

Department of Agriculture
State of Hawaii
Financial and Compliance Audit
Year Ended June 30, 2004

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII**

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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, 2004, 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, 2004, 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.

Attari & Co., CPAs, Inc.

Honolulu, Hawaii
March 7, 2005

Financial Audit

Hattori & Co., CPAs, Inc.

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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, 2004, 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, 2004, 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, 2004, 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.

INDEPENDENT AUDITOR'S REPORT, CONTINUED

In accordance with *Government Auditing Standards*, we have also issued a report dated March 07, 2004 on our consideration of the department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

Hullari & Co., CPAs, Inc.

Honolulu, Hawaii
March 7, 2005

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, 2004. 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

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

governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal 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, 2004 and June 30, 2003 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>2004</u>	<u>2003</u>
Current and other assets	\$ 31.1	32.9
Loans receivable	20.7	21.6
Capital assets	<u>78.0</u>	<u>53.2</u>
Total assets	<u>129.8</u>	<u>107.7</u>
Long-term liabilities	10.5	3.7
Other liabilities	<u>3.6</u>	<u>2.9</u>
Total liabilities	<u>14.1</u>	<u>6.6</u>
Net assets:		
Invested in capital assets	78.0	53.2
Restricted	48.1	50.2
Unrestricted (deficit)	<u>(10.4)</u>	<u>(2.3)</u>
Total net assets	<u>115.7</u>	<u>101.1</u>
Total liabilities and net assets	\$ <u>129.8</u>	<u>107.7</u>

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

	<u>2004</u>	<u>2003</u>
Revenue		
Program revenues:		
Charges for services	\$ 6.7	7.5
Operating grants and contributions	2.5	3.8
Capital grants and contributions	4.1	8.6
General revenues:		
State allotted appropriations	12.0	10.4
Intergovernmental revenues	-	1.6
Non-imposed employee fringe benefit	2.9	-
Transfers	<u>(1.3)</u>	<u>1.9</u>
Total revenues	<u>\$ 26.9</u>	<u>33.8</u>
Program expenses		
Productivity improvement and management assistance	\$ 10.8	9.8
Product development and marketing	3.4	2.9
General support for agriculture	5.0	5.9
Agricultural water development and irrigation services	4.5	2.0
Pollution control	1.5	2.0
Protection of the consumer	0.8	0.6
Aquaculture development	0.6	0.5
Agriculture loans	<u>1.7</u>	<u>1.3</u>
Total expenses	<u>28.3</u>	<u>25.0</u>
(Decrease) Increase in net assets	\$ <u>(1.4)</u>	<u>8.8</u>

**Department of Agriculture
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Management Discussion and Analysis**

The Department's total assets exceed liabilities by \$115.7 million at the end of the fiscal year. Net assets of the Department's governmental activities increased by 14% (\$115.7 million compared to \$101.1 million). The largest portion of the Department's net assets (\$78.0 million) reflects its investment in capital assets (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 (\$48.1 million) represents resources that are subject to external restrictions, enabling legislation, or other legal requirements on how they may be used. The remaining unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints changed from a \$2.3 million deficit to a \$10.4 million deficit at the end of the fiscal year due to identification of the bond issuance in 2001. Net assets invested in capital assets increased primarily due to the miscoding of irrigation and drainage system capital assets on the property inventory and the identification of irrigation and drainage system infrastructure assets incurred prior to July 2002.

The Department's total revenues decreased by \$6.9 million primarily due to decreased in capital grants and contributions. Total expenses increased by \$3.3 million, due to inclusion of payroll fringe benefit cost for employees funded by general fund appropriations not previously charged to the Department's operating funds.

State allotted appropriations increased by \$1.6 million while intergovernmental revenues decreased by \$1.6 million; grants and contracts from the federal government decreased by \$4.5 million; and operating grants and contributions decreased by \$1.3 million.

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>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Productivity improvement and management assistance	\$ 10.8	9.8	7.3	5.7
Product development and marketing	3.4	2.9	3.1	2.7
General support for agriculture	5.0	5.9	2.7	3.4
Agricultural water development and irrigation services	4.5	2.0	(.5)	(8.2)
Pollution control	1.5	2.0	.7	.7
All others	<u>3.1</u>	<u>2.4</u>	<u>1.7</u>	<u>.9</u>
Totals	<u>\$ 28.3</u>	<u>25.0</u>	<u>15.0</u>	<u>5.2</u>

Financial Analysis of the Department's Funds

The Department's governmental funds reported a combined fund balance of \$48.9 million. In addition, these other changes in fund balances should be noted:

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Management Discussion and Analysis**

- The Department received \$15.2 million of allotted appropriations and spent \$4.5 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.
- Cash disbursed from the Agriculture Loan Program decreased by \$0.5 million, primarily due to less carry-over of undisbursed loans approved in FY03 and less approved loans disbursed in FY04.
- During the current year, \$1.0 million was identified by the 2004 Legislature for transfer out of the Agricultural Loan Revolving Fund to the State general fund as a source of revenue to meet anticipated budget shortfalls and balance the State's budget.

General Fund Budgetary Highlights

The State began FY04 with a gloomy economic outlook with the Council on Revenues in June 2003 projecting declining revenues based on revenue collection trends and changes in tax law. Again, expenditures were expected to exceed projected general fund revenues forcing the Administration to take immediate steps to reduce general fund as well special fund spending, continue the freeze on hiring and the spending moratorium on certain discretionary non-payroll funds. By September 2003, however, the Council on Revenues projected that the economic conditions in Hawaii would improve and be relatively favorable through the FY 2003-05. With these encouraging projections, the Administration did not impose any statewide restrictions on funding, and the spending moratorium was lifted. The freeze on hiring, however, was not lifted and continued requiring Departments to obtain the Governor's prior approval before filling vacancies. Departments were instructed to ensure a disciplined and balanced budget that did not impose further financial burden on the State while continuing to provide essential services of government. Although the Council of Revenues maintained their forecast of moderate general fund tax revenue growth for FY04 at their May 2004 meeting, the Administration projected that collective bargaining costs would be substantial and have a serious impact on the State's financial condition. By the end of FY04, the Administration had restored a spending moratorium on all non-federal fund spending except for non-discretionary obligations. Both the freeze on hiring and the spending moratorium slowed down the Department's personnel hiring and expenditures.

Capital Assets

At the end of June 30, 2004, the Department had \$78.0 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 \$24.8 million over last year.

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

	<u>2004</u>	<u>2003</u>
Land	\$ 22.5	22.5
Buildings	20.2	14.2
Land improvements	17.5	3.9
Furniture and equipment	1.3	.8
Motor vehicles	.5	.4
Construction in progress	<u>16.0</u>	<u>11.4</u>

**Department of Agriculture
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Total

\$ 78.0

53.2

This year's major additions included \$4.5 million for construction of irrigation and drainage infrastructure and \$1 million in land improvements.

Economic Factors and Next Year's Budgets and Rates

Hawaii's economy continues to show steady improvements in all areas and general fund revenues are projected to grow at a moderate pace for the duration of the six-year planning period spanning from FY06 through FY11. Despite the projected moderate increases in revenues, the Administration projects that the State's expenditures will grow significantly as a result of appropriations including collective bargaining requirements made in the 2004 Legislative Session. Any positive balance is expected to disappear as early as FY06, forcing the State into a serious deficit position and therefore the Administration has taken steps in FY05 to reduce the overall spending to bring recurring expenses to the level supportable by recurring revenues. For FY05, the Department was imposed general fund restrictions totaling \$664,003 comprising of a 1% across-the-board efficiency savings restriction and targeted restrictions on specific items. The filling of vacant positions and expenditures for certain discretionary items shall continue to require Governor's prior approval as in the previous fiscal year. The 2004 Legislature also authorized the transfer of another \$1.7 million in special funds (\$800,000 from the Animal Quarantine Special Fund and \$900,000 from the Agricultural Loan Reserve Fund) as a source of revenue to meet anticipated budget shortfalls and balance the State's budget.

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, 2004**

Governmental Activities

ASSETS

Cash and cash equivalent	\$	30,283,776
Receivables, net		812,268
Loans receivable, net		20,717,660
Capital assets		
Land, improvements, and construction in progress		38,533,445
Other capital assets, net of depreciation		39,455,985

Total assets	\$	129,803,134
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LIABILITIES

Accounts payable and accrued liabilities	\$	1,114,963
Due to state general fund		8,000
Due to agency fund		3,832
Deferred revenues		924,743
Accrued vacation:		
Due within one year		1,332,761
Due in more than one year		2,379,856
Bond payable		
Due within one year		170,036
Due in more than one year		8,165,064

Total liabilities		14,099,255
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NET ASSETS (DEFICIT)

Investment in capital assets		77,989,430
Restricted for:		
Capital projects		14,037,884
Agricultural loan program		28,734,911
Other purpose		5,392,188
Unrestricted		(10,450,534)

Total net assets		115,703,879
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Total liabilities and net assets	\$	129,803,134
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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, 2004**

	Expenses	Program Revenues			Net (Expense) Revenue 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	\$ 10,757,522	2,785,828	626,732	-	\$ (7,344,962)
Product development and marketing	3,442,168	292,458	68,507	-	(3,081,203)
General support for agriculture	5,025,330	1,039,525	1,292,813	-	(2,692,992)
Agricultural water development and irrigation services	4,520,511	943,642	28,717	4,044,260	496,108
Pollution control	1,526,725	594,752	283,106	-	(648,867)
Protection of the consumer	773,722	-	-	-	(773,722)
Aquaculture development	569,406	2,765	45,470	-	(521,171)
Agricultural loans	1,636,953	1,064,414	188,114	-	(384,425)
Total departmental activities	\$ 28,252,337	6,723,384	2,533,459	4,044,260	(14,951,234) (a)

General Revenues

State allotted appropriations	11,984,567
Non-imposed employee fringe benefit	2,939,616
Intergovernmental revenues	-
Transfers	(1,316,546)
Total general revenues and special items	13,607,637 (a)

Other Revenue (Loss)

Loss on disposal of fixed assets	(2,546) (a)
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Change in Net Assets [sum of (a)]

(1,346,143)

Net assets, June 30, 2003	101,067,960
Prior year adjustments	15,982,062

Net Assets, June 30, 2004 \$ 115,703,879

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

DEPARTMENT OF AGRICULTURE, STATE OF HAWAII
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004

	General Fund	Irrigation & Drainage System Capital Projects	Agriculture Loan	Plant Pest & Disease Control	Agribusiness Development & Research	Other Governmental Funds	Total Governmental Funds
ASSETS							
Cash	\$ 1,340,828	14,279,582	8,191,686	381,778	234,630	5,855,272	\$ 30,283,776
Loan Receivable	-	-	20,717,660	-	-	-	20,717,660
Total assets	\$ 1,340,828	14,279,582	28,909,346	381,778	234,630	5,855,272	51,001,436
LIABILITIES AND FUND BALANCES							
Liabilities:							
Vouchers Payable	\$ 102,461	241,698	428	12,615	23,061	66,871	\$ 447,134
Accrued Payroll	438,748	-	23,353	35,632	-	170,096	667,829
Due to State General Fund	8,000	-	-	-	-	-	8,000
Due to Agency Fund	-	-	3,832	-	-	-	3,832
Deferred Revenues	-	-	-	333,531	211,569	379,643	924,743
Total liabilities	549,209	241,698	27,613	381,778	234,630	616,610	2,051,538
Fund Balances(Deficit):							
Reserved for:							
Encumbrances	1,148,792	4,641,049	120,691	121,225	1,497,377	1,006,645	8,535,779
Continuing appropriation	-	9,396,835	9,751,594	(121,225)	(1,497,377)	4,232,017	21,761,844
Noncurrent assets	-	-	19,009,448	-	-	-	19,009,448
Unreserved	(357,173)	-	-	-	-	-	(357,173)
Total fund balances	791,619	14,037,884	28,881,733	-	-	5,238,662	48,949,898 (a)
Total liabilities and fund balances	\$ 1,340,828	14,279,582	28,909,346	381,778	234,630	5,855,272	\$ 51,001,436

Total governmental fund balances, above (a)	\$ 48,949,898
Capital assets used in governmental activities are not financial resources and therefore not reported in governmental funds	77,989,430
Receivables in the statement of activities that do not provide current financial resources are not reported in governmental funds	812,268
Some liabilities, such as compensated absences, are not due and payable in the current period and therefore not reported in governmental funds	(3,712,617)
Long term liabilities, such as bond payable, are not due and payable in the current and therefore are not reported in governmental funds	(8,335,100)
Net assets of governmental activities	\$ 115,703,879

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, 2004

	General Fund	Irrigation & Drainage System Capital Projects	Financial Assistance for Agriculture	Plant Pest & Disease control	Agribusiness Development & Research	Other Governmental Funds	Total Governmental Funds
REVENUES							
Allotted appropriation	\$ 12,813,975	2,350,000	-	-	-	-	\$ 15,163,975
Intergovernmental revenues	-	1,894,260	-	519,155	856,416	833,869	4,103,700
Non-imposed employee fringe benefit	2,939,616	-	-	-	-	-	2,939,616
Interest on agricultural loans	-	-	1,060,860	-	-	-	1,060,860
Charges for services	-	-	954	-	-	5,596,007	5,596,961
Investment earnings	-	-	188,114	-	-	135,905	324,019
Other revenue	-	-	2,602	-	-	-	2,602
Total Revenues	15,753,591	4,244,260	1,252,530	519,155	856,416	6,565,781	29,191,733
EXPENDITURES							
Current:							
Productivity improvement and management assistance	6,863,153	-	-	519,155	-	2,963,186	10,345,494
Product development and marketing	3,090,166	-	-	-	-	292,692	3,382,858
General support for agriculture	2,564,999	-	-	-	856,416	1,568,063	4,989,478
Agricultural water development and irrigation services and irrigation services	164,186	-	-	-	-	1,088,881	1,253,067
Pollution control	861,616	-	-	-	-	686,149	1,547,765
Protection of the consumer	746,714	-	-	-	-	-	746,714
Aquaculture development	500,857	-	-	-	-	44,853	545,710
Agricultural loan administration	-	-	1,592,107	-	-	-	1,592,107
Capital outlay	-	4,485,566	-	-	-	-	4,485,566
Total Expenditures	14,791,691	4,485,566	1,592,107	519,155	856,416	6,643,824	28,888,759
Excess of revenue over(under) expenditure	961,900	(241,306)	(339,577)	-	-	(78,043)	302,974
Other financing sources:							
Lapsed appropriations	(829,408)	(200,000)	-	-	-	-	(1,029,408)
Operating transfers in	-	-	-	-	-	380,958	380,958
Operating transfers out	(380,958)	-	(1,000,000)	-	-	(528,364)	(1,909,322)
	(1,210,366)	(200,000)	(1,000,000)	-	-	(147,406)	(2,557,772)
Excess of revenues and other sources over(under) expenditures and other uses	(248,466)	(441,306)	(1,339,577)	-	-	(225,449)	(2,254,798)
Fund Balances - Beginning	587,610	14,479,190	8,773,868	-	-	5,464,111	29,304,779
Prior Year Adjustments	452,475	-	21,447,442	-	-	-	21,899,917
Fund Balances - Ending	\$ 791,619	14,037,884	28,881,733	-	-	5,238,662	48,949,898

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, 2004**

Net change in fund balances -total governmental funds	\$ (2,254,798)
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	738,025
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	62,962
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	(57,232)
Long term liabilities, such as bond payable, are not due and payable in the current and therefore are not reported in the governmental funds.	164,900
Change in net assets of governmental activities	\$ (1,346,143)

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2004**

	Private- Purpose Trusts	Agency
	<u> </u>	<u> </u>
ASSETS		
Cash and cash equivalents	\$ 61,933	\$ 47,889
Loans receivable, net	-	37,708
Due from special funds	-	3,832
Total Assets	<u>\$ 61,933</u>	<u>\$ 89,429</u>
LIABILITIES		
Vouchers Payable	\$ 2,487	\$ 11,768
Accrued Payroll	34,752	-
Due to others	-	36,121
Due to State General Fund	-	41,540
Total Liabilities	<u>37,239</u>	<u>89,429</u>
NET ASSETS (Deficit)	<u>24,694</u>	<u>-</u>
	<u>\$ 61,933</u>	<u>\$ 89,429</u>

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, 2004**

	Private- Purpose Trust
REVENUES	
Other revenues	\$ 480,117
EXPENDITURES	
Expendable trust funds	<u>449,012</u>
Excess of revenues over(under) expenditures	31,105
Net assets (deficit) at July 1, 2003	<u>(6,411)</u>
Net assets at June 30, 2004	<u><u>\$ 24,694</u></u>

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(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 Senate to serve a term of four years and may be 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, 2004 conform to generally accepted accounting principles (GAAP) in the United States of America as prescribed by GASB. In June 1999, the 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, 2004

(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 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 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:

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

presented is a part of the state's general fund and is limited only to those appropriations and obligations of the department.

Special revenue fund

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

Capital projects fund

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

Fiduciary funds

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

Major funds

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

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

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 employee vested vacation unpaid 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.

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.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- Encumbrances for outstanding commitments which generally are 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, 2004, 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 Statues (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.

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.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

Accrued Vacation

Vacation pay is accrued as earned by employees. Employees hired on or before July 1, 2001, earn vacation at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001, earn vacation at rates ranging between one and two working days for each month of service, depending upon the employees' years of service and job classification. Vacation days may be accumulated to a maximum of 90 days at the end of the calendar year and is convertible to pay upon termination of employment. The employees' accrued vacation is expected to be liquidated with future expendable resources and is therefore accrued in the statement of net assets.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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.

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.

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 \$2,939,616, have been reported as revenues and expenditures in the department's financial statements for the fiscal year ended June 30, 2004.

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.

(3) BUDGETING AND BUDGETARY CONTROL

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(3) BUDGETING AND BUDGETARY CONTROL (continued)

The department follows these procedures in establishing the budgetary data reflected in the financial statements:

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

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

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

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

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

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse dates and any other contingencies that may terminate the authorizations for other appropriations.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(3) BUDGETING AND BUDGETARY CONTROL (continued)

Differences between revenues and expenditures reported on the budgetary basis and those reported in accordance with GAAP are mainly due to the different methods used to recognize resource uses. For budgeting purposes, revenues are recognized when cash is received and expenditures are recognized when cash disbursements are made or funds are encumbered. In the accompanying financial statements presented in accordance with GAAP, revenues are recognized when they become available and measurable and expenditures are recognized as incurred. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2004, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the notes to the Required Supplementary Information.

Funds for the department appropriated from the state's general revenues for the fiscal year ended June 30, 2004 were authorized under the following appropriations:

Act 200, Session Laws of Hawaii (SLH) of 2003 for the operating budget of the department:

Productivity improvement and management assistance	\$ 5,641,476
Product development and marketing	2,773,539
General support for agriculture	2,245,467
Agricultural water development and irrigation services	253,401
Pollution control	732,008
Protection of the consumer	677,088
Aquaculture development	490,996
<hr/>	
Budget total	\$12,813,975

(4) CASH AND CASH EQUIVALENTS

At June 30, 2004, the carrying amount of the department's cash and cash equivalents was \$30,283,776, which approximates the bank balance.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(5) LOANS RECEIVABLE

At June 30, 2004, loans receivable consisted of the following:

	Special Revenue	Agency
Hawaii Agriculture Loan Program	\$20,877,852	-
Hawaii Aquaculture Loan Program	1,048,676	-
Hawaii Agricultural Products Loan Program	76,214	
Independent Sugar Growers Loan Program	-	2,114
Emergency Loan Program	-	35,594
Accrued interest	714,918	-
	<hr/> 22,717,660	-
Less allowance for doubtful receivables	2,000,000	-
	<hr/> \$20,717,660	37,708

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.

(6) ACCOUNTS RECEIVABLE

At June 30, 2004, accounts receivable consisted of the following:

Waiahole Water System	\$109,500
Lease Rental of Public Land	195,294
Sale of Water	396,397
Quarantine Fee	1,168,736
	<hr/> \$1,869,927
Less allowance for doubtful receivables	1,057,659
	<hr/> \$ 812,268

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(7) CAPITAL ASSETS

The changes to capital assets as of June 30, 2004 are as follows:

	Balance at July 1, 2003	Prior Year Adjustments	Beginning Balance as Restated	Additions and Transfers In	Disposals and Transfers Out	Ending Balance June 30, 2004
<i>Capital Assets Being Depreciated</i>						
Land improvements	\$ 19,802,206	32,019,846	51,822,052	962,500		\$ 52,784,552
Buildings	20,471,698	6,785,926	27,257,624	-	-	27,257,624
Vehicles	2,410,069	127,410	2,537,479	160,342	(76,192)	2,621,629
Equipment	3,782,804	379,011	4,161,815	143,765	(98,483)	4,207,097
	46,466,777	39,312,193	85,778,970	1,266,607	(174,675)	86,870,902
Less accumulated depreciation:						
Land improvements	15,918,559	15,791,609	31,710,168	3,538,490	-	35,248,658
Buildings	6,238,600	(118,498)	6,120,102	930,906	-	7,051,008
Vehicles	2,036,654	12,741	2,049,395	189,997	(76,192)	2,163,200
Equipment	3,001,050	(219,782)	2,781,268	274,577	(103,794)	2,952,051
	27,194,863	15,466,070	42,660,933	4,933,970	(179,986)	47,414,917
Subtotal	19,271,914	23,846,123	43,118,037	(3,667,363)	5,311	39,455,985
<i>Capital Assets Not Being Depreciated</i>						
Land	22,555,327	27,625	22,582,952	-	(85,488)	22,497,464
Construction in progress	11,371,162	179,253	11,550,415	4,485,566	-	16,035,981
Subtotal	33,926,489	206,878	34,133,367	4,485,566	(85,488)	38,533,445
Total capital assets	\$ 53,198,403	24,053,001	77,251,404	818,203	(80,177)	\$ 77,989,430

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(7) CAPITAL ASSETS (continued)

Depreciation expense for the year ended June 30, 2004 was charged to governmental activities as follows:

Productivity improvement and management assistance	\$ 674,439
Product development and marketing	71,056
General support for agriculture	235,140
Agricultural water development and irrigation services	3,191,220
Pollution control	19,086
Protection of the consumer	21,557
Aquaculture development	1,300
Agricultural loans	35,416
	\$ 4,249,214

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

(8) GENERAL OBLIGATION BOND

Pursuant to Act 111, SLH 1998, reimbursable general obligation bonds of \$8,500,000 were issued in 2001 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 and the interest rate is 3.00%. The principal repayment is due annually and the accrued interest is due semi-annually.

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

Balance at July 1, 2003	\$8,500,000
Increase	-
Decrease	164,900
	\$8,335,100
Balance at June 30, 2004	

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(8) GENERAL OBLIGATION BOND (continued)

Future bond principal repayment and interest payment for fiscal year ending after June 30, 2004 are as follows:

	Principal	Interest
2005	\$ 170,036	\$ 250,053
2006	175,141	244,952
2007	180,412	239,698
2008	185,866	234,285
2009	191,460	228,709
Thereafter	7,432,185	3,300,964
	\$8,335,100	\$4,498,661

(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, 2004 is as follows:

2005	\$ 389,000
2006	369,000
2007	369,000
2008	369,000
2009	368,000
Thereafter	10,325,574
	\$ 12,189,574

Rental income from leases at the agricultural parks for the fiscal year ended June 30, 2004 approximated to \$338,700, including \$5,200 for additional rent based on percentage of revenues.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(10) VACATION AND SICK LEAVE

Vacation

The changes to the general long-term debt compensated absences as of June 30, 2004 approximated the following:

Balance at July 1, 2003	\$3,655,400
Increase	57,200
Decrease	-
Balance at June 30, 2004	\$3,712,600

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.

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, 2004 was approximately \$10,924,000.

(11) RETIREMENT BENEFITS

Retirement Plan Description

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

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(11) RETIREMENT BENEFITS (continued)

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

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

Funding Policy

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

The state's contribution requirements as of June 30, 2004, 2003, and 2002 were approximately \$181,614,000, \$158,622,000, and \$113,984,000, respectively. The state contributed 100% of its required contributions for those years. Changes in salary growth assumptions and investment earnings pursuant to Act 100, SLH of 1999, decreased the June 30, 2001 and 2000 required contributions. Act 233, SLH of 2002, increased the 2003 contribution by providing a one-time lump-sum pensioner bonus to retirees who were 70 years and older with at least 20 years of credited service as of June 30, 2002. Also Act 284, SLH of 2001, provided an increase in the pension benefits effective 2003 to retirees with military service. The department's special revenue funds expended approximately \$316,000 in employer contributions for the year.

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(11) RETIREMENT BENEFITS (continued)

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.

There are currently approximately 24,200 state retirees receiving such benefits. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis. During fiscal 2004, expenditures of \$151,851,000 were recognized for post-retirement health care and life insurance benefits, approximately \$35,136,000 of which is attributable to the component units.

(12) COMMITMENTS AND CONTINGENCIES

Insurance Coverage

Insurance coverage is maintained at the state level. The state is self-insured for substantially all perils, including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the state General Fund.

The department is covered by the state's self-insured Workers' Compensation Program for medical expenses of injured department employees. However, the department is required to pay temporary total and temporary partial disability benefits as long as the employee is on the department's payroll. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities may be re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. Workers compensation expenditures for the year ended June 30, 2004 were \$17,680.

Deferred Compensation Plan

The state established a deferred compensation plan pursuant to Internal Revenue Code Section 457 that enables state employees to defer a portion of their compensation. The State of Hawaii, Department of Human Resources Development, has the fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property, or rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employees or other beneficiary) solely the property and rights of the state (without being restricted to the provisions of benefits under the plan), subject to the claims of the state's general creditors.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(12) COMMITMENTS AND CONTINGENCIES (continued)

Participants' rights under the plan are equal to those of the general creditors of the state in an amount equal to the fair market value of the deferred account for each participant. The assets of the plan and the deferred compensation payable are recorded in the State of Hawaii's Employee Benefits Agency Fund.

(13) TRANSFERS

For the year ended June 30, 2004, transfers by fund were as follows:

<u>Transfer From:</u>	<u>Transfer To:</u>	<u>Amount</u>
General fund	Irrigation System Revolving Fund	\$ 140,400
General fund	Hawaii Agriculture Development Revolving Fund	240,558
		380,958

<u>Transfer From:</u>	<u>Transfer To:</u>	
Waiahole Water System Revolving Fund	State general fund	400,000
Agricultural Loan Revolving Fund	State general fund	1,000,000
Pesticide Use Revolving Fund	State general fund	128,364
		\$1,528,364

The general fund transferred \$140,400 to the irrigation system revolving fund pursuant to Section 6 of Act 200, SLH2003, as amended by Act 41, SLH 2004, and \$240,558 to the Hawaii Agricultural Development Revolving Fund pursuant to Section 7 of Act 200, SLH2003, as amended by Act 41, SLH2004; \$50,000 of the transfer from the general fund to Hawaii Agricultural Development Revolving Fund was to be expended for operation and maintenance of East Kauai Irrigation System. Fixed assets transferred in approximated \$211,800.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Notes to Financial Statements
June 30, 2004

(14) PRIOR PERIOD ADJUSTMENTS

Adjustments were recorded to fund balance and net assets as of June 30, 2003 to recognize the existence of certain assets and correct reporting of certain other transactions. The following are the adjustments:

Government-wide financial statements:

Cost of capital assets	\$ 39,519,070
Less accumulated depreciation	(15,466,070)
<hr/>	
Net adjustment for capital assets	24,053,000
Correction to vouchers payable	500,044
Correction to prepaid expenses	(47,569)
Accounts receivable not due in current period	124,972
Loan receivable	(148,385)
Bond Payable	(8,500,000)
<hr/>	
	\$ 15,982,062
<hr/>	

Fund financial statements:

Long-term loans and interest receivable, net of allowance for doubtful accounts of \$1,150,000	\$ 21,447,442
<hr/>	
Correction to prepaid expenses	\$ (47,569)
Correction to vouchers payable	500,044
<hr/>	
	\$ 452,475
<hr/>	

As a result of the restatement, the department's operating expenses presented in the statement of activities for the year ended June 30, 2003 increased by approximately \$4,700,000, comprised of \$4,250,000 for depreciation of capital assets and \$450,000 net decrease of other expenses.

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, 2004

	Budgeted Amount		Actual Amount Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Budgetary fund balance at June 30, 2003	\$ -	\$ -	\$ -	\$ -
<i>Revenues</i>				
State allotted appropriation	12,813,975	12,813,975	12,813,975	-
Intergovernmental	-	-	-	-
Total Revenues	12,813,975	12,813,975	12,813,975	-
<i>Expenditures</i>				
Productivity improvement and management assistance	5,641,476	5,626,476	5,365,135	261,341
Product development and marketing	2,773,539	2,773,539	2,603,650	169,889
General support for agriculture	2,004,909	2,019,909	1,999,942	19,967
Agricultural water development and irrigation services	113,001	123,001	120,131	2,870
Pollution control	732,008	732,008	666,009	65,999
Protection of the consumer	677,088	677,088	599,530	77,558
Aquaculture development	490,996	480,996	428,138	52,858
Total Expenditures	12,433,017	12,433,017	11,782,535	650,482
Excess of revenue over(under) expenditure	380,958	380,958	1,031,440	650,482
<i>Other financing sources:</i>				
Operating transfers in				
Operating transfers out	(380,958)	(380,958)	(380,958)	-
Excess of revenues and other sources over(under) expenditures and other uses	-	-	650,482	650,482
Lapsed appropriations	-	-	(650,482)	(650,482)
Budgetary fund balance at June 30, 2004	\$ -	\$ -	\$ -	\$ -

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, 2004

	Budgeted Amounts		Actual Amounts Budgetary Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
Financial Assistance for Agriculture				
<i>Revenues</i>				
Charge for services and investment income	\$ 6,016,965	\$ 6,016,965	\$ 1,252,530	\$ (4,764,435)
<i>Expenditure</i>				
Agricultural Loans	6,016,965	6,016,965	1,576,629	4,440,336
Excess of revenues and other sources over (under) expenditures	-	-	(324,099)	(324,099)
<i>Other financing sources</i>				
Operating transfers in (out)	(1,000,000)	(1,000,000)	(1,000,000)	-
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ (1,000,000)	\$ (1,000,000)	\$ (1,324,099)	\$ (324,099)
Plant and Pest Disease Control				
<i>Revenues</i>				
Charges for services and investment income	\$ 1,197,718	\$ 1,197,718	\$ 629,682	\$ (568,036)
<i>Expenditure</i>				
Productivity improvement and management	1,197,718	1,197,718	544,018	653,700
Excess of revenues and other sources over (under) expenditures and other uses	\$ -	\$ -	\$ 85,664	\$ 85,664
Agribusiness Development and Research				
<i>Revenue</i>				
Charges for services and investment income	\$ 2,889,633	\$ 2,889,633	\$ 892,004	\$ (1,997,629)
<i>Expenditure</i>				
General support for agriculture	2,889,633	2,889,633	899,141	1,990,492
<i>Excess of revenues and other sources over (under) expenditures and other uses</i>	\$ -	\$ -	\$ (7,137)	\$ (7,137)

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, 2004

	General Fund	Financial Assistance for Agriculture	Plant Pest and Disease Control	Agribusiness Development and Research
Excess of revenues and other sources over (under) expenditures and other uses - actual on budgetary basis	\$ 650,482	\$ (1,324,099)	\$ 85,664	\$ (7,137)
Reserved for encumbrances at fiscal year-end	1,148,793	120,691	-	-
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	163,641	7,572	(85,664)	7,137
Lapsed appropriations	(829,408)	-	-	-
Expenditures for prior fiscal years' encumbrances	(1,381,974)	(143,741)	-	-
Excess of revenues and other sources over (under) expenditures and other uses - GAAP basis	\$ (248,466)	\$ (1,339,577)	\$ -	\$ -

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

Compliance Audit

Department of Agriculture
 Schedule of Expenditures of Federal Awards
 For the Year Ended June 30, 2004

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	03-8510-0744-CA	\$ 29,699
Red Imported Fire Ant Survey		03-8510-0666-CA	9,938
Seed Inspection Services		45-9417-6-9990	2,500
Homeland Security for Pest Detection Activity		02-8510-0586-CA	83,409
Homeland Security for Animal Disease Emergency Response		02-9715-0321-CA	4,989
Voluntary Scrapie Flock Certification		03-9715-1134-CA	2,652
Voluntary Johne's Disease Herd Status Program		03-9715-1133-CA	39,990
Foreign Animal Disease Surveillance, Bovine Spongiform Encephalopathy Surveillance, Animal Emergency Management		03-9715-1126-CA	18,287
Swine Health Protection		03-9715-1128-CA	2,944
HI Brown Tree Snake Detector Program			<u>228,962</u>
			<u>423,370</u>
Shell Egg Surveillance	10.162	12-25-A-3310	13,377
Meat Grading and Certification Service		12-25-A-3850	<u>1,281</u>
			<u>14,658</u>
Cooperative Pesticide Recordkeeping	10.163	12-25-A-4053	6,315
National Organic Certification Cost-Share Program		12-25-A-4147	<u>34,697</u>
			<u>41,012</u>
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	10.156	12-25-G-0303	<u>4,500</u>
Disease Management for Hawaiian Aquaculture	10.950	2002-38500-12039	<u>44,660</u>
Promote Specialty Crops	None	Public Law 107-27	<u>452,122</u>
Exploration for Biological Control of Melon Fly in Indo-Malayan Region	10.001	58-5320-1-530	<u>3,423</u>
Control of Fountain Grass Through Chemical and Physical Means	10.664	00-DG-11052000-146	<u>9,508</u>

Hattori & Co., CPAs, Inc.

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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, 2004, and have issued our report thereon dated March 7, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

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
March 7, 2005

Department of Agriculture
 Schedule of Expenditures of Federal Awards
 For the Year Ended June 30, 2004

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Grant Number	Expenditures
Upcountry Maui Watershed	10.904	68-9251-1-524	83,532
		68-9251-2-591	29,931
		65-9251-3-615	335,113
			<u>448,576</u>
Lower Hamakua Watershed, Hawaii	10.904	65-9251-1-514	12,338
		69-9251-1-516	9,632
		69-9251-1-562	4,750
		69-9251-1-563	23,653
		69-9251-1-564	23,344
		69-9251-1-565	270,827
		65-9251-1-584	8,363
		69-9251-2-602	665,031
		65-9251-3-616	116,920
		65-9251-3-617	30,391
			<u>1,165,249</u>
<u>Environmental Protection Agency (EPA)</u>			
Pesticide Enforcement	66.700	E-009159-02-2 / E-009159-04-0	231,424
Pesticide Certification		E-009419-02-2 / E-009419-04-0	30,704
Hawaii Agricultural Bioremediation Project		X-98951201-0	194,800
Pesticide Environmental Stewardship			21,715
			<u>478,643</u>
<u>Department of Commerce</u>			
Voluntary Inspection Services for Fish and Fishery Products		45ABNMA0B1070	<u>1,013</u>
<u>Department of Interior</u>			
Research and Development for Brown Tree Snake	15.875	2001/2002 Interior Appropriation Act	<u>175,126</u>
Hawaii Water Resources Study	15.504	02-FG-30-0029	<u>158,500</u>
Decision Support System for Evaluating Threats of Invasive Birds Project	15.808	99WRAG0028	<u>1,454</u>
Total Expenditures of Federal Awards			<u><u>\$ 3,421,814</u></u>

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

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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, 2004. 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, 2004. 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 04-1.

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
March 7, 2005

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004**

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.
- No reportable conditions in internal control over financial reporting were disclosed.
- No material noncompliance to the financial statements was disclosed.

2. Federal Awards

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

Identification of major programs:

CFDA Number	Federal Program
10.025	U.S Department of Agriculture, APHIS, PPQ, VS, WS
Public Law 107-27	Promote Agriculture, with Priority Being Given to Specialty Crops
10.904	Watershed Protection and Flood Protection
15.875	Research and Development for Brown Tree Snake

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

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004**

B. FINANCIAL STATEMENT FINDINGS

NONE

C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS - NONE

FEDERAL AWARDS - REPORTABLE CONDITIONS

DEPARTMENT OF AGRICULTURE (USDA)

Promote Specialty Crops
Public Law 107-27

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

Criteria: 7 CFR Part 3016.21 states – "*Interest earned on advances.* Except for interest earned on advances of funds exempt under the Intergovernmental Cooperative Act and Indian Self-Determination Act, grantees and subgrantees shall promptly, but at least quarterly, remit interest earned on advance to the Federal Agency. The grantee may keep interest amounts up to \$100 per year for administrative expenses."

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

Effect: Non-compliance with the "shall promptly" requirement to remit.

Recommendation: Procedures should be established to ensure timely transfer of interest earned on grant funds advanced.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII**

**Summary Schedule of Prior Year Findings and Questioned Costs
Year Ended June 30, 2004**

A. FINANCIAL STATEMENT FINDINGS - NONE

B. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

03-1 Upcountry Maui Watershed; Drainage, Waimanalo Irrigation System; Lower Hamakua Watershed, Hawaii. CFDA: 10.904; and Promote Agriculture with Priority Being Given to Specialty Crops. CFDA: None

Condition: According to Office of Management and Budget Circular A-133 Part 3(I), "Contractor receiving individual awards of \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred." Suspension and debarment certifications from contractors receiving Federal monies in excess of \$100,000 were not obtained.

Status: Resolved. There was no similar finding in fiscal year June 30, 2004 audit.

02-1 Finding for the year ended June 30, 2002 has been repeated and was again reported as finding 03-1 for the year ended June 30, 2003.

Status: Resolved. There was no similar finding in fiscal year June 30, 2004 audit.

Response of the Department of Agriculture

LINDA LINGLE
Governor



SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

Deputy to the Chairperson

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

March 15, 2005

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

Gentlemen

Thank you for the opportunity to review and provide comments on the draft report of the Financial and Compliance Audit of the Department of Agriculture for the fiscal year ended June 30, 2004.

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

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

Sincerely,

A handwritten signature in black ink, appearing to read "Sandra Lee Kunimoto".

Sandra Lee Kunimoto
Chairperson, Board of Agriculture

Enclosure

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2004**

Section C – Federal Award Findings and Questioned Costs

**Finding No. 04-01 INTEREST EARNED ON GRANT FUNDS ADVANCED WAS NOT
SUBMITTED TO COMMODITY CREDIT CORPORATION ON A TIMELY BASIS**

Condition:

Pursuant to 7 CFR Part 3016.21 cited in the agreement between the Commodity Credit Corporation and the State of Hawaii Department of Agriculture, the Department is required to transfer interest earned on grant funds advanced to Commodity Credit Corporation promptly, but at least quarterly. Interest earned for the quarter ending September 30, 2003 was not transferred to Commodity Credit Corporation until February 17, 2004, resulting in non compliance with the “shall promptly” requirement to remit.

Recommendation:

We recommend that the Department establish procedures to ensure timely transfer of interest earned on grant funds advanced.

Response:

The section in the Fiscal Office responsible for the Department’s administration of the funds and financial obligations, which include the reporting and remittance of interest earned on grant funds advanced has been reminded of the remittance requirement contained in the agreement between the Commodity Credit Corporation and the Department.

The Department will be diligent about the prompt transfer of interest earned on grant funds advanced to the Commodity Credit Corporation.