assets	113,676,809
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Total liabilities and net assets	\$ 126,861,119
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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, 2006**

	Expenses	Program Revenues			Net Revenue (Expense) and Changes in Net Assets
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Functions/Programs					
Departmental Activities:					
Productivity improvement and management assistance	\$ 12,660,011	3,167,712	822,852	-	\$ (8,669,447)
Product development and marketing	4,670,950	445,948	90,214	-	(4,134,788)
General support for agriculture	3,871,507	1,582,635	61,621	-	(2,227,251)
Agricultural water development and irrigation services	4,333,828	1,301,347	44,000	757,015	(2,231,466)
Pollution control	2,222,838	648,175	554,763	-	(1,019,900)
Protection of the consumer	1,016,196	-	-	-	(1,016,196)
Aquaculture development	749,655	-	33,020	-	(716,635)
Agricultural loans	912,553	809,196	437,138	-	333,781
Total departmental activities	\$ 30,437,538	7,955,013	2,043,608	757,015	(19,681,902) (a)
General Revenues					
State allotted appropriations					15,021,874
Non-imposed employee fringe benefit					3,897,472
Intergovernmental revenues					-
Transfers					1,192,154
Total general revenues and special items					20,111,500 (a)
Other Revenue (Loss)					
Loss on disposal of fixed assets					(13,164) (a)
Change in Net Assets [sum of (a)]					416,434
Net assets, June 30, 2005					113,260,375
Net Assets, June 30, 2006					\$ 113,676,809

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

DEPARTMENT OF AGRICULTURE, STATE OF HAWAII
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2006

	General Fund	Irrigation & Drainage System Capital Projects	Financial Assistance for Agriculture	Plant Pest & Disease Control	Other Governmental Funds	Total Governmental Funds
ASSETS						
Cash	\$ 3,345,579	12,429,773	12,397,446	235,429	6,864,804	\$ 35,273,031
Loan Receivable	-	-	16,480,148	-	-	16,480,148
Total assets	\$ 3,345,579	12,429,773	28,877,594	235,429	6,864,804	51,753,179
LIABILITIES AND FUND BALANCES						
Liabilities:						
Vouchers Payable	\$ 101,495	484,160	995	11,816	190,437	\$ 788,903
Accrued Payroll	483,004	-	24,330	21,960	205,778	735,072
Due to State General Fund	7,105	-	-	-	-	7,105
Deferred Revenues	-	-	-	201,653	79,070	280,723
Total liabilities	591,604	484,160	25,325	235,429	475,285	1,811,803
Fund Balances(Deficit):						
Reserved for:						
Encumbrances	3,120,162	6,527,394	72,200	167,666	2,158,719	12,046,141
Continuing appropriation	-	5,418,219	14,769,069	(167,666)	4,230,800	24,250,422
Noncurrent assets	-	-	14,011,000	-	-	14,011,000
Unreserved	(366,187)	-	-	-	-	(366,187)
Total fund balances	2,753,975	11,945,613	28,852,269	-	6,389,519	49,941,376 (a)
Total liabilities and fund balances	\$ 3,345,579	12,429,773	28,877,594	235,429	6,864,804	\$ 51,753,179
Total governmental fund balances, above (a)						\$ 49,941,376
Capital assets used in governmental activities are not financial resources and therefore not reported in governmental funds						74,312,609
Receivables in the statement of activities that do not provide current financial resources are not reported in governmental funds						795,331
Some liabilities, such as compensated absences, are not due and payable in the current period and therefore not reported in governmental funds						(3,296,810)
Long term liabilities, such as bond payable, are not due and payable in the current period and therefore are not reported in governmental funds						(8,075,697)
Net assets of governmental activities						\$ 113,676,809

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, 2006

	General Fund	Irrigation & Drainage System Capital Projects	Financial Assistance for Agriculture	Plant Pest & Disease control	Other Governmental Funds	Total Governmental Funds
REVENUES						
Allotted appropriation	\$ 15,241,335	1,460,000	-	-	-	\$ 16,701,335
Intergovernmental revenues	-	2,428,578	-	517,707	925,884	3,872,169
Non-imposed employee fringe benefit	3,897,472	-	-	-	-	3,897,472
Interest on agricultural loans	-	-	809,196	-	-	809,196
Charges for services	-	-	14,592	-	6,961,778	6,976,370
Investment earnings	-	-	422,546	-	162,880	585,426
Total Revenues	19,138,807	3,888,578	1,246,334	517,707	8,050,542	32,841,968
EXPENDITURES						
Current:						
Productivity improvement and management assistance	7,960,117	-	-	517,707	3,788,156	12,265,980
Product development and marketing	3,730,063	-	-	-	429,552	4,159,615
General support for agriculture	2,297,800	-	-	-	1,607,891	3,905,691
Agricultural water development and irrigation services	185,136	-	-	-	1,474,823	1,659,959
Pollution control	1,083,234	-	-	-	1,107,003	2,190,237
Protection of the consumer	849,410	-	-	-	-	849,410
Aquaculture development	691,953	-	-	-	32,287	724,240
Agricultural loan administration	-	-	879,510	-	-	879,510
Capital outlay	-	4,914,728	-	-	-	4,914,728
Total Expenditures	16,797,713	4,914,728	879,510	517,707	8,439,712	31,549,370
Excess of revenue over(under) expenditure	2,341,094	(1,026,150)	366,824	-	(389,170)	1,292,598
Other financing sources:						
Lapsed appropriations	(219,461)	(3,131,562)	-	-	-	(3,351,023)
Operating transfers in	-	-	-	-	1,215,558	1,215,558
Operating transfers out	(565,558)	-	-	-	(85,309)	(650,867)
	(785,019)	(3,131,562)	-	-	1,130,249	(2,786,332)
Excess of revenues and other sources over(under) expenditures and other uses	1,556,075	(4,157,712)	366,824	-	741,079	(1,493,734)
Fund Balances - Beginning	1,197,900	16,103,325	28,485,445	-	5,648,440	51,435,110
Fund Balances - Ending	\$ 2,753,975	11,945,613	28,852,269	-	6,389,519	49,941,376

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, 2006**

Net change in fund balances - total governmental funds	\$ (1,493,734)
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	1,727,705
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	184,039
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	(182,931)
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.	181,355
Change in net assets of governmental activities	\$ 416,434

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2006**

	Private- Purpose Trusts
<hr/>	
ASSETS	
Cash and cash equivalents	\$ 97,225
<hr/>	
Total Assets	\$ 97,225
<hr/>	
LIABILITIES	
Vouchers payable	\$ 2,914
Accrued payroll	35,592
Due to others	54,307
<hr/>	
Total Liabilities	92,813
<hr/>	
NET ASSETS	4,412
<hr/>	
	\$ 97,225
<hr/>	

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, 2006**

	Private- Purpose Trust
REVENUES	
Other revenues	\$ 523,234
EXPENDITURES	
Expendable trust funds	516,058
Excess of revenues over expenditures	7,176
Net assets (deficit) at July 1, 2005	(2,764)
Net assets at June 30, 2006	\$ 4,412

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(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, 2006 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, 2006

(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, 2006

(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.
- 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, 2006

(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, 2006

(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, 2006, 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, 2006

(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, 2006

(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, 2006

(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) CASH AND CASH EQUIVALENTS

At June 30, 2006, the carrying amount of the department's cash and cash equivalents was \$35,273,031, which approximates the bank balance.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(4) LOANS RECEIVABLE

At June 30, 2006, loans receivable consisted of the following:

	Special Revenue
Hawaii Agriculture Loan Program	\$17,045,689
Hawaii Aquaculture Loan Program	899,940
Hawaii Agricultural Products Loan Program	66,214
Accrued interest	472,361
	18,484,204
Less allowance for doubtful receivables	2,004,056
	\$16,480,148

Approximately \$1,712,000 of the total \$18,012,000 loan principal and \$432,000 of \$472,000 loan interest were over 90 days old.

(5) ACCOUNTS RECEIVABLE

At June 30, 2006, accounts receivable consisted of the following:

Waiahole Water System	\$ 81,728
Lease Rental of Public Land	238,137
Sale of Water	339,020
Quarantine Fee	1,554,461
	2,213,346
Less allowance for doubtful receivables	1,418,015
	\$ 795,331

Approximately \$1,799,119 of the \$2,213,346 total receivable balance was over 90 days old.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(6) CAPITAL ASSETS

The changes to capital assets as of June 30, 2006 are as follows:

	Balance at July 1, 2005	Additions	Disposals and Transfers In (Out)	Ending Balance June 30,2006
<i>Capital Assets Being Depreciated</i>				
Land improvements	51,270,085	772,375	(18,237)	52,024,223
Buildings	28,483,662	17,577	656,370	29,157,609
Vehicles	2,929,261	291,579	(275,606)	2,945,234
Equipment	4,174,972	385,739	(122,132)	4,438,579
	86,857,980	1,467,270	240,395	88,565,645
Less accumulated depreciation				
Land improvements	35,028,499	2,690,825	-	37,719,324
Land improvements - not depreciable	-			-
Buildings	8,309,523	926,628	21,879	9,258,030
Vehicles	2,320,489	287,422	(271,919)	2,335,992
Equipment	3,037,410	682,433	(105,626)	3,614,217
	48,695,921	4,587,308	(355,666)	52,927,563
Subtotal	38,162,059	(3,120,038)	596,061	35,638,082
<i>Capital Assets Not Being Depreciated</i>				
Land	22,148,942	20,900	18,237	22,188,079
Land improvements - not depreciable	911,262			911,262
Construction in progress	11,362,641	4,914,728	(702,183)	15,575,186
Subtotal	34,422,845	4,935,628	(683,946)	38,674,527
Total capital assets	72,584,904	1,815,590	(87,885)	74,312,609

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(6) CAPITAL ASSETS (continued)

Depreciation expense for the year ended June 30, 2006 was charged to governmental activities as follows:

Productivity improvement and management assistance	\$ 749,146
Product development and marketing	586,701
General support for agriculture	228,760
Agricultural water development and irrigation services	2,761,177
Pollution control	46,799
Protection of the consumer	166,789
Aquaculture development	12,520
Agricultural loans	35,416
	\$ 4,587,308

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.

(7) 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, 2006 approximated to \$250,000.

The changes to the general obligation bond as of June 30, 2006 are as follows:

Balance at July 1, 2005	\$8,257,052
Increase	-
Decrease	181,355
	\$8,075,697

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(7) GENERAL OBLIGATION BOND (continued)

Future bond principal repayment and interest payment for fiscal year ending after June 30, 2006 are as follows:

	Principal	Interest
2007	\$ 188,874	\$ 244,594
2008	194,742	238,719
2009	200,794	232,626
2010	208,184	226,310
2011	210,070	219,873
2012	216,551	213,341
2013	224,864	206,556
Thereafter	6,631,618	2,447,924
	\$8,075,697	\$4,029,943

(8) 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 \$3,897,472, have been reported as revenues and expenditures in the department’s financial statements for the fiscal year ended June 30, 2006.

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.

(9) 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, 2006 approximates as follows:

2007	\$ 426,000
2008	427,000
2009	426,000
2010	411,000
2011	409,000
Thereafter	10,274,000
	\$12,373,000

Rental income from leases at the agricultural parks for the fiscal year ended June 30, 2006 totaled \$452,994, including \$22,684 for additional rent based on percentage of revenues.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2006

(10) FUND BALANCE DEFICITS

The general fund had a deficit in the unreserved fund balance at June 30, 2006, of 366,187. 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.

(11) VACATION

The changes to the general long-term debt compensated absences as of June 30, 2006 approximated the following:

Balance at July 1, 2005	\$3,113,880
Increase	182,930
Decrease	
Balance at June 30, 2006	\$3,296,810

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.

(12) 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 publishes a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS, 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. 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, 2006

(12) 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 contributed 100% of its required contributions for years. Required contributions are not available on a departmental basis. 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. State-wide contribution requirements for the years June 30, 2006, 2005 and 2004, as well as covered payroll information, are included in the ERS comprehensive annual financial report referred to earlier.

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, 2006

(12) 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. Information regarding expenditures for post-retirement health care and life insurance benefits is included in the ERS comprehensive annual report.

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.

(13) 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 Waiahole Water System Revolving Fund with terms corresponding to that of the related general obligation bonds (see note 8). At June 30, 2006, outstanding commitments to repay general obligation bonds approximated \$8,075,697.

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, 2006 approximated \$11,924,353.

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, 2006

(14) 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, 2006 and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported.

(15) TRANSFERS

For the year ended June 30, 2006, transfers by fund were as follows:

<u>Transfer From:</u>	<u>Transfer To:</u>	<u>Amount</u>
General fund	Irrigation System Revolving Fund	\$ 425,000
General fund	Hawaii Agriculture Development Revolving Fund	140,558
		565,558
 <u>Transfer From:</u>	 <u>Transfer To:</u>	
Pesticide Use Revolving Fund	State general fund	\$ 85,309

The general fund transferred \$425,000 to the Irrigation System Revolving Fund pursuant to Section 5 of Act178, SLH 2005 and \$140,558 to the Hawaii Agricultural Development Revolving Fund pursuant to Section 7 of Act178, SLH 2005. In accordance with Chapter 149A-13.5(e), Hawaii Revised Statutes, any unencumbered or unexpended funds at the year end in excess of \$250,000 shall lapse to the state general fund. The Pesticide Use Revolving Fund transferred \$85,309 to the general fund. The Department of Land and Natural Resources transferred \$650,000 to the Hawaii Invasive Species Council Fund and the net fixed assets transferred and disposed of approximated \$596,000.

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, 2006

	Budgeted Amount		Actual Amount Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Budgetary fund balance at June 30, 2005	\$ -	\$ -	\$ -	\$ -
<i>Revenues</i>				
State allotted appropriation	13,889,019	15,366,335	15,366,335	-
Intergovernmental	-	-	-	-
Total Revenues	13,889,019	15,366,335	15,366,335	-
<i>Expenditures</i>				
Productivity improvement and management assistance	5,776,177	5,902,653	5,896,166	6,487
Product development and marketing	3,712,789	3,687,579	3,672,779	14,800
General support for agriculture	1,686,328	1,750,320	1,746,290	4,030
Agricultural water development and irrigation services	137,417	1,408,851	1,408,748	103
Pollution control	836,475	847,681	847,192	489
Protection of the consumer	671,431	671,431	670,586	845
Aquaculture development	502,844	532,262	531,885	377
Total Expenditures	13,323,461	14,800,777	14,773,646	27,131
Excess of revenue over(under) expenditure	565,558	565,558	592,689	(27,131)
<i>Other financing sources:</i>				
Operating transfers in				
Operating transfers out	(565,558)	(565,558)	(565,558)	-
Excess of revenues and other sources over(under) expenditures and other uses	-	-	27,131	(27,131)
Lapsed appropriations	-	-	(27,131)	27,131
Budgetary fund balance at June 30, 2006	\$ -	\$ -	\$ -	\$ -

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, 2006

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Financial Assistance for Agriculture				
<i>Revenues</i>				
Current-year appropriations	\$ 6,054,203	\$ 6,070,203	\$ 1,246,333	\$ (4,823,870)
<i>Expenditures</i>				
Agricultural Loans	6,054,203	6,070,203	811,005	5,259,198
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ -	\$ -	\$ 435,328	\$ (10,083,068)
Plant and Pest Disease Control				
<i>Revenues</i>				
Current-year appropriations	\$ 327,533	\$ 334,091	\$ 208,603	\$ (125,488)
Current-year funds	-	1,204,169	372,304	(831,865)
<i>Expenditures</i>				
Productivity improvement and management	327,533	1,538,260	521,895	1,016,365
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ -	\$ -	\$ 59,012	\$ 59,012

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, 2006

	General Fund	Financial Assistance for Agriculture	Plant Pest and Disease Control
Excess of revenues and other sources over (under) expenditures and other uses - actual on budgetary basis	\$ 27,131	\$ 435,328	\$ 59,012
Reserved for encumbrances at fiscal year-end	3,125,034	72,200	
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	296,633	11,485	(59,012)
Lapsed appropriations	(219,461)		
Expenditures for prior fiscal years' encumbrances	(1,673,262)	(152,189)	
Excess of revenues and other sources over (under) expenditures and other uses - GAAP basis	\$ 1,556,075	\$ 366,824	\$ -

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, 2006

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Grant Number	Expenditures
<u>Department of Agriculture (USDA)</u>			
Cooperative National Plant Pest Survey and Detection	10.025	05-8510-0586-CA	\$ 28,898
Survey and Detection of the Red Imported Fire Ant in Hawaii		05-8510-0666-CA	600
Detection Surveys for Papaya Mealybug in Hawaii		05-8510-0794-CA	16,509
Survey for Giant Salvinia and Fireweed in Hawaii		04-8510-0793-CA	27,835
Survey for Glassy-Winged Sharpshooter in Hawaii		05-8510-0874-CA	21,500
Seed Inspection Services		P.O. #45-9147-6-9990	2,299
Voluntary Scrapie Flock Certification		05-9715-1572-CA	8,661
Voluntary Johne's Disease Herd Status Program		05-9715-1422-CA	69,929
Foreign Animal Disease Surveillance, Bovine Spongiform Encephalopathy Surveillance, Animal Emergency Management		05-9715-1487-CA	86,144
Swine Health Protection		05-9715-1448-CA	88,331
National Animal Identification System Implementation		05-9715-1480-CA	36,742
HI Brown Tree Snake Detector Program		05-73-15-5388-GR	194,655
Biotechnology Program Development		05-2000-0027-GR	34,068
			<u>616,171</u>
Shell Egg Surveillance	10.162	12-25-A-3310	<u>14,815</u>
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	10.156	12-25-G-0303	<u>21,575</u>
Cooperative Pesticide Recordkeeping	10.163	12-25-A-4615	6,390
National Organic Certification Cost-Share Program		12-25-A-4460	24,418
			<u>30,808</u>
Economic Assessment of Select HI Agricultural Exports		12-25-G-0383	<u>2,672</u>
Disease Management in Pacific Aquaculture	10.200	2003-38500-13092	<u>32,249</u>
Exploration for Biological Control of Melon Fly in Indo-Malayan Region	10.001	58-5320-1-530	<u>4,616</u>
Upcountry Maui Watershed	10.904	65-9251-3-615	19,200
		69-9251-3-643	634,584
		69-9251-4-669	524,505
			<u>1,178,289</u>
Lower Hamakua Watershed, Hawaii	10.904	65-9251-1-514	25,500
		69-9251-1-564	53,843
		69-9251-2-602	35,979

Department of Agriculture
State of Hawaii
Schedule of Expenditures of Federal Awards
For Year Ended June 30, 2006

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Expenditures</u>
		65-9251-3-616	9,850
		65-9251-3-617	2,836
		69-9251-3-624	702,777
		65-9251-4-671	227,586
			<u>1,058,371</u>
Plantation Irrigation Drainage Systems (South Kona Watershed)	10.904	68-9251-3-630	75,000
		65-6251-4-665	75,000
			<u>150,000</u>
<u>Environmental Protection Agency (EPA)</u>			
Pesticide Enforcement	66.700	E-00915904/ E-00915906	274,508
Pesticide Certification		E-00941904/ E-00941906	34,690
Hawaii Agricultural Bioremediation Project Pesticide Environmental Stewardship		X-98951201	194,725
			3,240
			<u>507,163</u>
<u>Department of Commerce</u>			
Voluntary Inspection Services for Fish and Fishery Products		45ABNA0B1070	<u>3,118</u>
<u>Department of Interior</u>			
Research and Development for Brown Tree Snake	15.875	2005/2006 Interior Appropriation Act	<u>190,914</u>
Hawaii Water Resources Study	15.504	02-FG-30-0029	22,499
Hawaii Water Resources Study		05-FC-300014	21,024
			<u>43,523</u>
Total Expenditures of Federal Awards			<u><u>\$ 3,854,284</u></u>

Note: This Schedule of Expenditures of Federal Awards was prepared on accrual basis of accounting.



**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, 2006, and have issued our report thereon dated February 1, 2007. 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.

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 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.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting 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 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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.

Hullari & Co., CPAs, Inc.

Honolulu, Hawaii
February 1, 2007



**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, 2006. 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, 2006. However, the results of our auditing procedures disclosed an instance 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 item 05-7.

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.

Attari & Co., CPAs, Inc.

Honolulu, Hawaii
February 1, 2007

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2006

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.
- No reportable condition in internal control over major programs was disclosed.
- Unqualified opinion issued on compliance for major programs.
- There were no audit findings required to be reported under OMB Circular A-133 Section 510 (a).

Identification of major programs:

<u>CFDA Number</u>	<u>Federal Program</u>
10.025	U.S Department of Agriculture, APHIS, PPQ, VS, WS
10.904	Watershed Protection and Flood Protection
66.700	Pesticides

- 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

06-1 Loan files are not properly maintained.

Criteria: According to the loan agreement, the borrower's insurance on the collateral should be active and properly maintained to avoid the loan being called.

Condition: The insurance requirement is not being met.

Effect: The failure to adequately maintain the insurance requirement for the collateral placed the state at risk for its asset. The loan and underlying security might diminish in value.

Recommendation: Management needs to be more diligent in obtaining required loan documents and ensure that those required documents are updated.

06-2 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 the subsequent visits should be limited to twice annually. Farm visits 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: The failure to adequately monitor the physical operations of the loan recipients placed the state at risk for its asset. The loan and underlying security might diminish in value.

Recommendation: Perform required on-farm visits and retain adequate documentation as specified in the policies and procedures manual.

B. FINANCIAL STATEMENT FINDINGS (continued)

06-3 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.

C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended June 30, 2006

A. FINANCIAL STATEMENT FINDINGS

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

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

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

05-5 Participation loans are not adequately documented.

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.

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

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

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.

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

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

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.

Status: Resolved. Progress has been made as reflected in a decrease in the percentage of receivable balance over three months old over the past two years. However, management should be reminded to contemporaneously document its follow-up procedures.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII**

**Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended June 30, 2006**

B. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

05-8 Federal financial reports are untimely.

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

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

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

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

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

Response of the Department of Agriculture

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2006**

B. FINANCIAL STATEMENT FINDINGS

06-1 Loan files are not properly maintained.

Criteria:

According to the loan agreement, the borrower's insurance on the collateral should be active and properly maintained to avoid the loan being called.

Condition:

The insurance requirement is not being met.

Effect:

The failure to adequately maintain the insurance requirement for the collateral placed the state at risk for its asset. The loan and underlying security might diminish in value.

Recommendation:

Management needs to be more diligent in obtaining required loan documents and ensure that those required documents are updated.

Response:

In order to properly maintain loan files, the Division conducted an internal audit of the entire loan portfolio in June 2006 and found incidences where the insurance coverage on the collateral which secured the loan had expired. Loan Officers were instructed to follow up on any expired insurance policies. The Division will continue to conduct an internal audit on an annual basis to ensure that required documents are obtained and updated as required.

06-2 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 the subsequent visits should be limited to twice annually. Farm visits 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.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2006**

B. FINANCIAL STATEMENT FINDINGS (continued)

Effect:

The failure to adequately monitor the physical operations of the loan recipients placed the state at risk for its asset. The loan and underlying security might diminish in value.

Recommendation:

Perform required on-farm visits and retain adequate documentation as specified in the policies and procedures manual.

Response:

The Division was not able to complete the required on-farm visits due to position vacancies, and the need to respond to the flood and earthquake emergencies. The Division is currently in the process of filling a loan officer position which will allow the required inspections to be completed and documented on a timely basis.

06-3 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.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2006**

B. FINANCIAL STATEMENT FINDINGS (continued)

Response:

The Division will establish a written policy requiring monthly reconciliation of the loan master lists to FAMIS balances. The Division Administrator will monitor and review the monthly reconciliations to ensure that the reconciliations are completed on a timely basis.

C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None