



CERTIFIED PUBLIC ACCOUNTANTS

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# **State of Hawaii Department of Agriculture**

**Financial and Compliance Audit**

**June 30, 2008**

**Submitted by  
The Auditor  
State of Hawaii**

**State of Hawaii**  
**Department of Agriculture**  
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**June 30, 2008**

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## **Report of Independent Auditors**

The Auditor and 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 State of Hawaii, Department of Agriculture (the "Department"), as of and for the year ended June 30, 2008, which collectively comprise the Department's basic financial statements as listed in the index. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the basic financial statements of the Department are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008, 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.

As discussed in Note 14 to the basic financial statements, certain errors resulting in an understatement of the previously reported department-wide net assets and overstatement of governmental funds fund balance as of June 30, 2007, were discovered by management of the Department during the current year. Accordingly, the fiscal year 2007 financial statements have been restated and adjustments have been made to the department-wide net assets and governmental funds fund balance as of July 1, 2007 to correct the error.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.



In accordance with *Government Auditing Standards*, we have also issued our report dated June 8, 2009 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. As described in Note 1 to the Schedule of Expenditures of Federal Awards, the accompanying Schedule of Expenditures of Federal Awards was prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects on the basis of accounting described in Note 1, in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Accuity LLP". The signature is written in a cursive, flowing style with a large loop at the end of the "y".

Honolulu, Hawaii  
June 8, 2009

**State of Hawaii**  
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**Management's Discussion and Analysis**  
**June 30, 2008**

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Management's discussion and analysis of the Department of Agriculture of the State of Hawaii's (the "Department") financial performance provides an overview of the Department's financial activities for the fiscal year ended June 30, 2008. Please 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) department-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

**Department-Wide Financial Statements**

The department-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.

The Department's governmental activities are reported 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 department-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).

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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 a whole and other state and local 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 department-wide financial statements. However, unlike the department-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 governmental funds statement of revenues, expenditures and changes in fund balances 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 agency funds. The fiduciary funds are not reflected in the department-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. 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 department-wide and fund financial statements.

**Restatements**

The June 30, 2007 net assets and fund balances were restated by \$998,000 and \$1.7 million, respectively. Refer to footnote 14 of the financial statements for a detail of the restated items.

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**Department-Wide Financial Analysis**

The Department's condensed financial information of its governmental activities as of and for the years ended June 30, 2008 and 2007 is provided below.

**Summary of Net Assets**  
**(in Millions)**

	<b>2008</b>	<b>2007 (restated)</b>
Current and other assets	\$ 74.3	\$ 55.1
Loans receivable	13.6	15.1
Capital assets	<u>74.3</u>	<u>74.7</u>
Total assets	<u>\$ 162.2</u>	<u>\$ 144.9</u>
Long-term liabilities	\$ 9.9	\$ 10.0
Other liabilities	<u>5.1</u>	<u>3.3</u>
Total liabilities	<u>15.0</u>	<u>13.3</u>
Net assets		
Invested in capital assets, net	66.6	66.8
Restricted	74.1	55.3
Unrestricted	<u>6.5</u>	<u>9.5</u>
Total net assets	<u>147.2</u>	<u>131.6</u>
Total liabilities and net assets	<u>\$ 162.2</u>	<u>\$ 144.9</u>

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**Summary of Changes in Net Assets**  
**(in Millions)**

	<b>2008</b>	<b>2007</b> <b>(restated)</b>
General revenues and transfers		
State allotted appropriations	\$ 40.6	\$ 35.2
Non-imposed employee fringe benefit	4.7	4.2
Transfers	(0.9)	(0.7)
Total general revenues and transfers	<u>44.4</u>	<u>38.7</u>
Program revenues		
Charges for services	9.9	8.5
Operating grants and contributions	2.3	2.7
Capital grants and contributions	4.1	3.7
Total program revenues	<u>16.3</u>	<u>14.9</u>
Total revenues	<u>60.7</u>	<u>53.6</u>
Program expenses		
Productivity improvement and management assistance	16.7	14.4
Product development and marketing	6.3	5.1
General support for agriculture	5.4	5.5
Agricultural water development and irrigation services	12.3	7.1
Pollution control	2.0	2.0
Protection of the consumer	1.1	1.0
Aquaculture development	0.6	0.7
Agriculture loans	0.7	1.2
Total expenses	<u>45.1</u>	<u>37.0</u>
Increase in net assets	<u>\$ 15.6</u>	<u>\$ 16.6</u>

The Department's total assets exceeded liabilities by \$147.2 million at June 30, 2008. Net assets of the Department's governmental activities increased by \$15.6 million or 11.9% (\$147.2 million compared to \$131.6 million) over the prior fiscal year. The largest portion of the Department's net assets (\$74.1 million) represents resources that are subject to external restrictions, enabling legislation, or other legal requirements on how they may be used. A portion of the Department's net assets (\$66.6 million) is comprised of 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 capital assets are not available for future spending. The remaining unrestricted net assets, the part of net assets that can be used to finance day-to-day operations without constraints, totaled \$6.5 million.

The Department's total revenues and net transfers increased by \$7.1 million primarily due to State allotted appropriations which included \$11.9 million appropriated for repair and maintenance of various irrigation systems pursuant to Act 233, SLH 2006 and \$4.6 million transferred into the Department to mitigate damages at irrigation systems resulting from the October 2006 Kiholo Bay earthquake.

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The Department's total expenses increased by \$8.1 million primarily due to increased spending for agricultural water development and irrigation services to mitigate damages to irrigation systems resulting from the October 2006 earthquake.

The following table 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.

**Governmental Activities**  
**(in Millions)**

	<b>Total Cost of Services</b>		<b>Net Cost of Services</b>	
	<b>2008</b>	<b>2007 (restated)</b>	<b>2008</b>	<b>2007 (restated)</b>
Productivity improvement and management assistance	\$ 16.7	\$ 14.4	\$ 12.1	\$ 10.0
Product development and marketing	6.3	5.1	5.6	4.6
General support for agriculture	5.4	5.5	2.4	2.4
Agricultural water development and irrigation services	12.3	7.1	6.5	1.8
Pollution control	2.0	2.0	.8	1.0
All others	2.4	2.9	1.4	1.6
<b>Totals</b>	<b>\$ 45.1</b>	<b>\$ 37.0</b>	<b>\$ 28.8</b>	<b>\$ 21.4</b>

The increase in total cost of services from fiscal year 2007 to fiscal year 2008 in agricultural water development and irrigation services is primarily due to increased spending to mitigate damages to irrigation systems resulting from the October 2006 earthquake.

**Financial Analysis of the Department's Funds**

The Department's governmental funds reported a combined fund balance of \$83.6 million at June 30, 2008, an increase of approximately \$17.4 million in comparison with the prior fiscal year. Of the increase, approximately \$17.6 million is attributed to increases in the irrigation and drainage system capital projects fund balance primarily due to \$17.7 million in fiscal year 2008 appropriations.

**Financial Analysis of Significant General Fund Budget Variations**

The difference of \$4.3 million between the original and final budgeted amounts in State allotted appropriation revenues for fiscal year 2008 is primarily due to the appropriations to perform work necessary to mitigate damages at irrigation systems resulting from the October 2006 Kiholo Bay earthquake.

The \$565,558 in excess revenues over expenditure represents \$425,000 transferred to the Irrigation System Revolving Fund pursuant to Section 12 of Act 213, SLH 2007, and \$140,558 transferred to the Hawaii Agricultural Development Revolving Fund pursuant to Section 13 of Act 213, SLH 2007.

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The variance of \$756,503 between the final budgeted amount and the actual amount budgetary basis represents primarily \$245,000 of the \$500,000 grant-in-aid to the Hawaii Farm Bureau Federation that was not released by the Governor and approximately \$565,000 in personnel savings generated from the vacant positions the Department was unable to fill during the year.

**General Fund Budgetary Highlights**

Hawaii's economy saw only moderate expansion in fiscal year 2007 of 3.4% and a significantly lower 1.2% in fiscal year 2008. The softening of the economy is reflected in the downturn in tourism and construction, two principal drivers of our local economy. This softening of the economy and the recent crisis in the national credit and financial markets, as well as the domino effect of the global markets, raises uncertainty for the economy in the near future. Reflecting the softening economy, the 1.2% increase in general fund tax collections in fiscal year 2008 contrasts the increases in previous years of 3.4% in fiscal year 2007, 10.9% in fiscal year 2006, 16% in fiscal year 2005, and 8.4% in fiscal year 2004.

As a result of a softening economy and the anticipated decrease in general fund tax collections, the Governor implemented a 4% restriction on discretionary spending for all government departments, deferred spending cash for capital improvement projects, restricted out-of-state travel, curtailed the purchase of new equipment and vehicles, and put a hiring freeze on non-essential positions. In addition, the Governor has intensified efforts to stimulate the economy and generate additional revenue by moving forward on capital improvement projects to boost construction activity, increasing tourism marketing and outreach, lowering business fees and providing tax relief, attracting outside investments and maximizing federal dollars and partnerships.

**Capital Assets and Debt Administration**

***Capital Assets***

At June 30, 2008, the Department had \$74.3 million invested in a broad range of capital assets, including land, agricultural parks, buildings, equipment and motor vehicles (see table below). This amount represents a net decrease (including additions and deductions) of \$0.4 million from last year.

<b>Capital Assets Net of Depreciation (in Millions)</b>		
	<b>2008</b>	<b>2007 (restated)</b>
Land	\$ 22.2	\$ 22.2
Buildings	18.1	19.1
Land improvements	17.9	15.1
Furniture and equipment	1.3	1.2
Motor vehicles	1.0	0.7
Construction in progress	13.8	16.4
Total	<u>\$ 74.3</u>	<u>\$ 74.7</u>

Increases in land improvements resulted from completion of betterment projects for assets damaged by the October 2006 earthquake on the island of Hawaii.



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***Debt Administration***

At June 30, 2008, the Department had total bonded debt outstanding of \$7.7 million backed by the full faith and credit of the State. The changes to the general obligation bond as of June 30, 2008 were due to principal repayments as follows (in millions):

Balance at July 1, 2007	\$ 7.9
Decrease	<u>(0.2)</u>
Balance at June 30, 2008	<u>\$ 7.7</u>

**Currently Known Facts, Decisions, or Conditions**

At its meeting on October 29, 2008, the Council on Revenues adjusted the forecasted growth rates of General Fund tax revenues. The forecast was reduced from 1.0% to negative .05% for fiscal year 2009, and from 4.0% to 3.5% for fiscal year 2010. The Council also updated its growth forecasts of General Fund tax revenues for fiscal years 2011 through 2015, 4.5% for fiscal year 2011 to 6.5% for fiscal year 2015, raising the out-year projections.

Hawaii's economic outlook has deteriorated since the Council's October 2008 meeting. The intensification of the global financial crisis has resulted in an economic recession in the U.S. and abroad. This would have an adverse impact on Hawaii's economy for what may be an extended period. The Council's most recent assessment is that prospects for improved Hawaii tourism performance may be dim until the first half of fiscal year 2010. Inflation, as measured by changes in the Honolulu Consumer Price Index, is expected to decline from 4.8% in fiscal year 2008 to an estimated 3.7% in fiscal year 2009, faster than previously supposed because of a reversal in petroleum and other commodity price movements. Hawaii's unemployment rate went from 3.1% in January 2008 to 4.5% in September 2008. There were 12,050 more people out of work in September 2008 compared to September 2007, as Aloha Airlines, ATA and several other large businesses closed. The Council also reduced its forecast for growth of Hawaii total personal income from 4.5% to 4.3% in calendar year 2008 and 4.0% to 3.0% in calendar year 2009. All of these factors emphasize the challenging times ahead for the State in the near future.

Due to the damage caused to Kaua'i County and the City and County of Honolulu between December 10, 2008 and December 16, 2008 from the heavy rain and flooding, the Department's Agriculture Resource Management Division and Agriculture Development Corporation have projects estimated at \$1.03 million and \$2.5 million, respectively, for damages caused by the rains and flooding. The Department does not currently have federal grant agreements in place for these projects; however, the Department will be seeking Federal Emergency Management Agency assistance for reimbursement for the costs of these projects.

On July 1, 2008, Act 209 relating to agricultural loans was signed into law and established the Department's Alternative Energy Loan program. Act 209 allows the Department to provide lower interest loans for farm and aquaculture projects that improves the operation's viability but are not directly related to farm crop production. Allowable projects under Act 209 include projects such as photovoltaic energy, hydroelectric power, wind power generation, methane generation, food safety, product traceability, bio-diesel production, and ethanol production. The maximum loan amount that a borrower may be approved for is \$1.5 million or 85% of the project cost, whichever is less. The funds can be used for infrastructure, equipment, land improvement and operating costs associated with the project. The program offers favorable interest rates with a maximum loan term of 40 years. Thus far, one loan in the amount of \$1,275,000 was approved on December 16, 2008 and subsequently disbursed in April 2009.

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On July 1, 2008, Act 233 was also passed which allows the Chairperson of the Board of Agriculture, effective July 1, 2009, to approve an 85% loan guaranty to commercial lenders which would result in lower interest rates for agricultural borrowers on important agricultural lands. The interest rate on the guaranteed loans would be 1% below the lender's prime rate. The total principal amount of the guaranteed portion of all loans outstanding at any time shall not exceed \$2.5 million and the maximum term of the loan shall not exceed 10 years.

**Requests for Information**

This financial report is designed to provide users of the 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, please contact the Department's Administrative Office at 1428 South King Street, Honolulu, Hawaii.

**State of Hawaii**  
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**Statement of Net Assets**  
**June 30, 2008**

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**Assets**

Equity in cash and cash equivalents in State Treasury	\$ 53,467,094
Due from State Treasury	19,558,751
Accounts receivable, net	708,540
Loans receivable, net	13,633,031
Accrued interest receivable	603,408
Capital assets, net	<u>74,286,698</u>
Total assets	<u>\$ 162,257,522</u>

**Liabilities**

Vouchers payable	\$ 2,344,104
Accrued payroll	841,402
Due to State general fund	7,603
Deferred revenues	666,710
Deposits	59,333
Accrued vacation	
Due within one year	995,682
Due in more than one year	2,438,233
Bond payable	
Due within one year	200,794
Due in more than one year	<u>7,491,287</u>
Total liabilities	<u>15,045,148</u>

**Net assets**

Invested in capital assets, net of related debt	66,594,617
Restricted for	
Capital projects	35,838,421
Agricultural loan program	28,901,554
Other purpose	9,394,392
Unrestricted	<u>6,483,390</u>
Total net assets	<u>147,212,374</u>
Total liabilities and net assets	<u>\$ 162,257,522</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Statement of Activities**  
**Year Ended June 30, 2008**

			Program Revenues		Net Revenue (Expense) and Changes in Net Assets
			Charges for Services	Operating Grants and Contributions	
Expenses				Capital Grants and Contributions	Governmental Activities
<b>Functions/Programs</b>					
Departmental activities					
Productivity improvement and management assistance	\$ 16,683,774	\$ 4,106,877	\$ 459,364	\$ -	\$ (12,117,533)
Product development and marketing	6,316,597	557,475	131,347	-	(5,627,775)
General support for agriculture	5,357,999	2,747,828	237,264	-	(2,372,907)
Agricultural water development and irrigation services	12,355,700	1,663,419	90,527	4,113,641	(6,488,113)
Pollution control	2,038,930	835,091	427,180	-	(776,659)
Protection of the consumer	1,058,944	-	-	-	(1,058,944)
Aquaculture development	646,500	-	2,427	-	(644,073)
Agricultural loan administration	710,388	31,772	972,259	-	293,643
Total departmental activities	<u>\$ 45,168,832</u>	<u>\$ 9,942,462</u>	<u>\$ 2,320,368</u>	<u>\$ 4,113,641</u>	<u>(28,792,361)</u>
<b>General revenues</b>					
State allotted appropriations, net of lapsed appropriations					40,627,232
Non-imposed employee fringe benefit					4,698,267
Transfers, net					(906,962)
Total general revenues					<u>44,418,537</u>
<b>Change in net assets</b>					15,626,176
Net assets, July 1, 2007, as previously reported					130,588,101
Prior period adjustments					998,097
Net assets, July 1, 2007, as restated					<u>131,586,198</u>
Net assets, June 30, 2008					<u>\$ 147,212,374</u>

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

**State of Hawaii**  
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**Balance Sheet – Governmental Funds**  
**June 30, 2008**

	General Fund	Irrigation and Drainage System Capital Projects	Financial Assistance for Agriculture	Other Governmental Funds	Total Governmental Funds
<b>Assets</b>					
Equity in cash and cash equivalents in State Treasury	\$ -	\$ 28,817,228	\$ 14,853,009	\$ 9,796,857	\$ 53,467,094
Due from State Treasury	19,558,751	-	-	-	19,558,751
Loans receivable, net	-	-	13,633,031	-	13,633,031
Accrued interest receivable	-	-	603,408	-	603,408
Total assets	<u>\$ 19,558,751</u>	<u>\$ 28,817,228</u>	<u>\$ 29,089,448</u>	<u>\$ 9,796,857</u>	<u>\$ 87,262,284</u>
<b>Liabilities and Fund Balances</b>					
<b>Liabilities</b>					
Vouchers payable	\$ 1,467,737	\$ 670,888	\$ 1,119	\$ 204,360	\$ 2,344,104
Accrued payroll	532,559	-	30,363	278,480	841,402
Due to State general fund	7,603	-	-	-	7,603
Deferred revenues	-	-	-	444,230	444,230
Deposits	-	-	-	59,333	59,333
Total liabilities	<u>2,007,899</u>	<u>670,888</u>	<u>31,482</u>	<u>986,403</u>	<u>3,696,672</u>
<b>Fund balances (deficit)</b>					
<b>Reserved for</b>					
Encumbrances	17,998,721	7,001,974	64,891	2,483,106	27,548,692
Continuing appropriation	-	21,144,366	14,756,636	6,327,348	42,228,350
Receivables	-	-	14,236,439	-	14,236,439
Unreserved	(447,869)	-	-	-	(447,869)
Total fund balances	<u>17,550,852</u>	<u>28,146,340</u>	<u>29,057,966</u>	<u>8,810,454</u>	<u>83,565,612</u>
Total liabilities and fund balances	<u>\$ 19,558,751</u>	<u>\$ 28,817,228</u>	<u>\$ 29,089,448</u>	<u>\$ 9,796,857</u>	<u>\$ 87,262,284</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Reconciliation of the Governmental Funds Balance Sheet**  
**to the Statement of Net Assets**  
**June 30, 2008**

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<b>Total governmental fund balances</b>	<b>\$ 83,565,612</b>
Amounts reported for governmental activities in the statement of net assets are different because	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	74,286,698
Receivables in the statement of net assets that do not provide current financial resources are not reported in the funds.	708,540
Deferred revenues that do not require current financial resources are not reported in the funds.	(222,480)
Some long-term liabilities are not due and payable in the current period and therefore are not reported in the funds, including	
Accrued vacation	(3,433,915)
Bonds payable	(7,692,081)
<b>Net assets of governmental activities</b>	<b><u>\$ 147,212,374</u></b>

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

**State of Hawaii**  
**Department of Agriculture**  
**Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds**  
**Year Ended June 30, 2008**

	General Fund	Irrigation and Drainage System Capital Projects	Financial Assistance for Agriculture	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>					
State allotted appropriations	\$ 24,273,970	\$ 17,690,000	\$ -	\$ -	\$ 41,963,970
Intergovernmental revenues	-	4,113,641	-	1,205,533	5,319,174
Non-imposed employee fringe benefit	4,698,267	-	-	-	4,698,267
Interest on agricultural loans	-	-	708,222	-	708,222
Charges for services	-	-	31,772	10,072,051	10,103,823
Investment earnings	-	-	264,036	142,573	406,609
Total revenues	<u>28,972,237</u>	<u>21,803,641</u>	<u>1,004,030</u>	<u>11,420,157</u>	<u>63,200,065</u>
<b>Expenditures</b>					
Current					
Productivity improvement and management assistance	11,909,525	-	-	4,624,827	16,534,352
Product development and marketing	5,904,407	-	-	375,446	6,279,853
General support for agriculture	2,495,417	-	-	2,701,756	5,197,173
Agricultural water development and irrigation services	5,354,806	-	-	1,726,641	7,081,447
Pollution control	1,139,311	-	-	891,677	2,030,988
Protection of the consumer	917,890	-	-	-	917,890
Aquaculture development	636,190	-	-	20,804	656,994
Agricultural loan administration	-	-	675,054	-	675,054
Capital outlay	-	4,202,375	-	-	4,202,375
Total expenditures	<u>28,357,546</u>	<u>4,202,375</u>	<u>675,054</u>	<u>10,341,151</u>	<u>43,576,126</u>
Excess of revenues over expenditures	<u>614,691</u>	<u>17,601,266</u>	<u>328,976</u>	<u>1,079,006</u>	<u>19,623,939</u>
Other financing sources (uses)					
Transfers in	-	-	-	565,558	565,558
Transfers out	(1,243,416)	-	-	(229,104)	(1,472,520)
Total other financing sources (uses)	<u>(1,243,416)</u>	<u>-</u>	<u>-</u>	<u>336,454</u>	<u>(906,962)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(628,725)	17,601,266	328,976	1,415,460	18,716,977
Lapsed appropriations	(1,336,672)	(66)	-	-	(1,336,738)
Net change in fund balances	<u>(1,965,397)</u>	<u>17,601,200</u>	<u>328,976</u>	<u>1,415,460</u>	<u>17,380,239</u>
Fund balances at July 1, 2007, as previously reported	19,516,249	11,946,274	28,844,500	7,619,983	67,927,006
Prior period adjustments	-	(1,401,134)	(115,510)	(224,989)	(1,741,633)
Fund balances at July 1, 2007, as restated	<u>19,516,249</u>	<u>10,545,140</u>	<u>28,728,990</u>	<u>7,394,994</u>	<u>66,185,373</u>
Fund balances at June 30, 2008	<u>\$ 17,550,852</u>	<u>\$ 28,146,340</u>	<u>\$ 29,057,966</u>	<u>\$ 8,810,454</u>	<u>\$ 83,565,612</u>

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



**State of Hawaii**  
**Department of Agriculture**  
**Reconciliation of the Governmental Funds Statement of Revenues, Expenditures**  
**and Changes in Fund Balances to the Statement of Activities**  
**Year Ended June 30, 2008**

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<b>Net change in fund balances – governmental funds</b>	\$ 17,380,239
Amounts reported for governmental activities in the statement of activities are different because	
Capital outlays are reported as expenditures in governmental funds, however, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. Excess of depreciation expense over capital outlay.	(1,759,118)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	(161,360)
The net increase in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and therefore are not reported as expenditures in the funds.	(28,327)
Repayment of bond principal is recorded as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net assets.	194,742
<b>Change in net assets of governmental activities</b>	<u>\$ 15,626,176</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Statement of Revenues and Expenditures –**  
**Budget and Actual (Budgetary Basis) – General Fund**  
**Year Ended June 30, 2008**

	<b>Budgeted Amounts</b>		<b>Actual</b>	<b>Variance with</b>
	<b>Original</b>	<b>Final</b>	<b>(Budgetary Basis)</b>	<b>Final Budget Over (Under)</b>
State allotted appropriations	\$ 21,158,054	\$ 25,497,033	\$ 25,497,033	\$ -
Expenditures				
Productivity improvement and management assistance	9,125,510	9,412,110	8,911,203	(500,907)
Product development and marketing	6,688,109	6,762,209	6,605,929	(156,280)
General support for agriculture	2,392,440	1,796,582	1,796,298	(284)
Agricultural water development and irrigation services	148,157	4,723,023	4,708,445	(14,578)
Pollution control	930,478	941,478	884,705	(56,773)
Protection of the consumer	719,145	732,145	726,017	(6,128)
Aquaculture development	588,657	563,928	542,375	(21,553)
Total expenditures	<u>20,592,496</u>	<u>24,931,475</u>	<u>24,174,972</u>	<u>(756,503)</u>
Excess of revenues over expenditures	565,558	565,558	1,322,061	756,503
Other financing sources				
Transfers out	<u>(565,558)</u>	<u>(565,558)</u>	<u>(565,558)</u>	<u>-</u>
Excess of revenues and other sources over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 756,503</u>	<u>\$ 756,503</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Statement of Revenues and Expenditures –**  
**Budget and Actual (Budgetary Basis) –**  
**Financial Assistance for Agriculture**  
**Year Ended June 30, 2008**

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	<b>Budgeted Amounts</b>		<b>Actual (Budgetary Basis)</b>	<b>Variance with Final Budget Over (Under)</b>
	<b>Original</b>	<b>Final</b>		
<b>Financial assistance for agriculture</b>				
Current-year appropriations	\$ 6,105,036	\$ 6,124,993	\$ 3,417,468	\$ (2,707,525)
Expenditures				
Agricultural loans	<u>6,105,036</u>	<u>6,124,993</u>	<u>1,860,851</u>	<u>(4,264,142)</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,556,617</u>	<u>\$ 1,556,617</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Statement of Fiduciary Net Assets – Agency Fund**  
**June 30, 2008**

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**Assets**

Cash and cash equivalents	\$ 3,723
Total assets	<u>\$ 3,723</u>

**Liabilities**

Due to others	\$ 3,723
Total liabilities	<u>\$ 3,723</u>

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

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**1. Organization and Summary of Significant Accounting Policies**

**Reporting Entity**

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

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

The Department is part of the executive branch of the State of Hawaii (the "State"). The Department's financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the Department's assets, liabilities, net assets and financial activities.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for state and local governments as prescribed by the Governmental Accounting Standards Board ("GASB").

**Department-Wide Financial Statements**

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

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are reported in three categories: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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Fiduciary funds account for net assets held in a trustee or agent capacity for others. These funds are not reflected in the department-wide financial statements since these resources are not available to support the Department's programs.

**Governmental Funds Financial Statements**

The governmental funds financial statements are accounted and reported using the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and liabilities are generally included on the balance sheet. The revenues and expenditures represent increases and decreases in net current assets. Under the modified accrual basis of accounting, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures are generally recognized when the related liability is incurred, except for vested but unpaid employee vacation and workers compensation benefits, which are recognized as expenditures when payable from expendable available resources.

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 uses fund accounting to report 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 balances, 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 presented is a part of the state's general fund and is limited only to those appropriations and obligations of the Department.

***Special revenue funds***

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

***Capital projects funds***

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

**Fiduciary Funds**

Agency funds are used to account for the cash collected and expended by the Department in a custodial capacity.

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**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 and the legislature provides specific lapsing dates.

**Fund Balances**

Reserved amounts in fund balances represent amounts that are not available for appropriation or are legally restricted for a specific future use. Portions of the fund balances are reserved for the following:

- Encumbrances for outstanding commitments that are generally liquidated in the subsequent fiscal year.
- 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.
- Receivables which are not currently available for expenditure at the balance sheet date.

**Equity in Cash and Cash Equivalents in State Treasury**

The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State which, in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account and are reduced by an allocation of investment writedowns, if any.

The State requires that depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures* requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit, and custodial risks are not determinable at the Department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") for the fiscal year ended June 30, 2008. The State's CAFR can be found at the Department of Accounting and General Services' website: <http://hawaii.gov/dags/rpts>.



**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**Due from State Treasury**

The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody and ownership of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as due from state in the accompanying fund and department-wide financial statements.

**Accounts Receivable**

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

**Loans Receivable**

The Department grants credit in the form of loans to farmers, all located in the State of Hawaii. Loans are collateralized by real estate, equipment, crops and other assets of borrowers. Payments received are first applied against interest balances. Management discontinues accruing interest on loans after the loans are 90 days delinquent as to principal or interest. The unsecured portion of a loan and accrued interest is reserved as an allowance if payment for the loan is 90 days delinquent.

**Capital Assets**

Capital assets (primarily land, buildings, improvements, furniture and equipment) are reported in the department-wide financial statements. The capitalization thresholds are \$5,000 for equipment and vehicles, and \$100,000 for land improvements and buildings with estimated useful lives greater than one year.

Purchased and constructed capital assets are valued at cost. Donated assets are recorded at their fair market value at the date of donation. Maintenance and repairs are charged to operations when incurred.

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

Buildings	30 years
Land improvements	15 years
Equipment	7 years
Vehicles	5 years

**Accrual Vacation and Sick Leave**

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet. All vacation pay is accrued when incurred in the department-wide financial statements.

Sick leave accumulates at the rate of one and three-quarter leave working days for each month service without limit. It can be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the Department's statement of net assets or governmental funds balance sheet. However, an employee who retires or leaves government service in good standing with sixty days

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave at June 30, 2008 approximated \$11,615,000.

**Bonds Payable**

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

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

**Due to State of Hawaii**

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

**Intra-fund and Inter-fund Transactions**

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

All inter-fund transfers are reflected in the governmental fund financial statements but are eliminated in the departmental financial statements.

**Grants 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 accounting principles generally accepted in the United States of America, 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.

**New Accounting Pronouncements**

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The provisions of this Statement

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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are effective for the fiscal year beginning after December 15, 2007. Management does not expect this Statement to have a material effect on the Department's financial statements.

In March 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement provides clearer fund balance classifications that can be more consistently applied and clarifies the existing governmental fund type definitions. This Statement also establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds and provides for additional classifications such as restricted, committed, assigned, and unassigned fund balance. The provisions of this Statement are effective for the fiscal year beginning after June 15, 2010. Fund balance reclassifications made to conform to the provisions of this Statement will be applied retroactively by restating the fund balance for all prior periods presented.

In April 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP. The requirements of this Statement became effective upon its issuance and did not materially impact the Department's financial statements.

**2. Budgeting and Budgetary Control**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues in the statement of revenues and expenditures – budget and actual (budgetary basis) – are those estimates as compiled and reviewed by the Department of Budget and Finance, State of Hawaii.

Budgeted expenditures are derived primarily from the General Appropriations Act of 2005 (Act 178, Session Laws of Hawaii ("SLH") 2005), and from other authorizations contained in the State Constitution, HRS, and other specific appropriation acts in various SLH.

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2008 – 2009 biennial budget. The general and special revenue funds have legally appropriated annual budgets.

The final legally-adopted budget in the accompanying statement of revenues and expenditures – budget and actual (budgetary basis) – general and special revenue funds 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 act. The Governor is authorized 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. During the fiscal year ended June 30, 2008, there were no expenditures in excess of appropriations at the legal level of budgetary control.

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

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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The Department's annual budget is prepared on the modified accrual basis of accounting with several differences from the preparation of the statement of revenues, expenditures and changes in fund balances, principally related to (1) encumbrance of purchase orders and contract obligations, (2) accrued revenues and expenditures, and (3) unbudgeted programs (federal award programs).

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2008:

	<b>General Fund</b>	<b>Financial Assistance for Agriculture</b>
Excess of revenues and other sources over expenditures actual on budgetary basis	\$ 756,503	\$ 1,556,617
Reserved for encumbrances at fiscal year-end	17,998,721	64,891
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	(73,531)	(1,266,387)
Lapsed appropriations	(1,336,672)	-
Expenditures for prior fiscal years' encumbrances	<u>(19,310,418)</u>	<u>(26,145)</u>
Net change in fund balances – GAAP basis	<u>\$ (1,965,397)</u>	<u>\$ 328,976</u>

**3. Loans Receivable**

At June 30, 2008, special revenue funds loans receivable consisted of the following:

Hawaii Agriculture Loan Program	\$ 14,807,478
Hawaii Aquaculture Loan Program	<u>827,255</u>
Total loans receivable	15,634,733
Less: Allowance for loan losses	<u>2,001,702</u>
Loans receivable, net	<u>\$ 13,633,031</u>

Agriculture loans require annual, semi-annual, or monthly payments, including interest at 3.00% to 10.25%, with loans maturing between 2 to 40 years. Agriculture loan amounts expected to be collected within one year approximated \$764,000. Aquaculture loans require annual or monthly payments, including interest at 5.00%, with loans maturing between 3 to 24 years. Aquaculture loan amounts expected to be collected within one year approximated \$15,000.

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

**4. Accounts Receivable**

At June 30, 2008, accounts receivable consisted of the following:

Waiahole water system	\$ 84,133
Lease rental of public land	255,296
Sale of water	312,252
Quarantine fee	<u>866,936</u>
Total receivable	1,518,617
Less: Allowance for doubtful accounts	<u>810,077</u>
Net receivable	<u>\$ 708,540</u>

**5. Capital Assets**

The changes to capital assets as of June 30, 2008 are as follows:

	Balance July 1, 2007	Prior Period Adjustments	Balance July 1, 2007 (Restated)	Additions	Disposals and Transfers	Balance June 30, 2008
<b>Capital assets being depreciated</b>						
Land improvements	\$ 54,568,709	\$ -	\$ 54,568,709	\$ 5,479,042	\$ -	\$ 60,047,751
Buildings	29,067,272	155,817	29,223,089	-	-	29,223,089
Vehicles	3,045,594	136,543	3,182,137	576,488	(65,256)	3,693,369
Equipment	4,873,875	246,346	5,120,221	351,026	(104,190)	5,367,057
	<u>91,555,450</u>	<u>538,706</u>	<u>92,094,156</u>	<u>6,406,556</u>	<u>(169,446)</u>	<u>98,331,266</u>
Less: Accumulated depreciation						
Land improvements	40,277,582	134,900	40,412,482	2,605,589	-	43,018,071
Buildings	10,181,023	7,791	10,188,814	950,690	-	11,139,504
Vehicles	2,468,914	2,028	2,470,942	280,946	(65,256)	2,686,632
Equipment	3,848,042	32,588	3,880,630	301,063	(89,876)	4,091,817
	<u>56,775,561</u>	<u>177,307</u>	<u>56,952,868</u>	<u>4,138,288</u>	<u>(155,132)</u>	<u>60,936,024</u>
Subtotal	<u>34,779,889</u>	<u>361,399</u>	<u>35,141,288</u>	<u>2,268,268</u>	<u>(14,314)</u>	<u>37,395,242</u>
<b>Capital assets not being depreciated</b>						
Land	22,188,080	-	22,188,080	-	-	22,188,080
Land improvements	911,262	-	911,262	-	-	911,262
Construction in progress	15,426,855	992,140	16,418,995	3,032,797	(5,659,678)	13,792,114
Subtotal	<u>38,526,197</u>	<u>992,140</u>	<u>39,518,337</u>	<u>3,032,797</u>	<u>(5,659,678)</u>	<u>36,891,456</u>
Capital assets, net	<u>\$ 73,306,086</u>	<u>\$ 1,353,539</u>	<u>\$ 74,659,625</u>	<u>\$ 5,301,065</u>	<u>\$ (5,673,992)</u>	<u>\$ 74,286,698</u>

Depreciation expense for the year ended June 30, 2008 was charged to governmental activities as follows:

Agricultural water development and irrigation services	\$ 2,538,198
Productivity improvement and management assistance	782,294
General support for agriculture	381,493
Protection of the consumer	178,747
Product development and marketing	136,463
Pollution control	77,637
Agricultural loan administration	29,473
Aquaculture development	<u>13,983</u>
Total depreciation expense	<u>\$ 4,138,288</u>

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**6. General Obligation Bond**

Pursuant to Act 111, SLH 1998, reimbursable general obligation bonds of \$8,500,000 were issued in 2001 and \$91,988 in other years to fund the acquisition of the Waiahole Water System. Section 14, Part IV of Act 111, SLH 1998, requires the Agribusiness Development Corporation ("ADC") to reimburse the general fund in accordance with a schedule determined by the Director of Finance, with the approval of the governor. The term of the bonds is 34 years with an interest rate of 3.00%. The principal repayment is due annually and the accrued interest is due semi-annually. The interest expense for the year ended June 30, 2008 approximated \$238,000.

The changes to the general obligation bond as of June 30, 2008 are as follows:

Balance at July 1, 2007	\$ 7,886,823
Increase	-
Decrease	<u>(194,742)</u>
Balance at June 30, 2008	<u>\$ 7,692,081</u>

Future bond principal repayment and interest payment for fiscal year ending after June 30, 2008 are as follows:

	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2009	\$ 200,794	\$ 232,626	\$ 433,420
2010	208,184	226,310	434,494
2011	210,070	219,873	429,943
2012	216,551	213,341	429,892
2013	224,864	206,556	431,420
2014 to 2018	1,206,248	924,944	2,131,192
2019 to 2023	1,378,351	733,654	2,112,005
2024 to 2028	1,618,942	513,003	2,131,945
2029 to 2033	1,896,596	254,018	2,150,614
2034 to 2035	<u>531,481</u>	<u>22,304</u>	<u>553,785</u>
	<u>\$ 7,692,081</u>	<u>\$ 3,546,629</u>	<u>\$ 11,238,710</u>

**7. 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 approximately \$4,698,000, have been reported as revenues and expenditures in the Department's financial statements for the fiscal year ended June 30, 2008.

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.

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**8. Accrued Vacation**

The changes to accrued vacation as of June 30, 2008 are as follows:

Balance at July 1, 2007	\$ 3,405,587
Increase	187,097
Decrease	<u>(158,769)</u>
Balance at June 30, 2008	<u>\$ 3,433,915</u>

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

**9. General Fund Unreserved Fund Balance Deficit**

The general fund had a deficit in the unreserved fund balance at June 30, 2008, of \$447,869. The deficit resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when the funds are measurable and available.

**10. Retirement Benefits**

Substantially all eligible employees of the Department are members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

The ERS is composed of a contributory retirement option and a noncontributory retirement option. Prior to July 1, 1984, the ERS consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively. 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 and prior to January 1, 2003, is based on the three highest paid years of service, excluding the vacation payment. Effective January 1, 2003, the AFC is the highest three calendar years or highest five calendar years plus lump sum vacation payment, highest three school contract years, or last 36 credited months or last 60 credited months plus lump sum vacation payment. Contributions for employees of the Department are paid from the State General Fund.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Effective July 1, 2005, employer contribution rates are a fixed



**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 members, all members of the noncontributory plan and certain members of the contributory plan were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits, and other aspects of the ERS, is also not available on a departmental or agency basis.

ERS issues a CAFR that includes financial statements and required supplementary information which may be obtained from the following address:

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

Effective July 1, 2007, the State adopted the provisions of GASB Statement No. 50, *Pension Disclosures – An Amendment to GASB Statements No. 25 and 27*. The State has determined that the State funded the contribution requirement, and accordingly, the Department has not recorded a liability for pension benefits in its statement of net assets as of June 30, 2008. To obtain a copy of the State's CAFR, refer to the address listed in Note 1.

**Post-Retirement Health Care and Life Insurance Benefits**

The State contributes to the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF"), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The State also contributes to the Hawaii State Teachers Association ("HSTA") Voluntary Employees Beneficiary Association ("VEBA") Trust that was established effective March 1, 2006. HSTA VEBA provides health benefits only to HSTA members, retirees and their dependents. The eligibility requirements for retiree health benefits are the same for both plans as follows:

For employees hired before July 1, 1996, the State pays the entire base monthly contribution for employees retiring with 10 years or more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less 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 base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

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**Notes to Financial Statements**  
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For employees hired on or after July 1, 2001, and who retire with less 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 base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

The actuarial valuation of the EUTF does not provide other postemployment benefits ("OPEB") information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution ("ARC"), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's CAFR or in stand alone departmental financial statements. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years June 30, 2008, 2007, and 2006 were approximately \$352,000, \$282,000 and \$261,000, respectively.

The State's CAFR includes the required footnote disclosures and required supplementary information on the State's OPEB plans, which can be found at the Department of Accounting and General Services' website.

**Deferred Compensation Plan**

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all State employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the accompanying basic financial statements.

**11. Leases**

The Department leases property under non-cancelable agreements for parcels of agricultural land located throughout the Hawaii. The lease agreements require minimum rent and, where applicable, additional rent based on a percentage of revenues and terms of up to 55 years.

Certain non-agricultural park leases have been transferred to the Department by the State of Hawaii Department of Land and Natural Resources ("DLNR") in accordance with Act 90 (SLH 2003). Parcels of land that have been mutually approved by the Department and DLNR's boards for transfer and officially transferred by law through the Governor's Executive Orders are included as part of the future lease revenue of the Department.

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Future minimum lease revenue for fiscal years ending after June 30, 2008 is:

2009	\$	802,000
2010		802,000
2011		796,000
2012		775,000
2013		769,000
Thereafter		14,254,000
	\$	<u>18,198,000</u>

Rental income from leases for parcels of agricultural land and non-agricultural park leases for the fiscal year ended June 30, 2008 approximated \$937,000, including \$23,000 for additional rent based on percentage of revenues.

**12. Commitments and Contingencies**

**General Obligation Bonds**

The Department has issued general obligation bonds in which repayments, including interest, are reimbursed from specific revenue sources of the Waiahole Water System Revolving Fund with terms corresponding to that of the related general obligation bonds (see note 6).

**Litigation**

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position, other than the ceded lands issue disclosed below. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

**Ceded Lands**

The Office of Hawaiian Affairs ("OHA") and the State are presently in litigation involving the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provision of the Hawaii State Constitution and Chapter 10 of the Hawaii Revised Statutes for use by the State of certain ceded lands.

In January 2008, the OHA and the State announced a settlement resolving the ceded land revenues dispute, which is subject to legislative approval. However, the State subsequently appealed the case to the United States Supreme Court. The United States Supreme Court agreed to hear the case and a decision will likely be issued by July 2009.

**Insurance**

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance-related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2008, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation liability was not material at June 30, 2008.

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**13. Transfers**

For the year ended June 30, 2008, transfers by fund were as follows:

<b>Transfer From</b>	<b>Transfer To</b>	<b>Amount</b>
General Fund	Irrigation System Revolving Fund	\$ 425,000
General Fund	Hawaii Agriculture Development Revolving Fund	140,558
General Fund	Department of Accounting and General Services General Fund	677,858
Pesticide Use Revolving Fund	State Treasury	205,104
Animal Quarantine Special Fund	Department of Accounting and General Services Special Fund	24,000
		<u>\$ 1,472,520</u>

The general fund transferred \$1.2 million to other funds and to the Department of Accounting and General Services for various projects. The Pesticide Use Revolving Fund transferred \$205,104 in excess cash to the State Treasury. The Animal Quarantine Special Fund transferred \$24,000 to the Department of Accounting and General Services Special Fund pursuant to Section 175 of Act 213, SLH 2007 for kennel structural analysis.

**14. Restatement of Net Assets and Fund Balances**

The Department's net assets in the department-wide statement of net assets and fund balance in the governmental funds balance sheet as of June 30, 2007 have been restated to correct errors in accounting for equity in cash and cash equivalents in the State Treasury, vouchers payable, improperly reported special revenue funds, and capital assets.

The following are the corrections made to the previously reported net assets in the department-wide and fund balances in the governmental funds financial statements:

**Governmental Activities**

Net assets, June 30, 2007 as previously reported	\$ 130,588,101
Adjustments attributable to	
Overstatement of equity in cash and cash equivalents in State Treasury	(112,738)
Understatement of vouchers payable	(277,064)
Previously reported special revenue funds as fiduciary funds	34,360
Understatement of capital assets	<u>1,353,539</u>
Net assets, June 30, 2007 as restated	<u>\$ 131,586,198</u>

**State of Hawaii**  
**Department of Agriculture**  
**Notes to Financial Statements**  
**June 30, 2008**

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**Governmental Funds**

	<b>General Fund</b>	<b>Irrigation and Drainage System Capital Projects</b>	<b>Financial Assistance for Agriculture</b>	<b>Other Governmental Funds</b>	<b>Total Governmental Funds</b>
Fund balances at June 30, 2007, as previously reported	\$ 19,516,249	\$ 11,946,274	\$ 28,844,500	\$ 7,619,983	\$ 67,927,006
Adjustments attributable to					
Overstatement of equity in cash and cash equivalents in State Treasury	-	-	(112,738)	-	(112,738)
Understatement of vouchers payable		(14,943)	(2,772)	(259,349)	(277,064)
Previously reported special revenue funds as fiduciary funds	-	-	-	34,360	34,360
Understatement of capital assets	-	(1,386,191)	-	-	(1,386,191)
Fund balances at June 30, 2007 as restated	<u>\$ 19,516,249</u>	<u>\$ 10,545,140</u>	<u>\$ 28,728,990</u>	<u>\$ 7,394,994</u>	<u>\$ 66,185,373</u>

**Schedule of  
Expenditures of Federal Awards**

**State of Hawaii**  
**Department of Agriculture**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2008**

Federal Grantor/Pass-Through Grantor/Program Title	Grant Number	CFDA Number	Federal Expenditures
<b>U.S. Department of Agriculture</b>			
Cooperative National Plant Pest Survey and Detection	06-8510-0586-CA, 07-8510-0586-CA, 06-8510-1022-CA, 07-8510-1055-CA, 06-8510-0987-CA, 06-8510-1004-CA, 07-8510-1056-CA, 07-8510-1061-CA	10.025	\$ 229,329
Survey and Detection of the Red Imported Fire Ant in Hawaii	06-8510-0666-CA, 07-8510-0666-CA	10.025	8,369
Seed Inspection Services	P.O. #AG-32KW-P-07-0207	10.025	2,007
Biological Control of Fireweed	06-8510-0918-CA	10.025	44,008
Voluntary Scrapie Flock Certification	07-9715-1723-CA	10.025	13,853
Voluntary Johne's Disease Herd Status Program	07-9715-1422-CA, 08-9715-1422-CA	10.025	20,203
Foreign Animal Disease Surveillance, Bovine Spongiform Encephalopathy Surveillance, Animal Emergency Mgmt	07-9715-1487-CA, 07-9715-1745-CA	10.025	3,859
Swine Health Protection	07-9715-1754-CA	10.025	28,579
National Animal Identification System Implementation	05-9715-1480-CA, 07-9715-1762-CA, 08-9715-1762-CA	10.025	56,780
Live Bird Market Surveillance – Highly Pathogenic Avian Influenza Virus	06-9715-1614-CA, 07-9715-1614-CA	10.025	32,113
Molokai Bovine TB Mitigation	06-9715-1726-CA, 07-9715-1826-CA	10.025	10,143
			<u>\$ 449,243</u>
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	12-25-G-0303, 12-25-G-0476	10.156	20,110
Economic Assessment of Select HI Agricultural Exports	12-25-G-0383	10.156	19,251
Statewide Food Traceability System	12-25-G-0550	10.156	5,697
			<u>45,058</u>
Shell Egg Surveillance	12-25-A-3310	10.162	13,019
Cooperative Pesticide Recordkeeping	12-25-A-4712, 12-25-A-4836	10.163	10,145
National Organic Certification Cost-Share Program	12-25-A-4460	10.163	11,230
Country of Origin Labeling	12-25-A-4893	10.163	2,479
			<u>23,854</u>
Hawaii Specialty Crop	12-25-B-0618	10.169	9,865
Upcountry Maui Watershed	65-9251-3-615 69-9251-3-643 69-9251-4-669	10.904 10.904 10.904	14,719 500 129,305
	65-9251-5-701	10.904	37,900
Lower Hamakua Watershed, Hawaii	69-9251-3-624 69-9251-5-699	10.904 10.904	26,847 575,279
2006 Earthquake Damage	68-9251-7-754 68-9251-7-759 68-9251-7-760 68-9251-7-761 68-9251-7-762 68-9251-7-766 68-9251-7-767	10.904 10.904 10.904 10.904 10.904 10.904 10.904	87,498 800,397 136,350 657,878 57,589 705,354 431,182
			<u>3,660,798 *</u>
Total U.S. Department of Agriculture			<u>4,201,837</u>

\* Denotes Major Federal Program

**State of Hawaii**  
**Department of Agriculture**  
**Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2008**

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<b>Federal Grantor/Pass-Through Grantor/Program Title</b>	<b>Grant Number</b>	<b>CFDA Number</b>	<b>Federal Expenditures</b>	
<b>U.S. Environmental Protection Agency</b>				
Pesticide Enforcement	E-00915906, E-00915908	66.700	335,837	
Pesticide Certification	E-00941906, E-00941908	66.700	<u>32,307</u>	
Total U.S. Environmental Protection Agency				368,144
<b>U.S. Department of Commerce</b>				
Voluntary Inspection Services for Fish and Fishery Products	45ABNA0B1070	11.413		2,456
<b>U.S. Department of Interior</b>				
Research and Development for the Brown Tree Snake	2006-2007 Interior Apprns Acts	15.875	165,836	
Hawaii State Irrigation Systems Water Conservation	06-FG-300021	15.504	<u>24,870</u>	
Improvement Study				
Total U.S. Department of Interior				190,706
<b>U.S. Department of Homeland Security</b>				
Pass-through from the Hawaii State Dept. of Defense – State Homeland Security	2005-GE-T5-0034	97.067		24,295
<b>Federal Emergency Management Agency</b>				
Pass-through from the Hawaii State Dept. of Defense – Flood-proofing of the Lower Hamakua Ditch	EMF-2005-PC-0004	97.017	255,270 *	
Pass-through from the Hawaii State Dept. of Defense – Civil Defense	FEMA-1640-DR-HI	97.036	<u>119,687</u>	
Total Federal Emergency Management Agency				<u>374,957</u>
<b>Total Expenditures of Federal Awards</b>				<b>\$ 5,162,395</b>

\* Denotes Major Federal Program



**State of Hawaii**  
**Department of Agriculture**  
**Note to the Schedule of Expenditures of Federal Awards**  
**Year Ended June 30, 2008**

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**1. Basis of Presentation**

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

**PART II**

**Government Auditing Standards**

**Report of Independent Auditors on Internal Control Over  
Financial Reporting and on Compliance and  
Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with *Government Auditing Standards***

The Auditor and Board of Agriculture  
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Agriculture (the "Department") as of and for the year ended June 30, 2008, which collectively comprise the Department's basic financial statements and have issued our report thereon dated June 8, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as Finding Nos. 08-01 to 08-06 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider Finding Nos. 08-01 and 08-02 to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we have reported to the State Auditor and the Board of Agriculture in a separate letter dated June 8, 2009.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State Auditor, the Board of Agriculture, the Department's 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.

A handwritten signature in black ink, appearing to read "Accounty LLP", with a stylized, cursive script.

Honolulu, Hawaii  
June 8, 2009

**PART III**  
**OMB Circular A-133**

**Report of Independent Auditors on Compliance with Requirements  
Applicable to Each Major Program and on Internal Control Over  
Compliance in Accordance with OMB Circular A-133**

The Auditor and Board of Agriculture  
State of Hawaii

**Compliance**

We have audited the compliance of the State of Hawaii, Department of Agriculture (the "Department") 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, 2008. 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.

As described in Finding No. 08-07 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding Cash Management and Reporting that are applicable to its Watershed Protection and Flood Prevention Program and Flood-proofing of the Lower Hamakua Ditch Program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described above regarding the Department's compliance with the requirements for Cash Management and Reporting, 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, 2008. However, the results of our auditing procedures disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and



questioned costs as Finding Nos. 08-08 and 08-09. We also noted certain other matters that we have reported to the State Auditor and the Board of Agriculture in a separate letter dated June 8, 2009.

### **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 the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Finding Nos. 08-07 and 08-08 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider Finding No. 08-07 to be a material weakness.

The Department's responses to the findings identified in our audit are described in the Department's Corrective Action Plan. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the State Auditor, the Board of Agriculture, the Department's 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.

A handwritten signature in black ink that reads "Accuity LLP". The signature is stylized, with the "A" being particularly large and the "LLP" written in a more compact, cursive-like font.

Honolulu, Hawaii  
June 8, 2009

## **PART IV**

### **Schedule Of Findings and Questioned Costs**



**State of Hawaii**  
**Department of Agriculture**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2008**

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**Section I – Summary of Auditors' Results**

**Financial Statements**

Type of auditors' report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	Yes
Significant deficiency(ies) identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

**Federal Awards**

Internal control over major programs:	
Material weakness(es) identified?	Yes
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	Yes
Type of auditors' report issued on compliance for major programs	Qualified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	Yes

**Identification of major programs:**

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster</b>
10.904	U.S. Department of Agriculture Watershed Protection and Flood Prevention
97.017	Federal Emergency Management Agency Flood-proofing of the Lower Hamakua Ditch

Dollar threshold used to distinguish between type A and type B programs:	\$300,000
Auditee qualified as low-risk auditee?	Yes

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**II – Financial Statement Findings**

		<b>Questioned Cost</b>
<b>Finding No. 08-01:</b>	<b>Restatement of Beginning Fund Balance/Net Assets (Material Weakness)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.                      Not applicable.	

**Condition**

During our current year audit, we identified accounting errors in the Department's basic financial statements as of and for the year ended June 30, 2007.

**Criteria**

§\_\_\_.310 of Office of Management and Budget ("OMB") Circular A-133 requires the auditee to prepare financial statements that reflect its financial position, results of operations or changes in net assets and, where appropriate, cash flows for the fiscal year audited.

§\_\_\_.320 requires the auditee to submit a reporting package that includes:

- (1) Financial statements and schedule of expenditures of federal awards.
- (2) Summary schedule of prior audit findings.
- (3) Auditor's report.
- (4) Corrective action plan.

Although audited financial statements were prepared and submitted as of and for the year ended June 30, 2007, the financial statements submitted were misstated, and restated beginning balances are reported in the financial statements as of and for the year ended June 30, 2008.

**Effect**

Due to the errors, the Department restated its beginning net assets of the governmental activities and governmental funds fund balances as of July 1, 2007 to correct these errors.

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The following table reconciles the June 30, 2007 net assets of the governmental activities, as previously reported, to its restated balance:

**Governmental Activities**

Net assets, June 30, 2007 as previously reported	\$ 130,588,101
Adjustments attributable to	
Overstatement of equity in cash and cash equivalents in State Treasury	(112,738)
Understatement of vouchers payable	(277,064)
Previously reported special revenue funds as fiduciary funds	34,360
Understatement of capital assets	<u>1,353,539</u>
Net assets, June 30, 2007 as restated	<u>\$ 131,586,198</u>

The following table reconciles the June 30, 2007 governmental funds fund balances, as previously reported, to its restated balances:

**Governmental Funds**

	General Fund	Irrigation and Drainage System Capital Projects	Financial Assistance for Agriculture	Other Governmental Funds	Total Governmental Funds
Fund balances at June 30, 2007, as previously reported	\$ 19,516,249	\$ 11,946,274	\$ 28,844,500	\$ 7,619,983	\$ 67,927,006
Adjustments attributable to					
Overstatement of equity in cash and cash equivalents in State Treasury	-	-	(112,738)	-	(112,738)
Understatement of vouchers payable		(14,943)	(2,772)	(259,349)	(277,064)
Previously reported special revenue funds as fiduciary funds	-	-	-	34,360	34,360
Understatement of capital assets	-	<u>(1,386,191)</u>	-	-	<u>(1,386,191)</u>
Fund balances at June 30, 2007 as restated	<u>\$ 19,516,249</u>	<u>\$ 10,545,140</u>	<u>\$ 28,728,990</u>	<u>\$ 7,394,994</u>	<u>\$ 66,185,373</u>

**Cash**

During our testing of the cash balance reported by the Department, we noted that there was an unreconciled difference of \$112,738 between the cash reported and the amounts included on the Department's Financial Accounting and Management Information System ("FAMIS") reports as of June 30, 2008. It appears that cash was overstated for the Financial Assistance for Agriculture governmental fund as of June 30, 2007 and resulted in this adjustment in the current year.

**Vouchers Payable**

During our testing of the vouchers payable reported by the Department, we noted that there were differences between the June 30, 2007 vouchers payable balance and the beginning balance as of July 1, 2007. It appears that vouchers payable was understated in the prior year resulting in a prior period adjustment of approximately \$277,000. This was due to under reporting of fiscal 2007 expenditures, resulting from the final vouchers payable/expenditures schedule not being used to prepare the 2007 financial statements.

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**Fiduciary Funds**

During our testing of the fiduciary funds reported by the Department, we noted that there were trust accounts that should have been classified as special revenue funds under Governmental Accounting Standards Board Statement No. 34, that were improperly classified as fiduciary funds as of June 30, 2007. All accounts previously included as fiduciary funds in the financial statements, other than the Office of Hawaiian Affairs Ceded Lands Proceeds trust fund, which was properly classified as an agency fund, were restated as special revenue funds.

**Capital Assets**

During our testing of the capital assets and construction-in-progress reported by the Department, we noted that there were capital assets expenditures, including construction-in-progress that should have been recorded in the prior period as the goods and services were received in the prior period. Therefore, capital assets, net of accumulated depreciation, were understated by \$1,353,539 in the governmental activities and capital outlay expenditures were understated by \$1,386,191 in the governmental funds as of and for the year ended June 30, 2007.

**Cause**

These errors were due to the lack of oversight by fiscal management over the calculation of year end balances.

**Recommendation**

We recommend that, and the Department has already, restated the beginning balances in its basic financial statements for the year ended June 30, 2008 to correct the errors identified. We also recommend that fiscal management of the Department provide greater oversight to ensure that the basic financial statements are prepared and presented in accordance with generally accepted accounting principles.

**Corrective Action Plan**

The Department does not have accounting staff experienced with preparing financial statements. According to the Department, the Department's Fiscal management team relies on a contracted certified public accounting ("CPA") firm to prepare and present the financial statements in accordance with generally accepted accounting principles. Going forward, throughout the preparation period, Fiscal management will review entries with the contracted CPA firm to ensure accuracy in reporting.

Contact Person: Cheryl Mitsuyuki; Keith Aragaki

Anticipated completion date: October 30, 2009 and ongoing

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		Questioned Cost
<b>Finding No. 08-02:</b>	<b>Deficiency in Accounting for Capital Assets (Material Weakness)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.                      Not applicable.	

**Condition**

During the current year audit, we noted that the Department did not properly report capital purchases and construction-in-progress in accordance with GAAP and the State's policies and procedures.

We noted capital asset expenditures were not properly reported in the State's Fixed Asset Inventory System ("FAIS") for the current year, resulting in audit adjustments to the Department's financial statements of approximately \$1.3 million.

**Criteria**

The Department is required to follow GAAP and the guidance set forth in the State Procurement Office's Inventory Management Branch Training Manual ("State Inventory Manual") issued by the Inventory Management Office. The State Inventory Manual is the guide for all State agencies to establish State-wide controls for fixed assets purchased with State and Federal funds. In order for the Department to ensure that their financial records related to capital assets are properly recorded in FAIS, all of the Department's programs need to comply with the State Inventory Manual.

**Effect**

The Department's capital assets balances were misstated.

**Cause**

The Department does not maintain adequate records to reconcile assets recorded in FAIS and expenditures recorded in the State's Financial Accounting and Management Information System ("FAMIS"). The Department's various program personnel are responsible for completing the proper forms to ensure that the capital asset additions, disposals, and transfers for their division are accurately reported in a timely manner. However, the program personnel did not complete the appropriate forms in a timely manner, and therefore, the capital assets were not recorded into FAIS in the appropriate period.

**Recommendation**

We recommend that the Department report capital asset additions to the State Procurement Office ("SPO") in a timely manner in accordance with the State Inventory Manual. We also recommend that the Department implement procedures for property custodians to reconcile quarterly equipment acquisitions in FAMIS to the DAGS computerized inventory reports (MDB reports) from the FAIS in a timely manner. We recommend that the Department carefully review expenditures to ensure capital assets are properly recorded to eliminate future audit adjustments.

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**Corrective Action Plan**

The Office Services Supervisor shall provide a summary guideline to the property custodians regarding the reporting requirements in accordance with the State Inventory Manual. The guideline shall include Department procedures for property custodians to reconcile quarterly equipment acquisitions in FAMIS to the DAGS computerized inventory reports (MDB reports) from the FAIS in a timely manner. The Office Services Supervisor shall audit the reports quarterly to ensure proper follow through and share the results of the audit and any ongoing failures of property custodians to follow procedures to the Administrative Services Officer for resolution.

Contact Person: Valerie Ahina; Keith Aragaki

Anticipated completion date: July 31, 2009, and ongoing

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		Questioned Cost
<b>Finding No. 08-03:</b>	<b>Lack of Segregation of Duties – Information Technology (Significant Deficiency)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.	Not applicable.

**Condition**

The Department uses internally developed APPX applications for many of its operations, including those related to agricultural resource management, agricultural loans, animal quarantine, and requisitions and purchase orders. We noted during our testing of the Department's information technology controls that the developer of the APPX applications is the same person who is responsible for migrating changes into the production environment.

**Criteria**

Adequate segregation of duties is required to reduce the risk of unauthorized changes to critical financial applications.

**Effect**

Developer access to the production environment increases the risk of unauthorized changes to the critical financial applications. Without proper segregation of duties, errors or fraudulent activity may take place that could cause a material misstatement of the Department's financial statements.

**Cause**

The Department has a small information technology staff and therefore proper segregation of duties is difficult to implement in the environment.

**Recommendation**

The Department should examine the feasibility of segregating development and operational functions. Alternatively, the Department can implement compensating controls such as temporary access to the production environment tied closely with a monitoring control to ensure only authorized changes are made to the applications.

**Corrective Action Plan**

As the Information Services Section is comprised of only two staff members, it would be difficult to totally segregate development and operational functions. Since June of 2004, the IT section has documented activities in its Trouble Log database. This includes requestor, date requested and completed, and general description of request and what was done. A weekly report is sent to the Administrative Services Officer.

The INFORMATION TECHNOLOGY REQUEST ("ITR") form (created in 2000) was revised and reintroduced in January of 2009. This form documents requests by users and detailed actions taken by the Computer Services staff for changes to applications or changes to the network not covered through other request forms. The requestor is required to sign the form to indicate that they have tested and approved all changes. Actions taken by the Computer Services staff identifies the functions that have

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been modified or created. The APPX system allows for documentation within the functions. A log is kept of all ITR's issued. Both the log and scanned image of ITR's are accessible by the Administrative Services Officer. These procedures maintain a check and balance system to monitor and control application changes.

Contact Person: Helene Okamura; Keith Aragaki

Anticipated completion date: Corrective action has already been implemented.



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		<b>Questioned Cost</b>
<b>Finding No. 08-04:</b>	<b>Deficiency in Accounting for Compensated Absences (Significant Deficiency)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.                      Not applicable.	

**Condition**

During our testing over compensated absences, we noted the following:

- Vacation, sick and compensatory time balances as of June 30, 2008, as reported in the Department's vacation and sick leave balance schedule maintained by the personnel technician, did not agree to our recalculated balances using the employee's Form G-1 and required an audit adjustment to the Department's balances of approximately \$58,000.
- Records of approved Form G-1s were incomplete and misplaced for one employee selected for testing.

**Criteria**

Employees are entitled to compensated absences earned, which should be completely and accurately maintained throughout the year.

**Effect**

Compensated absences are susceptible to misstatement in the financial statements if management does not comply with established policies and procedures. In addition, individual employees may be relying on the Department to maintain accurate and complete records of their vacation, sick, and compensatory time balances.

**Cause**

It appears the errors were caused by Department personnel not properly following the State policy to account for compensated absences. The Department's decentralized process for maintaining compensated absence records was a contributing factor.

**Recommendation**

We recommend the Department enforce existing policies and procedures to ensure compensated absence records for the Department's employees are complete and accurate.

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**Corrective Action Plan**

The Department's time keeping function is delegated to the branches, thus their secretarial staff manages the accountability. Going forward, to provide support, the Personnel Section shall do the following:

1. The Personnel Technician will develop and provide refresher training to timekeepers on proper reporting of leave accounting.
2. The Personnel Technician and Personnel Clerk will perform random audits throughout the year.
3. Timekeepers who are proficient with Excel will be trained to use an electronic DPS7.

Contact Person: Lana Isono

Anticipated completion date: July 31, 2009, and ongoing.

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		<b>Questioned Cost</b>
<b>Finding No. 08-05:</b>	<b>Inadequate Loan Monitoring (Significant Deficiency)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.                      Not applicable.	

**Condition**

During our current year audit, we noted the Department was not consistently following internal loan servicing procedures to monitor loan receivables. The Department's policy is to perform site visits of its borrowers. The Agricultural Loan Administrator stated that ideally a minimum of two site visits should be performed annually in order to properly monitor the borrower's operations and inspect the collateral. The following was noted during our testing:

- Only one site visit was performed for 14 out of the 25 loans tested.
- No site visits were performed for 5 out of the 25 loans tested.

**Criteria**

The Department's policy states that if loans are performing satisfactorily "visits should be limited to twice annually", but the procedures do not state the required number of visits.

**Effect**

The Department is unable to consistently monitor borrowers' operations, inspect collateral, and determine whether there are conditions that may affect the collectibility and valuation of the borrowers' loans, without properly performing the internal loan servicing procedures.

**Cause**

The Department's procedures do not clearly state the number of site visits that are required.

**Recommendation**

We recommend that the Department clarify its loan servicing procedures to specifically state the number of site visits that are required for borrowers and follow established policies and procedures.

**Corrective Action Plan**

The Division Administrator will develop written policies and procedures to require a minimum of two site visits per borrower starting FY10. The Division's computer system is currently being modified by the Department's computer services section to track the completion of field report. Division Supervisors will be responsible for completing semi-annual reports to document completion, to report on any deficiencies and to address accordingly.

Contact Person: Dean Matsukawa

Anticipated completion date: Corrective action has already been implemented.

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		Questioned Cost
<b>Finding No. 08-06:</b>	<b>Inadequate Accounting of Lease Commitments (Significant Deficiency)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Finding is not specific to a Federal Agency.	
<b>CFDA Number and Title:</b>	Finding is not specific to a Federal Agency.	
<b>Award Number and Award Year:</b>	Not applicable.                      Not applicable.	

**Condition**

During our audit, we noted discrepancies in the future lease commitment schedule as lease rents were not updated to reflect current rental information. For the Department's non-agriculture leases which are managed by the Department of Land and Natural Resources ("DLNR"), the Department does not have a master schedule that reflects both the most current rental information and leases that have been transferred to the Department.

**Criteria**

To accurately disclose the future lease commitments in its financial statements, the Department should ensure that all lease schedules completely and accurately reflect the current lease terms and properly project the lease rent amounts over the terms of the leases.

**Effect**

The Department's future lease commitment schedule was inaccurate and incomplete and required numerous revisions.

**Cause**

The Department has various schedules that reflect the information that should be reported in the future lease commitment schedule. In addition, as some of the non-agriculture leases are managed by DLNR, the Department relied on DLNR to provide updated lease information, rather than regularly requesting and working with DLNR to obtain updated information.

**Recommendation**

We recommend that the Department establish procedures to ensure all affected programs and divisions are notified of changes made to the lease agreements. The Department should also assign an appropriate individual to update the lease schedules for any changes to the Department's lease agreements, on at least a quarterly basis, and obtain updated lease information for those leases managed by DLNR.

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**Corrective Action Plan**

The Division's staff shall establish procedures to review all encumbrances upon its transfer by Executive Order to confirm specifics relating to the encumbrance (i.e., rental account, reopening dates, lease expiration, performance bond status, insurance status, etc.) and follow up with DLNR staff as necessary. The Division's staff shall update the lease schedules for any changes to the Department's lease agreements, on a quarterly basis, and obtain updated lease information for those leases managed by DLNR.

Contact Person: Brian Kau

Anticipated completion date: July 31, 2009, and ongoing.

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**III – Federal Award Findings and Questioned Costs**

		<b>Questioned Cost</b>
<b>Finding No. 08-07:</b>	<b>Cash Management and Reporting (Material Weakness)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Natural Resources Conservation Service, Department of Agriculture U.S. Dept. of Homeland Security, Federal Emergency Management Agency	
<b>CFDA Number and Title:</b>	10.904 Watershed Protection and Flood Prevention 97.017 Flood-proofing of the Lower Hamakua Ditch	
<b>Award Number and Award Year:</b>	68-9251-7-754 68-9251-7-759 68-9251-7-760 68-9251-7-761 68-9251-7-762 68-9251-7-766 68-9251-7-767 EMF-2005-PC-0004	

**Condition**

During our current year audit, we noted instances where the Department did not comply with the cash management and reporting requirements set forth in the federal Watershed Protection and Flood Prevention and Flood-proofing of the Lower Hamakua Ditch programs. Per the award documents, the federal government will provide reimbursements to the Department for expenditures incurred for program activities through reporting on the Standard Form ("SF") 270. However, in all 25 transactions tested for the Watershed Protection and Flood Prevention program, the Department improperly requested advances before the expenditures were incurred, but stated the advances were reimbursements on the respective SF-270s.

The Memorandum of Agreement ("MOA") between the Department and the State of Hawaii Civil Defense ("CDD") for the Flood-proofing of the Lower Hamakua Ditch program states that the Department's payments will be made on a reimbursable basis after review and approval by the CDD. However, we noted for 7 out of 10 receipts tested, the Department requested reimbursements prior to paying for the goods and services.

**Criteria**

In accordance with OMB Circular A-133, the Department is required to comply with cash management and reporting requirements stated in the award documents for the respective programs.

**Effect**

Failure to comply with cash management and reporting requirements may result in questioned costs and deferral or additional restrictions of future federal funding.

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**Cause**

We were informed that, as the Department does not always have sufficient cash reserves, the Department requests advances to pay for the expenditures incurred in carrying out program activities.

**Recommendation**

We recommend that the Department comply with the cash management and reporting requirements as stated in the award agreements. The Department should request reimbursements for expenditures incurred and prepare accurate SF-270 reports. If the Department has insufficient funds to operate the programs on a reimbursement basis, the Department should discuss amendments to the award agreements with the federal awarding agency or pass-through entity to allow the receipt of federal funds as advances rather than on a reimbursement basis.

**Corrective Action Plan**

The Division shall review and comply with the cash management and reporting requirements as stated in the award agreements. The Division shall also work with the participating agencies to ensure that proper cash management procedures are adhered to. If the Division has insufficient funds to operate the programs on a reimbursement basis, the Division shall discuss amendments to the award agreements with the federal awarding agency or pass-through entity to allow the receipt of federal funds as advances rather than on a reimbursement basis. In addition, the Division shall work with the Department's Fiscal Office to ensure compliance.

Contact Person: Brian Kau

Anticipated completion date: Corrective action has already been implemented.

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		Questioned Cost
<b>Finding No. 08-08:</b>	<b>Noncompliance with the Davis-Bacon Act (Significant Deficiency)</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Natural Resources Conservation Service, Department of Agriculture	
<b>CFDA Number and Title:</b>	10.904 Watershed Protection and Flood Prevention	
<b>Award Number and Award Year:</b>	69-9251-3-624 69-9251-5-699	

**Condition**

During our current year audit, we noted the following instances of noncompliance related to the Department's compliance with the Davis-Bacon requirement:

- Inadequate review of certified payroll reports as we noted three instances of an employee who was not working on the project being included on the certified payroll reports, resulting in questioned costs of \$430. We understand that after the Department brought these errors to the contractor's attention, subsequent to our testing, the contractor provided revised certified payroll reports.
- The prevailing wage rate clause was not included as part of the contract or purchase order for two of the three contracts tested.

**Criteria**

The Davis-Bacon Act (the "Act") requires all laborers and mechanics employed by contractors or subcontractors working on construction contracts in excess of \$2,000 financed by federal funds be paid no less than the wages established for the locality of the project. Included in the Act is a requirement for which the recipient includes the prevailing wage rate clause in all of its contracts with contractors and subcontractors that are subject to the Act. The Act also requires the contractor or subcontractor to submit a copy of the payroll and a statement of compliance (certified payrolls) to the non-Federal entity. Certified payroll listings are to be reviewed to ensure compliance with the Act.

**Effect**

Non-compliance with Davis-Bacon Act requirements may result in questioned costs and other noncompliance with federal compliance requirements and further restrictions on future federal funding.

**Cause**

Although the Department receives the certified payrolls, there are no formal procedures in place to ensure that the certified payrolls are reviewed and that laborers and mechanics are being paid the prevailing wage rates.

The Department also does not have procedures in place to ensure that the prevailing wage rate clause is included in applicable contracts.

**Recommendation**

The Department should develop formal procedures to ensure that the prevailing wage rate clause is included in all contracts with contractors and subcontractors subject to the Davis-Bacon Act. The Department should also establish and implement procedures to review certified payrolls and investigate exceptions to the prevailing wage in a timely manner.



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**Corrective Action Plan**

Division staff, responsible for ensuring that the prevailing wage rate clause is included in all contracts with contractors and subcontractors subject to the Davis-Bacon Act, have attended procurement workshops to fully understand the rules. As required, staff shall ensure that the prevailing wage rate clause will be included in future contracts and purchase orders and shall review certified payroll reports for all of the Department's managed projects. If exceptions are discovered, staff shall investigate in a timely manner and provide a report to the Division Administrator for review. For Department projects that are managed by DLNR, their Engineering Branch will continue to review the submitted certified payroll reports.

Contact Person: Brian Kau

Anticipated completion date: Corrective action has already been implemented.

**State of Hawaii**  
**Department of Agriculture**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2008**

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		<b>Questioned Cost</b>
<b>Finding No. 08-09:</b>	<b>Noncompliance with Non-Segregated Facilities Special Provisions</b>	<b>\$ _____</b>
<b>Federal Agency:</b>	Natural Resources Conservation Service, Department of Agriculture	
<b>CFDA Number and Title:</b>	10.904 Watershed Protection and Flood Prevention	
<b>Award Number and Award Year:</b>	68-9251-7-754 68-9251-7-759 68-9251-7-760 68-9251-7-761 68-9251-7-762 68-9251-7-766 68-9251-7-767	

**Condition**

During our current year audit, we noted one out of three contracts tested did not include the required Certification of Nonsegregated Facilities, Form SCS-AS-819, as it was not submitted by contractors prior to the awarding of federally assisted construction contracts exceeding \$10,000 that are not exempt from the provisions of the Equal Opportunity clause.

**Criteria**

Attachment B – Special Provisions of the award documents contain the following statements:

Notice To Prospective Federally Assisted Construction Contractors

- (a) A Certification of Nonsegregated Facilities must be submitted prior to the award of a federally assisted construction contract exceeding \$10,000 which is not exempt from the provisions of the Equal Opportunity clause.
- (b) Contractors receiving federally assisted construction contract awards exceeding \$10,000 which are not exempt from the provisions of the Equal Opportunity clause will be required to provide for the forwarding of the following notice to prospective subcontractors for supplies and construction contracts where the subcontracts exceed \$10,000 and are not exempt from the provisions of the Equal Opportunity clause.

**Effect**

As the Department is not in compliance with the grant awards and federal requirements, there is a risk that the federal government will withhold future funds from the Department or this specific program.

**Cause**

Although Department personnel were aware of the general requirement, the Department does not have a process or control in place to ensure that the Certification of Nonsegregated Facilities is obtained or forwarded to subcontractors.

**Recommendation**

We recommend that the Department establish formal procedures to require prospective contractors to submit the Certification of Nonsegregated Facilities prior to the final awarding of federally assisted construction contracts that exceed the \$10,000 threshold. This certification, along with other certifications and supporting documentation required by the federal awarding agency, should be maintained in the Department's contract files.

**State of Hawaii**  
**Department of Agriculture**  
**Schedule of Findings and Questioned Costs**  
**Year Ended June 30, 2008**

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**Corrective Action Plan**

The Division shall establish procedures to require prospective contractors to conform to the Non-Segregated Facilities Special Provisions. The procedures shall include the required Certification of Nonsegregated Facilities prior to the final awarding of federally assisted construction contracts that exceed the \$10,000 threshold, and maintaining certifications and supporting documentation required by the federal awarding agency, in the Division's contract files.

Contact Person: Brian Kau

Anticipated completion date: July 31, 2009

## **PART V**

### **Prior Year Findings And Questioned Costs**

This section updates the status of findings and questioned costs that were reported in prior years by previous auditors. Finding numbers relate to the sequence reported in the respective year.

**State of Hawaii  
Department of Agriculture  
Financial Statement Findings  
Status of Prior Year Findings and Questioned Costs  
Year Ended June 30, 2008**

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**Financial Statement Findings**

**Finding No. 07-01: Tracking Construction-in-Progress (Significant Deficiency)**

In the prior year audit, it was noted that the Department does not maintain adequate records of capital projects in progress. Therefore, there was no reconciliation of the accounting records to FAMIS as projects progressed to ensure the accuracy and completeness of costs for reporting purposes as well as for the transfer of costs upon completion of projects.

It was recommended that the Department maintain subsidiary accounting records, by project, which are updated monthly, reconciled to FAMIS, and reviewed by supervisory personnel.

**Status**

Unresolved. We noted similar issues in the current year. See Finding No. 08-02. Consequently, this finding will not be carried forward.

**Corrective Action Plan**

For capital improvement projects that either began or were awarded in FY2009, separate "Project Assignment Numbers" will be devised and used to track expenses for those projects. A project will include anything associated with land acquisition, planning, design, construction, and equipment. A new tracking system will be in place by July 1, 2009, and we will reconcile to FAMIS on a quarterly basis or more frequently, as needed. We will also develop and continually update a master list of "Project Assignment Numbers" each time a new project begins.

**Finding No. 07-02: Internal Loan Records Are Not Reconciled to FAMIS on a Monthly Basis (Significant Deficiency)**

In the prior year audit, it was noted that the Department does not reconcile the loan division master lists to FAMIS reports on a monthly basis. Therefore, this increases the risk that errors or other discrepancies could occur and not be detected in a timely manner.

It was recommended that the Department establish a policy to require monthly reconciliations of the loan master lists to the corresponding items in FAMIS, which should be monitored and reviewed by appropriate personnel.

**Status**

Resolved. During our current year audit, we noted that the Department began performing monthly reconciliations in April 2008.

**State of Hawaii**  
**Department of Agriculture**  
**Federal Award Findings and Questioned Costs**  
**Status of Prior Year Findings and Questioned Costs**  
**Year Ended June 30, 2008**

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**Federal Award Findings and Questioned Costs**

There were no prior year federal award findings and questioned costs.