

State of Hawaii
Department of Agriculture
Financial and Compliance Audit
June 30, 2009

Submitted by
The Auditor
State of Hawaii

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Department of Agriculture
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June 30, 2009

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PART I
Financial Statements

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, 2009, 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, 2009, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2009, 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 March 19, 2010 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 11 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.

Accuity LLP

Honolulu, Hawaii
March 19, 2010

State of Hawaii
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Management's Discussion and Analysis
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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, 2009. 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.

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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, 2009 and 2008 is provided below.

Summary of Net Assets
(in Millions)

	2009	2008
Current and other assets	\$ 59.7	\$ 74.3
Loans receivable	15.5	13.6
Capital assets	80.8	74.3
Total assets	<u>\$ 156.0</u>	<u>\$ 162.2</u>
Long-term liabilities	\$ 10.0	\$ 9.9
Other liabilities	6.5	5.1
Total liabilities	<u>16.5</u>	<u>15.0</u>
Net assets		
Invested in capital assets, net	73.4	66.6
Restricted	72.9	74.1
Unrestricted	(6.8)	6.5
Total net assets	<u>139.5</u>	<u>147.2</u>
Total liabilities and net assets	<u>\$ 156.0</u>	<u>\$ 162.2</u>

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Summary of Changes in Net Assets
(in Millions)

	2009	2008
General revenues and transfers		
State allotted appropriations	\$ 16.4	\$ 40.6
Non-imposed employee fringe benefit	5.1	4.7
Transfers	<u>(0.2)</u>	<u>(0.9)</u>
Total general revenues and transfers	<u>21.3</u>	<u>44.4</u>
Program revenues		
Charges for services	12.0	9.9
Operating grants and contributions	1.3	2.3
Capital grants and contributions	<u>1.1</u>	<u>4.1</u>
Total program revenues	<u>14.4</u>	<u>16.3</u>
Total revenues	<u>35.7</u>	<u>60.7</u>
Program expenses		
Productivity improvement and management assistance	17.3	16.7
Product development and marketing	6.9	6.3
General support for agriculture	5.4	5.4
Agricultural water development and irrigation services	6.1	12.3
Pollution control	2.3	2.0
Protection of the consumer	1.0	1.1
Aquaculture development	0.8	0.6
Agriculture loans	<u>3.6</u>	<u>0.7</u>
Total expenses	<u>43.4</u>	<u>45.1</u>
Change in net assets	<u>\$ (7.7)</u>	<u>\$ 15.6</u>

The Department's total assets exceeded liabilities by \$139.5 million at June 30, 2009. Net assets of the Department's governmental activities decreased by \$7.7 million or 5% (\$139.5 million compared to \$147.2 million) over the prior fiscal year. The restricted portion of the Department's net assets (\$72.9 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 (\$73.4 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 in 2008, while the Department reported a deficit of \$6.8 million in 2009.

The Department's total revenues and net transfers decreased by \$25.0 million primarily due to a decrease in State-allotted appropriations related to irrigation and drainage capital project appropriations of \$17.7 million received in 2008 and a \$6.3 million decrease in allotments to the Department's General Fund.

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The Department's total expenses decreased by \$1.7 million, primarily due to decreased 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)			
	Total Cost of Services		Net Cost of Services	
	2009	2008	2009	2008
Productivity improvement and management assistance	\$ 17.3	\$ 16.7	\$ 10.9	\$ 12.1
Product development and marketing	6.9	6.3	6.3	5.6
General support for agriculture	5.4	5.4	2.6	2.4
Agricultural water development and irrigation services	6.1	12.3	3.2	6.5
Agricultural loans	3.6	0.7	3.0	2.5
All others	4.1	3.7	3.0	(0.3)
Totals	\$ 43.4	\$ 45.1	\$ 29.0	\$ 28.8

The decrease in total cost of services from fiscal year 2008 to fiscal year 2009 in agricultural water development and irrigation services is primarily due to decreased 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 \$69.5 million at June 30, 2009, a decrease of approximately \$14.0 million in comparison with the prior fiscal year. Of the decrease, approximately \$11.8 million is attributed to a decrease in the general fund balance primarily due to decreased allotted appropriations (\$6.3 million) without comparable decrease in expenditures.

Financial Analysis of Significant General Fund Budget Variations

The difference of \$815,000 between the original and final budgeted amounts in State allotted appropriations for fiscal year 2009 is primarily due to the increased appropriations for the various operating programs of the Department.

The \$559,058 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 \$134,058 transferred to the Hawaii Agricultural Development Revolving Fund pursuant to Section 13 of Act 213, SLH 2007.

The variance of \$1,106,044 between the final budgeted amount and the actual amount on a budgetary basis represents primarily \$400,000 in product development and marketing funds that was not released by the Governor, approximately \$600,000 in personnel savings generated from vacant positions the Department was unable to fill during the year and approximately \$100,000 in miscellaneous other current expenses that were carried forward to fiscal year 2010.

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General Fund Budgetary Highlights

Recent economic indicators all pointed to a perceptible slowdown in business activities in the State. After several years of extraordinary expansion, Hawaii's growth rates have experienced increasing declines. The housing bubble and credit market difficulties continue to have negative reverberations throughout the U.S. economy, and the sharp increases in commodity and fuel costs have had a global impact, particularly on travel and transportation. In Hawaii, we have witnessed a downturn in tourism and construction, two principal drivers of our local economy.

Reflecting the softening economy, general fund tax collections experienced double-digit declines through April 2009 and appeared to be continuing the trend through May 2009, based on reports from the Department of Taxation. Moderation in the rate of growth of our local economy has been anticipated and has been a limiting factor in the execution of the fiscal year 2009 budget. As revenue projections were revised downward by the Council on Revenues, appropriate measures were taken to control spending and limit the State's exposure to economic and financial uncertainties.

On May 28, 2009, the Council again reduced its forecasted growth rate of general fund tax revenues from (5.0%) to (9.0%) for fiscal year 2009 and from 0.5% to 0.0% for fiscal year 2010. On August 27, 2009, the Council reported actual growth rate of general fund tax revenues of (9.5%) for fiscal year 2009 from the previous year and reduced its forecasted growth rate of general fund tax revenues from 0.0% to (1.5%) for fiscal year 2010.

As a result of a softening economy and the anticipated decrease in general fund tax collections, the Governor implemented in August 2008 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, 2009, the Department had \$80.8 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 increase (including additions and deductions) of \$6.5 million from last year.

Capital Assets Net of Depreciation (in Millions)		
	2009	2008
Land	\$ 22.2	\$ 22.2
Buildings	17.1	18.1
Land improvements	24.5	17.9
Furniture and equipment	1.2	1.3
Motor vehicles	0.8	1.0
Construction in progress	15.0	13.8
Total	<u>\$ 80.8</u>	<u>\$ 74.3</u>

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Increases in land improvements included substantial amounts from completion of betterment projects for assets damaged by the October 2006 earthquake on the island of Hawaii and watershed improvements on the island of Maui.

Debt Administration

At June 30, 2009, the Department had total bonded debt outstanding of \$7.5 million backed by the full faith and credit of the State. The changes to the general obligation bond as of June 30, 2009 were due to principal repayments as follows (in millions):

Balance at July 1, 2008	\$ 7.7
Decrease	<u>(0.2)</u>
Balance at June 30, 2009	<u>\$ 7.5</u>

Currently Known Facts, Decisions, or Conditions

The State of Hawaii faces a fiscal emergency that is unprecedented in size and scope. The national and global recession since last year has seriously affected our tourism and construction industries and produced a major, negative impact on our local economy. When the economy contracts, tax revenues decline.

During fiscal year 2009, the State's revenue projections from March 2008 to September 2009 were estimated to result in a \$2.9 billion deficit over the biennium. While approximately \$2 billion of the gap was closed through the Governor's budget and the legislature by May 2009, a \$900 million shortfall needed to be addressed by the Governor through reductions in the general funded State budget. The Governor instituted the following:

- Governor, Lieutenant Governor and Cabinet officials (State Directors and Deputies) took a 5% pay cut, plus a two-day-per-month furlough – totaling a 14% cut in wages.
- Restricted the budgets of the University of Hawaii, Department of Education and the Hawaii Health Systems Corporation by 14%.
- On August 4, 2009, the Governor announced that 1,100 state employees were given notice of a reduction-in-force ("RIF"). Only general-funded departments were initially affected including the Department of Agriculture and the Departments of Health, Human Services, Accounting and General Services, Business Economic Development & Tourism, Labor & Industrial Relations, Land & Natural Resources, Defense, Budget & Finance, Public Safety, Tax and Human Resources Development.
- 600 state employees who were "exempt excluded" employees were under a three day-per-month furlough, also amounting to a 14% wage decrease beginning in mid-September.

During the 2009 Legislative Session, the Department's general funds were reduced by 19%, 25 positions were eliminated, 36 positions were transferred to special funds, and all research and extension funds were deleted.

Out of the 214 general funded positions within the Department, 96 positions were on the RIF list and were to be abolished on or around November 20, 2009. The RIF positions equated to 45% of the Department's general fund staff.

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The following is a breakdown by division:

Division	General Funded Positions	RIF Positions
Plant Industry	111	46
Animal Industry	20	8
Quality Assurance	30	13
Aquaculture Development	8	6
Agriculture Development	15	9
Agriculture Resources Management	1	-
Administration	29	14
Total	214	96

When the RIF was first announced, 50 of the 83 plant quarantine inspector positions were to be eliminated. However, in September 2009, 22 of the 50 positions were restored by tapping alternate sources of funding, leaving 28 positions slated for RIF.

During October 2009, the Hawaii Government Employees Association ("HGEA") members ratified a new two-year contract which called for full-time state employees under the Governor's jurisdiction to be placed on furlough for 18 days for the remainder of fiscal year 2010, beginning October 23, 2009 and continuing through June 30, 2010; and 24 days of furlough for fiscal year 2011, starting July 1, 2010 through June 30, 2011. Part-time employees were placed on furlough on a pro-rated equivalent basis. The furlough plan applied to HGEA employees in the Executive Branch including 16 state departments and their attached agencies. In addition, the plan applied to non-union "exempt excluded" employees in the Executive Branch. The exempt excluded employees who were taking three furlough days per month since September 16, 2009 would now conform to two furlough days per month as reflected in the new HGEA contract.

Revenue forecasts by the Council on Revenues were revised downward continuously over the past year. The latest forecast on August 27, 2009 resulted in a reduction of \$63 million in general fund tax revenues for fiscal year 2010 or (1.5%) growth from the previous year.

On November 10, 2009, budget execution policies for the third interim budget for fiscal year 2010 were released to all department heads. As actual general fund tax collections in the first quarter of fiscal year 2010 have decreased by (9.4%) as of September 30, 2009 and preliminary figures for October indicate collections have declined by (10.9%), the rapid decline in revenues continues to exert tremendous pressure on the State's budget. Due to a continuing tax collection decline, department heads were instructed to develop contingency plans to reduce expenditures beyond the 13.8% restrictions already planned for the fourth quarter. In addition, all computer, computer-related purchases, purchases of handheld and landline communication devices and other electronic equipment are now restricted for all dollar amounts and means of financing unless exempted and will require Governor's approval through Budget & Finance.

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 had projects estimated at \$1.0 million and \$2.5 million, respectively, for damages caused by the rains and flooding. The Department's Agriculture Resource Management Division and Agriculture Development Corporation submitted projects to the Federal Emergency Management Agency ("FEMA") for review and have recently received approved project worksheets that are eligible for federal funding under FEMA. The Agriculture Resource

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Management Division's eligible amount for reimbursement approximated \$443,000 of which 75% would be the reimbursed federal share, while the Agriculture Development Corporation's eligible amount was less than \$200,000 of which 75% would be the reimbursed federal share. The Department must now file claims through the State Civil Defense for the federal reimbursement.

On July 1, 2008, Act 233 was also passed which allowed 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 for operating costs or 20 years for capital improvements. The Department currently does not have any loan guarantees outstanding or applications in process.

On October 2, 2009, the Bureau of Conveyances recorded the purchase of a conservation easement from the Hawaii Agriculture Research Center to the Department for approximately 108 acres of land in Kunia on Oahu. The Department purchased the easement for \$2.6 million with \$1.1 million transferred from the State of Hawaii, Department of Land and Natural Resources under the State's Legacy Land Conservation Program and with \$1.5 million in federal funds from the United States of America Commodity Credit Corporation under the Farm and Ranch Lands Protection Program.

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
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Assets

Equity in cash and cash equivalents and investments in State Treasury	\$ 50,258,389
Due from State Treasury	8,359,680
Accounts receivable, net	513,906
Loans receivable, net	15,496,008
Accrued interest receivable	551,897
Capital assets, net	<u>80,863,853</u>
Total assets	<u>\$ 156,043,733</u>

Liabilities

Vouchers payable	\$ 3,784,725
Accrued payroll	859,746
Due to State general fund	6,674
Deferred revenues	592,149
Deposits	74,203
Accrued vacation	
Due within one year	997,756
Due in more than one year	2,707,993
Bond payable	
Due within one year	208,184
Due in more than one year	<u>7,283,103</u>
Total liabilities	<u>16,514,533</u>

Net assets

Invested in capital assets	73,372,566
Restricted for	
Capital projects	34,477,413
Agricultural loan program	26,636,403
Other purpose	11,792,820
Unrestricted	<u>(6,750,002)</u>
Total net assets	<u>139,529,200</u>
Total liabilities and net assets	<u>\$ 156,043,733</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, 2009**

	Expenses	Program Revenues			Net Revenue (Expense) and Changes in Net Assets
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Functions/Programs					
Departmental activities					
Productivity improvement and management assistance	\$ 17,317,719	\$ 5,759,828	\$ 623,800	\$ -	\$ (10,934,091)
Product development and marketing	6,938,758	556,359	73,898	-	(6,308,501)
General support for agriculture	5,341,672	2,758,201	(60,122)	-	(2,643,593)
Agricultural water development and irrigation services	6,099,341	1,837,951	(50,720)	1,062,251	(3,249,859)
Pollution control	2,340,981	973,175	225,667	-	(1,142,139)
Protection of the consumer	999,937	-	-	-	(999,937)
Aquaculture development	801,290	50,518	(1,962)	-	(752,734)
Agricultural loans	3,547,432	24,882	519,838	-	(3,002,712)
Total departmental activities	\$ 43,387,130	\$ 11,960,914	\$ 1,330,399	\$ 1,062,251	(29,033,566)
General revenues					
State allotted appropriations, net of lapsed appropriations					16,402,509
Non-imposed employee fringe benefit Transfers					5,099,883
Total general revenues					<u>21,350,392</u>
Change in net assets					<u>(7,683,174)</u>
Net assets, June 30, 2008					147,212,374
Net assets, June 30, 2009					<u>\$ 139,529,200</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, 2009**

	General Fund	Irrigation and Drainage System Capital Projects	Financial Assistance for Agriculture	Other Governmental Funds	Total Governmental Funds
Assets					
Equity in cash and cash equivalents and investments in State Treasury	\$ -	\$ 28,223,960	\$ 10,155,409	\$ 11,879,020	\$ 50,258,389
Due from State Treasury	8,359,680	-	-	-	8,359,680
Loans receivable, net	-	-	15,496,008	-	15,496,008
Accrued interest receivable	-	-	455,826	96,071	551,897
Total assets	\$ 8,359,680	\$ 28,223,960	\$ 26,107,243	\$ 11,975,091	\$ 74,665,974
Liabilities and Fund Balances					
Liabilities					
Vouchers payable	\$ 2,092,643	\$ 1,237,837	\$ 6,535	\$ 447,710	\$ 3,784,725
Accrued payroll	557,270	-	36,599	265,877	859,746
Due to State general fund	6,674	-	-	-	6,674
Deposits	-	-	-	74,203	74,203
Deferred revenues	-	-	-	406,413	406,413
Total liabilities	2,656,587	1,237,837	43,134	1,194,203	5,131,761
Fund balances (deficit)					
Reserved for					
Encumbrances	6,871,077	13,821,652	10,273	2,240,823	22,943,825
Continuing appropriation	-	13,164,471	10,102,002	8,443,994	31,710,467
Receivables	-	-	15,951,834	96,071	16,047,905
Unreserved	(1,167,984)	-	-	-	(1,167,984)
Total fund balances	5,703,093	26,986,123	26,064,109	10,780,888	69,534,213
Total liabilities and fund balances	\$ 8,359,680	\$ 28,223,960	\$ 26,107,243	\$ 11,975,091	\$ 74,665,974

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Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2009

Total governmental fund balances	\$ 69,534,213
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.	80,863,853
Receivables in the statement of net assets that do not provide current financial resources are not reported in the funds.	513,906
Deferred revenues that do not require current financial resources are not reported in the funds.	(185,736)
Some liabilities are not due and payable in the current period and therefore not reported in the funds, including	
Accrued vacation	(3,705,749)
Bonds payable	<u>(7,491,287)</u>
Net assets of governmental activities	<u>\$ 139,529,200</u>

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, 2009**

	General Fund	Irrigation and Drainage System Capital Projects	Financial Assistance for Agriculture	Other Governmental Funds	Total Governmental Funds
Revenues					
Allotted appropriations	\$ 17,934,987	-	-	-	\$ 17,934,987
Intergovernmental revenues	-	1,065,030	-	1,030,569	2,095,599
Non-imposed employee fringe benefit	5,099,883	-	-	-	5,099,883
Interest on agricultural loans	-	-	841,384	-	841,384
Charges for services	-	-	24,882	12,093,921	12,118,803
Investment losses	-	-	(324,325)	(220,008)	(544,333)
Total revenues	<u>23,034,870</u>	<u>1,065,030</u>	<u>541,941</u>	<u>12,904,482</u>	<u>37,546,323</u>
Expenditures					
Current					
Productivity improvement and management assistance	11,891,182	-	-	5,157,638	17,048,820
Product development and marketing	6,249,441	-	-	626,814	6,876,255
General support for agriculture	2,514,484	-	-	2,819,030	5,333,514
Agricultural water development and irrigation services	9,080,413	-	-	1,848,296	10,928,709
Pollution control	1,316,567	-	-	998,137	2,314,704
Protection of the consumer	844,236	-	-	-	844,236
Aquaculture development	745,549	-	3,535,798	43,191	788,740
Agricultural loans	-	-	-	-	3,535,798
Capital outlay	-	2,222,468	-	-	2,222,468
Total expenditures	<u>32,641,872</u>	<u>2,222,468</u>	<u>3,535,798</u>	<u>11,493,106</u>	<u>49,893,244</u>
Excess of revenues over (under) expenditures	<u>(9,607,002)</u>	<u>(1,157,438)</u>	<u>(2,993,857)</u>	<u>1,411,376</u>	<u>(12,346,921)</u>
Other financing sources (uses)					
Transfers in	-	-	-	559,058	559,058
Transfers out	(711,058)	-	-	-	(711,058)
Total other financing sources (uses)	<u>(711,058)</u>	<u>-</u>	<u>-</u>	<u>559,058</u>	<u>(152,000)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	<u>(10,318,060)</u>	<u>(1,157,438)</u>	<u>(2,993,857)</u>	<u>1,970,434</u>	<u>(12,498,921)</u>
Lapsed appropriations	(1,529,699)	(2,779)	-	-	(1,532,478)
Net change in fund balances	<u>(11,847,759)</u>	<u>(1,160,217)</u>	<u>(2,993,857)</u>	<u>1,970,434</u>	<u>(14,031,399)</u>
Fund balances					
Beginning of year	17,550,852	28,146,340	29,057,966	8,810,454	83,565,612
End of year	<u>\$ 5,703,093</u>	<u>\$ 26,986,123</u>	<u>\$ 26,064,109</u>	<u>\$ 10,780,888</u>	<u>\$ 69,534,213</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, 2009

Net change in fund balances – governmental funds	\$ (14,031,399)
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 capital outlay over depreciation expense.	6,577,155
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	(157,890)
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.	(271,834)
Repayment of bond principal is recorded as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of activities.	<u>200,794</u>
Change in net assets of governmental activities	<u>\$ (7,683,174)</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, 2009**

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget Over (Under)
	Original	Final		
Revenues				
State allotted appropriations	\$ 18,463,610	\$ 19,278,969	\$ 19,278,969	\$ -
Total revenues	18,463,610	19,278,969	19,278,969	-
Expenditures				
Productivity improvement and management assistance	8,285,838	8,700,612	8,179,493	(521,119)
Product development and marketing	5,700,851	5,842,922	5,439,596	(403,326)
General support for agriculture	1,793,063	1,950,821	1,861,076	(89,745)
Agricultural water development and irrigation services	568,457	154,287	146,243	(8,044)
Pollution control	859,927	907,222	897,113	(10,109)
Protection of the consumer	571,219	592,250	572,976	(19,274)
Aquaculture development	550,197	571,797	517,370	(54,427)
Total expenditures	18,329,552	18,719,911	17,613,867	(1,106,044)
Excess of revenues over expenditures	134,058	559,058	1,665,102	1,106,044
Other financing uses				
Transfers out	(134,058)	(559,058)	(559,058)	-
Excess of revenues over expenditures and other financing uses	\$ -	\$ -	\$ 1,106,044	\$ 1,106,044

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, 2009

	Budgeted Amounts		Actual (Budgetary Basis)	Variance with Final Budget Over (Under)
	Original	Final		
Financial assistance for agriculture				
Revenues	\$ 6,105,036	\$ 6,154,993	\$ 2,589,211	\$ (3,565,782)
Expenditures				
Agricultural loans	<u>6,105,036</u>	<u>6,154,993</u>	<u>6,577,899</u>	<u>422,906</u>
Excess of expenditures over revenues	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (3,988,688)</u>	<u>\$ (3,988,688)</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, 2009

Assets

Cash and cash equivalents	\$ 5,585
Total assets	<u>\$ 5,585</u>

Liabilities

Due to others	\$ 5,585
Total liabilities	<u>\$ 5,585</u>

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

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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 included among program revenues are reported 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, 2009

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 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. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. 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, 2009

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 generally 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 and Investments in State Treasury

The State Director of Finance is responsible for the safekeeping of cash and investments 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.

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 an entity. 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, 2009. 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, 2009

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 of whom are located in 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 uncollateralized 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 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

Accrued 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. 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 of 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 60 days

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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, 2009 approximated \$13,160,000.

Bonds Payable

In the department-wide financial statements, long-term debts are reported as liabilities in the statement of net assets. 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 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 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

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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 March 2009, the GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement incorporates the hierarchy of GAAP for state and local governments into GASB authoritative literature. The GAAP hierarchy consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles. The provisions of this Statement were effective upon issuance.

In March 2009, the GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards into GASB authoritative literature. This Statement addresses three issues not included in the authoritative literature that establishes accounting principles — related party transactions, going concern considerations, and subsequent events. The provisions of this Statement were effective upon issuance.

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 State of Hawaii, Department of Budget and Finance.

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, Hawaii Revised Statutes, 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, 2009, there were no expenditures in excess of available appropriations at the legal level of budgetary control.

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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.

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, 2009:

	General Fund	Financial Assistance for Agriculture
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses actual on budgetary basis	\$ 1,106,044	\$ (3,988,688)
Reserved for encumbrances at fiscal year-end	6,871,077	10,273
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	2,185,721	2,552,438
Lapsed appropriations	(1,529,699)	-
Expenditures for prior fiscal years' encumbrances	<u>(20,480,902)</u>	<u>(1,567,880)</u>
Net change in fund balances – GAAP basis	<u>\$ (11,847,759)</u>	<u>\$ (2,993,857)</u>

3. Loans Receivable

At June 30, 2009, special revenue funds loans receivable consisted of the following:

Hawaii Agriculture Loan Program	\$ 16,837,227
Hawaii Aquaculture Loan Program	<u>801,984</u>
Total loans receivable	17,639,211
Less: Allowance for loan losses	<u>2,143,203</u>
Loans receivable, net	<u>\$ 15,496,008</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 \$917,000. 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 \$23,000.

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

4. Accounts Receivable

At June 30, 2009, accounts receivable consisted of the following:

Waiahole water system	\$ 91,078
Lease rental of public land	248,063
Sale of water	381,619
Quarantine fee	<u>895,404</u>
Total receivable	1,616,164
Less: Allowance for doubtful accounts	<u>1,102,258</u>
Net receivable	<u>\$ 513,906</u>

5. Capital Assets

The changes to capital assets as of June 30, 2009 are as follows:

	Balance July 1, 2008	Additions	Disposals and Transfers	Balance June 30, 2009
Capital assets being depreciated				
Land improvements	\$ 60,047,751	\$ 9,389,816	\$ -	\$ 69,437,567
Buildings	29,223,089	-	-	29,223,089
Vehicles	3,693,369	102,409	(146,691)	3,649,087
Equipment	<u>5,367,057</u>	<u>311,805</u>	<u>(114,945)</u>	<u>5,563,917</u>
	98,331,266	9,804,030	(261,636)	107,873,660
Less: Accumulated depreciation				
Land improvements	43,018,071	2,824,987	-	45,843,058
Buildings	11,139,504	950,690	-	12,090,194
Vehicles	2,686,632	330,589	(137,978)	2,879,243
Equipment	<u>4,091,817</u>	<u>338,692</u>	<u>(110,724)</u>	<u>4,319,785</u>
	60,936,024	4,444,958	(248,702)	65,132,280
Subtotal	<u>37,395,242</u>	<u>5,359,072</u>	<u>(12,934)</u>	<u>42,741,380</u>
Capital assets not being depreciated				
Land	22,188,080	-	-	22,188,080
Land improvements	911,262	-	-	911,262
Construction in progress	<u>13,792,114</u>	<u>10,613,834</u>	<u>(9,382,817)</u>	<u>15,023,131</u>
Subtotal	<u>36,891,456</u>	<u>10,613,834</u>	<u>(9,382,817)</u>	<u>38,122,473</u>
Capital assets, net	<u>\$ 74,286,698</u>	<u>\$ 15,972,906</u>	<u>\$ (9,395,751)</u>	<u>\$ 80,863,853</u>

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

Depreciation expense for the year ended June 30, 2009 was charged to governmental activities as follows:

Agricultural water development and irrigation services	\$ 2,888,066
Productivity improvement and management assistance	843,056
General support for agriculture	265,845
Protection of the consumer	173,121
Product development and marketing	139,341
Pollution control	89,095
Agricultural loans	29,473
Aquaculture development	<u>16,961</u>
Total depreciation expense	<u>\$ 4,444,958</u>

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, 2009 approximated \$232,000.

The changes to the general obligation bond for the year ended June 30, 2009 are as follows:

Balance at July 1, 2008	\$ 7,692,081
Increase	-
Decrease	<u>(200,794)</u>
Balance at June 30, 2009	<u>\$ 7,491,287</u>

Future bond principal repayment and interest payment for fiscal years ending after June 30, 2009 are as follows:

	Principal	Interest	Total
2010	\$ 208,184	\$ 226,473	\$ 434,657
2011	210,070	219,873	429,943
2012	216,551	213,341	429,892
2013	224,864	206,556	431,420
2014	230,206	199,546	429,752
2015 to 2019	1,234,995	888,159	2,123,154
2020 to 2024	1,422,924	692,304	2,115,228
2025 to 2029	1,671,128	464,435	2,135,563
2030 to 2034	1,859,772	197,120	2,056,892
2035	<u>212,593</u>	<u>6,378</u>	<u>218,971</u>
	<u>\$ 7,491,287</u>	<u>\$ 3,314,185</u>	<u>\$ 10,805,472</u>

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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 \$5,100,000, are reported as revenues and expenditures in the Department's financial statements for the fiscal year ended June 30, 2009.

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.

8. Accrued Vacation

The changes to accrued vacation for the year ended June 30, 2009 are as follows:

Balance at July 1, 2008	\$ 3,433,915
Increase	1,329,006
Decrease	<u>(1,057,172)</u>
Balance at June 30, 2009	<u>\$ 3,705,749</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, 2009, of \$1,167,984. 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 employees of the Department participate in the State's various employee benefit plans, including the Employees' Retirement System ("ERS") of the State of Hawaii, post-employment healthcare and life insurance plan, and a deferred compensation plan. For more information on the State's benefit plans, refer to the State of Hawaii and ERS CAFRs. The State's CAFR can be found at the Department of Accounting and General Services' ("DAGS") website. The ERS CAFR can be found at the ERS website: <http://www4.hawaii.gov/ers/default.htm>.

Employees' Retirement System

The ERS is 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.

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. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years ended June 30, 2009, 2008, and 2007 were approximately \$402,000, \$352,000, and \$282,000 respectively.

Required Supplementary Information and Disclosures

The State's CAFR includes the required footnote disclosures and supplementary information on the State's other postemployment benefit plan.

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.

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 were 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.

Future minimum lease revenue for fiscal years ending after June 30, 2009 are:

2010	\$ 850,000
2011	821,000
2012	817,000
2013	817,000
2014	817,000
Thereafter	<u>13,653,000</u>
	<u>\$ 17,775,000</u>

Rental income from leases for parcels of agricultural land and non-agricultural park leases for the fiscal year ended June 30, 2009 approximated \$1,105,000, including \$5,000 for additional rent based on percentage of revenues.

State of Hawaii
Department of Agriculture
Notes to Financial Statements
June 30, 2009

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. Further disclosure of the lawsuits and claims against the State are included in the State's CAFR.

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, 2009, 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, 2009.

13. Transfers

For the year ended June 30, 2009, transfers by fund were as follows:

Transfer From	Transfer To	Amount
General Fund	Irrigation System Revolving Fund	\$ 425,000
General Fund	Hawaii Agriculture Development Revolving Fund	134,058
General Fund	Department of Accounting and General Services General Fund	152,000
		<u>\$ 711,058</u>

The general fund transferred \$711,058 to other funds and to the Department of Accounting and General Services for various projects.

**Schedule of
Expenditures of Federal Awards**

**State of Hawaii
Department of Agriculture
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2009**

Federal Grantor/Pass-Through Grantor/Program Title	Grant Number	CFDA Number	Federal Expenditures	
U.S. Department of Agriculture				
Cooperative National Plant Pest Survey and Detection	07-8510-0586-CA	10.025	\$ 248,718	
	08-8510-0586-CA			
	07-8510-1055-CA			
	08-8510-1055-CA			
	08-8510-1204-CA			
	07-8510-1056-CA			
	08-8510-1056-CA			
	07-8510-1061-CA			
	08-8510-1061-CA			
	09-8510-1216-CA			
Survey and Detection of the Red Imported Fire Ant in Hawaii	07-8510-0666-CA	10.025	6,447	
	08-8510-0666-CA			
Seed Inspection Services	Letter of notif 10/1/08	10.025	4,083	
Biological Control of Fireweed	06-8510-0918-CA	10.025	11,992	
Classical Swine Fever	08-9715-1850-CA	10.025	19,305	
Voluntary Scrapie Flock Certification	07-9715-1723-CA	10.025	14,902	
	08-9715-1723-CA			
Voluntary Johne's Disease Herd Status Program	08-9715-1422-CA	10.025	7,710	
Foreign Animal Disease Surveillance	08-9715-1745-CA	10.025	14,769	
Swine Health Protection	07-9715-1754-CA	10.025	35,768	
	08-9715-1754-CA			
National Animal Identification System Implementation	08-9715-1762-CA	10.025	29,401	
Molokai Bovine TB Mitigation	07-9715-1826-CA	10.025	18,309	
			<u>18,309</u>	\$ 411,404 *
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	12-25-G-0476	10.156	9,300	
Statewide Food Traceability System	12-25-G-0550	10.156	24,737	
Improving E-commerce Marketing of Hawaii's Agricultural Products Using a Value-Based-Advertising Network	12-25-G-0667	10.156	10,000	
			<u>10,000</u>	44,037
Shell Egg Surveillance	12-25-A-3310	10.162		12,212
Cooperative Pesticide Recordkeeping	12-25-A-4836	10.163	4,275	
Agricultural Management Assistance Organic Certification Cost-Share Program	12-25-S-4946	10.163	7,250	
National Organic Certification Cost-Share Program	12-25-A-4460	10.163	382	
National Organic Certification Cost-Share Program	12-25-A-5002	10.163	1,810	
Country of Origin Labeling	12-25-A-4893	10.163	2,974	
			<u>2,974</u>	16,691
Hawaii Specialty Crop	12-25-B-0618	10.169		48,781
Upcountry Maui Watershed	65-9251-3-615	10.904	2,784	
	69-9251-4-669	10.904	43,496	
	65-9251-5-701	10.904	8,000	
Lower Hamakua Watershed, Hawaii	69-9251-1-564	10.904	24,806	
	69-9251-3-624	10.904	35,627	
	69-9251-3-625	10.904	499	
	65-9251-4-671	10.904	11,250	
	69-9251-5-699	10.904	25,103	
Plantation Irrigation Drainage Systems	65-9251-7-779	10.904	8,000	
2006 Earthquake Damage	68-9251-7-759	10.904	145,562	
	68-9251-7-760	10.904	124,650	
	68-9251-7-761	10.904	92,500	
	68-9251-7-762	10.904	54,311	
	68-9251-7-766	10.904	65,174	
	68-9251-7-767	10.904	594,750	
			<u>594,750</u>	1,236,512 *
Total U.S. Department of Agriculture			<u>1,769,637</u>	

* Denotes Major Federal Program

**State of Hawaii
 Department of Agriculture
 Schedule of Expenditures of Federal Awards
 Year Ended June 30, 2009**

Federal Grantor/Pass-Through Grantor/Program Title	Grant Number	CFDA Number	Federal Expenditures	
U.S. Environmental Protection Agency				
Pesticide Enforcement	E-00915908	66.700	206,932	
Pesticide Certification	E-00941908	66.700	<u>28,453</u>	
Total U.S. Environmental Protection Agency				235,385
U.S. Department of Commerce				
Voluntary Inspection Services for Fish and Fishery Products	45ABNMA0B1070	11.413		3,272
U.S. Department of Interior				
Hawaii State Irrigation Systems Water Conservation Improvement Study	06-FG-300021	15.504	32	
Support for Brown Tree Snake Rapid Response Efforts and Grass Carp Control	122008G019	15.608	13,162	
Research and Development for the Brown Tree Snake	2007-2008 Interior Apprns Acts	15.875	<u>151,771</u>	
Total U.S. Department of Interior				164,965
U.S. Department of Homeland Security				
Pass-through from the Hawaii State Dept. of Defense – State Homeland Security	2005-GE-T5-0034	97.067	555	
	2006-GE-T6-0033		<u>40,496</u>	
Total U.S. Homeland Security				41,051
Federal Emergency Management Agency				
Pass-through from the Hawaii State Dept. of Defense – Flood-proofing of the Lower Hamakua Ditch	EMF-2005-PC-0004	97.017		<u>1,188</u>
Total Expenditures of Federal Awards				<u>\$ 2,215,498</u>

State of Hawaii
Department of Agriculture
Note to the Schedule of Expenditures of Federal Awards
Year Ended June 30, 2009

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, 2009, which collectively comprise the Department's basic financial statements and have issued our report thereon dated March 19, 2010. 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. 09-01 to 09-03 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 No. 09-01 to be a material weakness.

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 March 19, 2010.

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.

Accuity LLP

Honolulu, Hawaii
March 19, 2010

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, 2009. The Department's major federal programs are identified in the summary of auditors' 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 Nos. 09-04 and 09-05 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding Cash Management and Equipment that are applicable to its Plant and Animal Disease, Pest Control, and Animal Care Program. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described above regarding the Department's compliance with the requirements for Cash Management and Equipment, 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, 2009. 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. 09-06 and 09-07. We also noted certain other matters that we have reported to the State Auditor and the Board of Agriculture in a separate letter dated March 19, 2010.

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. 09-04 to 09-07 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 Nos. 09-04 and 09-05 to be material weaknesses.

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.

Accuity LLP

Honolulu, Hawaii
March 19, 2010

PART IV

Schedule Of Findings and Questioned Costs

**State of Hawaii
 Department of Agriculture
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2009**

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:

CFDA		
Number	Name of Federal Program or Cluster	
10.904	U.S. Department of Agriculture Watershed Protection and Flood Prevention	
10.025	U.S. Department of Agriculture Plant and Animal Disease, Pest Control, and Animal Care (“CAPS”)	
Dollar threshold used to distinguish between type A and type B programs:		\$300,000
Auditee qualified as low-risk auditee?		No

**State of Hawaii
 Department of Agriculture
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2009**

II – Financial Statement Findings

	Questioned Cost
Finding No. 09-01: Deficiency in Accounting for Capital Assets (Material Weakness)	\$ _____ –
Federal Agency: Finding is not specific to a Federal Agency.	
CFDA Number and Title: Finding is not specific to a Federal Agency.	
Award Number and Award Year: Not applicable. Not applicable.	

Condition

During the prior 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 which resulted in an audit restatement to the Department’s July 1, 2007 net assets balance of approximately \$1.3 million.

We noted similar issues in the current year. During the current year audit, the following audit adjustments were made to the Department’s financial statements:

- \$2,429,000 adjustment for the transfer of construction-in-progress to land improvements for a project completed during fiscal year 2009 and related depreciation expense of \$81,000.
- \$698,000 to record internally developed computer software.
- \$1,248,000 adjustment to reverse improper recordation of assets as construction-in-progress that should have been expensed.

We also noted net capital asset expenditures of \$41,985 were not properly reported in the State’s Fixed Asset Inventory System (“FAIS”) for the current year.

Criteria

The Department is required to follow GAAP and the guidance set forth in the State Procurement Office’s (“SPO”) 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 materially misstated.

State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

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 program 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 perform the following:

- Report capital asset additions to the SPO in a timely manner in accordance with the State Inventory Manual.
- 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.
- Carefully review expenditures to ensure capital assets are properly recorded to eliminate future audit adjustments.
- Ensure that property custodians are properly trained to perform these duties.

Corrective Action Plan

Division property custodians are required to reconcile quarterly equipment acquisitions in FAMIS to the DAGS computerized inventory reports (MDB reports) from the FAIS in a timely manner. The Administrative Services Office shall conduct random audits to ensure proper follow through and share the results of the audits. It will also inform Division Administrators to follow up on ongoing failures of property custodians in following procedures.

Contact Person: Keith Aragaki

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, 2009**

		Questioned Cost
Finding No. 09-02:	Deficiency in Accounting for Compensated Absences (Significant Deficiency)	\$ <u> -</u>
Federal Agency:	Finding is not specific to a Federal Agency.	
CFDA Number and Title:	Finding is not specific to a Federal Agency.	
Award Number and Award Year:	Not applicable.	Not applicable.

Condition

During our prior year audit, we noted that the Department's vacation, sick and compensatory balances were misstated, resulting in an audit adjustment of \$58,000. We also noted a situation where records of Form G-1s were incomplete and misplaced for one individual.

During our current year testing of compensated absences, we noted similar errors as follows:

- Vacation, sick and compensatory balances as of June 30, 2009, 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 by approximately \$13,000.
- The reported vacation hours earned for an employee was less than the amount the employee was entitled to receive per review of the DPS-7 Employee Leave Record forms. For one month, the employee received 12 vacation hours rather than 14 vacation hours earned for the month.

We also noted inconsistencies in the tracking of employee leave as some timekeepers manually input hours earned and hours used on the DPS-7 forms, while other timekeepers maintain records on Excel spreadsheets. We noted that the manually-maintained records were sometimes illegible resulting in miscalculations of employees' compensated balances.

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 leave, and compensatory time balances.

Cause

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

Recommendation

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

State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

Corrective Action Plan

The Department's timekeeping function is delegated to the branches and as such, the respective secretarial staff manages the accountability of the records. Hence forth, the Personnel Section shall provide the following support:

1. The Personnel Technician developed a refresher training for timekeepers on proper reporting of leave accounting. The training was scheduled for fiscal year 2010. Subsequently, the State went through a massive Reduction-in-Force ("RIF") that greatly impacted the Department of Agriculture, including the Personnel Section. Since July 2009, the Personnel Section has been challenged to focus all of its attention and resources to completing pre-work and post-work tasks associated with the RIF implementation. This is in addition to all the RIF-related functions the Personnel Section was responsible for during the RIF. The Personnel Section is still in the process of auditing five (5) years of leave records for each employee that has been affected by the RIF as well as for employees that voluntarily retired. The total number of employee leave records that need to be audited is approximately 115. The audits need to be completed with fewer staff which, in addition to their regularly assigned tasks, are responsible to complete other tasks that have been redistributed to them due to the RIF.
2. The Personnel Technician will perform random audits throughout the year.
3. Timekeepers will be trained to use an electronic DPS Form 7. Those programs with staff on seven-day work week schedules shall continue to use the manual forms.

Contact Person: Llana Isono

Anticipated completion date: June 30, 2010

**State of Hawaii
 Department of Agriculture
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2009**

		Questioned Cost
Finding No. 09-03	Inadequate Accounting of Lease Commitments (Significant Deficiency)	\$ <u> -</u>

Federal Agency: Finding is not specific to a Federal Agency.

CFDA Number and Title: Finding is not specific to a Federal Agency.

**Award Number and
Award Year:** Not applicable. Not applicable.

Condition

During our prior year audit, we noted discrepancies in the future lease revenue disclosure as lease rents were not updated to reflect current rental information. For non-agriculture leases managed by the Department of Land and Natural Resources (“DLNR”), the Department does not maintain a master schedule that reflects both the most current rental information and leases that were transferred to the Department.

We noted similar issues during the current year audit as follows:

- Future lease revenue disclosure was not updated to reflect current rental information.
- Department of Hawaiian Home Land entitlements were miscalculated in the schedule.
- Future rental income was improperly calculated on a calendar year rather than fiscal year basis.

Criteria

In order to accurately disclose the future lease revenue, the Department should ensure that all lease schedules accurately state the current lease terms and project the correct lease rent over the terms of the leases.

Effect

The Department’s future lease commitments schedule was misstated and required numerous corrections.

Cause

The Department has various schedules and different version of schedules that reflect the information that should be disclosed in the future lease revenue commitments disclosure. In addition, as some of the non-agriculture leases are managed by DLNR, the Department did not obtain the current rental information from DLNR.

Recommendation

The Department should institute a procedure whereby all affected programs and divisions are notified of changes made to the lease agreements. The Department should update the audited version of the schedule and regularly obtain updated rental information for those leases managed by DLNR.

**State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009**

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. These actions were implemented in FY 2010.

The Department will also change future reporting to reflect a fiscal year time period.

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, 2009**

III – Federal Award Findings and Questioned Costs

		Questioned Cost
Finding No. 09-04:	Cash Management (Material Weakness)	\$ _____ –
Federal Agency:	United States Department of Agriculture	
CFDA Number and Title:	10.025 Plant and Animal Disease, Pest Control, and Animal Care Program	
Award Number and Award Year:	07-8510-0586-CA 08-8510-0586-CA 07-8510-1055-CA 08-8510-1055-CA 08-8510-1204-CA 09-8510-1216-CA 07-8510-1056-CA 08-8510-1056-CA 07-8510-1061-CA 08-8510-1061-CA	

Condition

During our current year audit, we noted instances where the Department did not comply with the cash management requirements as set forth by the Office of Management and Budget (“OMB”). While the Department is required to disburse funds within a reasonable period upon receipt, the Department did not completely disburse the drawdowns for over 50 days in 5 out of the 10 drawdowns tested.

Criteria

In accordance with 31 Code of Federal Regulations (“CFR”) Part 205, Subpart B 205.33, the recipient of federal funds is required to disburse the funds “... as close as administratively feasible to a state’s actual cash outlay...”.

Effect

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

Cause

Program personnel did not fully understand the cash management requirements related to the grant. There was also a lack of oversight and a failure to employ a consistent methodology in requesting funds.

Recommendation

We recommend the Department comply with the cash management requirements set forth in 31 CFR Part 205 and time drawdowns to coincide with disbursements.

**State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009**

Corrective Action Plan

The Department was instructed by the grantor (USDA) to request quarterly allotments under this contract. The cooperative agreement states, "Submit to APHIS a properly certified Request for Advance or Reimbursement, SF-270, when requesting payment for expenditures. A payment request may be submitted quarterly or more frequently; however, advance of funds will be made by APHIS in increments as indicated under 11.j of the SF-270 to cover monthly disbursement needs." The Department is in the process of seeking additional information and formal confirmation as to the proper timing of requests and disbursement of funds from USDA. Once received, the Department will follow the updated guidance provided.

Contact Person: Neil Reimer

Anticipated completion date: June 30, 2010

**State of Hawaii
 Department of Agriculture
 Schedule of Findings and Questioned Costs
 Year Ended June 30, 2009**

		Questioned Cost
Finding No. 09-05:	Equipment (Material Weakness)	\$ _____ -
Federal Agency:	United States Department of Agriculture	
CFDA Number and Title:	10.025 Plant and Animal Disease, Pest Control, and Animal Care Program	
Award Number and Award Year:	07-8510-0586-CA 08-8510-0586-CA 07-8510-1055-CA 08-8510-1055-CA 08-8510-1204-CA 09-8510-1216-CA 07-8510-1056-CA 08-8510-1056-CA 07-8510-1061-CA 08-8510-1061-CA	

Condition

During our current year audit, we noted that the Department did not properly report \$34,400 in equipment purchases in accordance with the State's policies and procedures as capital asset expenditures were not properly reported in the FAIS nor properly tagged with a State of Hawaii decal number for 13 out of the 15 items tested.

Criteria

Per Part 3 of the March 2009 OMB Circular A-133 Compliance Supplement, states are required to manage equipment purchased under a federal grant in accordance with state laws and procedures. Consequently, the Department is required to follow the guidance set forth in the State Inventory Manual. 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 to ensure the Department's capital asset records are properly recorded in FAIS, all of the Department's programs need to comply with the State Inventory Manual.

Effect

The Department's capital asset balances may be misstated due to assets not being properly recorded in FAIS. In addition, there is an increased risk that assets not properly assigned a State of Hawaii decal number may be misappropriated.

Cause

The Department does not maintain adequate records to reconcile assets recorded in FAIS and expenditures recorded in FAMIS. The Department's program personnel are responsible for completing the proper forms to ensure that the capital asset additions, disposals, and transfers for their program are accurately reported in a timely manner. However, due to the program personnel's inexperience and misunderstanding of how to accurately report purchases of fixed assets, they did not complete the appropriate forms in a timely manner, and therefore, the capital assets were not recorded in FAIS in the appropriate period. Additionally, capital assets were not assigned a State of Hawaii decal number, preventing them from being uniquely identifiable.

State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

Recommendation

We recommend that the Department report capital asset additions to the SPO Inventory Management Office 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 (MDB Reports) from FAIS in a timely manner. The Department's management should also ensure that property custodians are properly trained to perform these duties.

Corrective Action Plan

The Plant Pest Control Branch that administers this fund did not have any clerical help during this period and subsequently there was a lapse in the recording of inventory. A clerk was hired, given the responsibility of inventory custodian, and the inventory was brought up to date. The clerk is no longer with the Department due to the State's RIF. This duty is now assigned to the division Secretary.

Contact Person: Neil Reimer

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, 2009**

		Questioned Cost
Finding No. 09-06:	Payroll Certifications (Significant Deficiency)	<u>\$</u> <u> -</u>
Federal Agency:	United States Department of Agriculture	
CFDA Number and Title:	10.025 Plant and Animal Disease, Pest Control, and Animal Care Program	
Award Number and Award Year:	07-8510-0586-CA 08-8510-0586-CA 07-8510-1055-CA 08-8510-1055-CA 08-8510-1204-CA 09-8510-1216-CA 07-8510-1056-CA 08-8510-1056-CA 07-8510-1061-CA 08-8510-1061-CA	

Condition

During our current year audit, we noted that two individuals fully dedicated towards the CAPS program failed to file the required payroll certifications. Employees compensated by a federal program who fully dedicate their time toward the program are required to prepare certifications, certifying their time was dedicated solely to the federal program.

Criteria

2 CFR, Attachment B, paragraph 8g(3) states:

“Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.”

Effect

Failure to comply with allowable cost requirements may result in further scrutiny and restrictions, as well as hinder future federal funding.

Cause

Program personnel did not fully understand the requirements related to employees that work solely on one federal grant.

Recommendation

We recommend the Department’s management ensure they understand all federal requirements. The Department should also prepare the written certifications on at least a semiannual basis for employees working solely on the CAPS programs, as required under 2 CFR Attachment B, paragraph 8g(3).

State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

Corrective Action Plan

The Branch was unaware of the requirement, as was the federal contractor, USDA. Branch personnel currently understand the requirement, were trained and are now in compliance.

Contact Person: Neil Reimer

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, 2009**

		Questioned Cost
Finding No. 09-07:	Matching (Significant Deficiency)	<u>\$</u> <u> -</u>
Federal Agency:	United States Department of Agriculture	
CFDA Number and Title:	10.025 Plant and Animal Disease, Pest Control, and Animal Care Program	
Award Number and Award Year:	07-8510-0586-CA 08-8510-0586-CA 07-8510-1055-CA 08-8510-1055-CA 08-8510-1204-CA 09-8510-1216-CA 07-8510-1056-CA 08-8510-1056-CA 07-8510-1061-CA 08-8510-1061-CA	

Condition

During our testing of the matching requirements set forth in the 2008 Citrus Health Cooperative Agricultural Pest Survey agreement, we noted the Department violated the grant’s matching requirement. The agreement required that the Department cover 25% of the costs with the federal agency contributing 75% of the costs. We noted the Department only covered 14% of the program costs and should have contributed an additional \$5,785 to meet the grant’s matching requirement. Therefore, the Department received \$5,785 more in federal funds than it should have.

Criteria

The 2008 Citrus Health Cooperative Agreement between the Department and the USDA explicitly states that the “Federal award for this Agreement is in the amount of \$54,097 and the Cooperator’s share is \$18,032 for a total project cost \$72,129. These contributions establish a cost share ratio which shall be maintained throughout the funding period. In the event that project costs are less than projected, the ratio will be maintained.”

Effect

Failure to comply with the terms of the grant agreement conditions may result in restrictions on federal funds awarded to the Department.

Cause

The condition is the result of a lapse of oversight on the part of Department officials charged with managing this grant agreement.

Recommendation

The Department should establish formal procedures to ensure the program personnel fully understand all grant requirements and that the program complies with all matching requirements specified in the grant agreements.

State of Hawaii
Department of Agriculture
Schedule of Findings and Questioned Costs
Year Ended June 30, 2009

Corrective Action Plan

The program agreed to match 25% of the federal grant in “in-kind” services in the 2008 agreement. This has been difficult to achieve with the reduction in staff in fiscal 2009. The program will continue to make every effort to achieve the 25% match for the duration of this agreement. The CAPS guidelines recommends but does not require matching funds in these agreements. Therefore, the Department will include matching funds in future agreements but will seek to reduce the Department’s matching contribution to reflect current staffing. Going forward, if the Department is unable to meet the matching requirement, management will submit a request to revise the agreement prior to the termination date.

Contact Person: Neil Reimer

Anticipated completion date: Corrective action has already been implemented.

PART V

Prior Year Findings And Questioned Costs

This section updates the status of findings and questioned costs that were reported in prior years. 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, 2009**

Financial Statement Findings

Finding No. 08-01: Restatement of Beginning Fund Balance/Net Assets (Material Weakness)

In the prior year audit, we identified accounting errors in the Department's basic financial statements as of and for the year ended June 30, 2007. Although audited financial statements were prepared and submitted as of and for the year ended June 30, 2007, the financial statements were misstated, and restated beginning balances were reported in the financial statements as of and for the year ended June 30, 2008.

Status

Resolved. The Department restated the beginning balances in its basic financial statements for the year ended June 30, 2008 to correct the errors identified.

Finding No. 08-02: Deficiency in Accounting for Capital Assets (Material Weakness)

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

It was recommended that the Department 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 program 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 in FAIS in the appropriate period.

Status

Unresolved. We noted similar issues in the current year that are reported in Finding No. 09-01. Consequently, this finding will not carry forward.

Finding No. 08-03: Lack of Segregation of Duties – Information Technology (Significant Deficiency)

In the prior year audit, we noted the Department's developer of APPX applications was the same person who was responsible for migrating changes into the production environment.

It was recommended that the Department examine the feasibility of segregating development and operational functions. Alternatively, the Department could 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.

Status

Unresolved. Based on the recommendations from the prior year audit, the Department implemented additional controls at the end of fiscal year 2009, including the creation of an Information Technology Request ("ITR") form, generation of a log for changes made, and the availability of the forms and log for review by the Administrative Services Officer. However, we noted that the Department was unable to

**State of Hawaii
Department of Agriculture
Financial Statement Findings
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2009**

separate operations and development duties. To address the underlying risk of a lack of segregation of duties, we further recommend the Department segregate log generation and access from the IT developer. Restricting access can be done fairly easily but may require a third party to setup. However, if the IT developer can turn off logging, the developer is able to perform unauthorized activity without anyone's knowledge. Therefore, someone outside of the development environment must control access to and generation of the logs.

In addition, review of the change log must be formalized and regularly performed by an individual who is able to understand the log. The reviewer should also validate the changes via the ITRs, as there should be an authorized ITR specifying the changes made for every modification of code or data in the production environment. The reviewer should document evidence of the review performed.

Corrective Action Plan

As of January 1, 2010, the Information Services Section is comprised of only one staff member. It would be difficult to segregate development and operational functions. Since June 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. The log is accessible by the Administrative Services Officer.

The INFORMATION TECHNOLOGY REQUEST ("ITR") form (created in 2000) was revised and reintroduced in January 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 were modified or created. The APPX system allows for documentation within the functions. A log is kept of all ITRs issued. Both the log and scanned image of ITRs 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.

Finding No. 08-04: Deficiency in Accounting for Compensated Absences (Significant Deficiency)

In the prior year audit, we noted the Department's vacation, sick and compensatory time balances were misstated, resulting in an audit adjustment of \$58,000. We also noted a situation where records of Form G-1s were incomplete and misplaced for one particular individual.

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

Status

Unresolved. We noted similar issues in the current year which are reported in Finding No. 09-02. Consequently, this finding will not carry forward.

**State of Hawaii
Department of Agriculture
Financial Statement Findings
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2009**

Finding No. 08-05: Inadequate Loan Monitoring (Significant Deficiency)

In the prior year audit, the Department was not consistently following internal loan servicing procedures to monitor loan receivables. The Department was responsible for making a minimum of two site visits a year to monitor the borrower's operations and inspect the collateral. Of the 25 loans tested, we noted only one site visit was performed for 14 of those loans tested and no site visits were performed for 5 of those loans tested.

It was recommended 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.

Status

Unresolved. Due to the completion date of the prior year audit, the corrective action plan was implemented during fiscal year 2010.

Corrective Action Plan

The Division Administrator developed written policies and procedures to require a minimum of two site visits per borrower starting fiscal year 2010. The Division's computer system was modified by the Department's computer services section to track the completion of field reports. 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.

Finding No. 08-06: Inadequate Accounting of Lease Commitments (Significant Deficiency)

In the prior year audit, we noted discrepancies in the future lease commitments schedule as lease rents were not updated to reflect current rental information.

It was recommended that the Department establish procedures to ensure all affected programs and divisions are notified of changes made to lease agreements. It was also suggested that the Department assign an individual to be responsible for updating the lease schedules for any changes to the Department's lease agreements.

Status

Unresolved. We noted similar issues in the current year that are reported in Finding No. 09-03. Consequently, this finding will not carry forward.

**State of Hawaii
Department of Agriculture
Watershed Protection and Flood Prevention
Flood-proofing of the Lower Hamakua Ditch
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2009**

Federal Award Findings and Questioned Costs

Finding No. 08-07: Cash Management and Reporting (Material Weakness)

In the prior year audit, it was noted that 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.

It was recommended the Department comply with the stated cash management and reporting requirements in accordance with the award agreements.

Status

Resolved. During our current year audit, we confirmed with officials from the awarding agencies that the Department's cash management and reporting practices are in compliance with the requirements over those two areas.

**State of Hawaii
Department of Agriculture
Watershed Protection and Flood Prevention
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2009**

Finding No. 08-08: Noncompliance with the Davis-Bacon Act (Significant Deficiency)

In the prior year audit, it was noted that the Department did not comply with the Davis-Bacon Act and did not perform an adequate review of certified payroll reports. We noted that an employee not assigned to a project was improperly included on the certified reports, resulting in questioned costs of \$430. Additionally, the prevailing wage rate clause was not included as part of the contract or purchase order for two of the three contracts tested.

It was recommended that the Department develop formal procedures to ensure that the prevailing wage rate clause is included in all contacts with contractors and subcontractors subject to the Davis-Bacon Act. Furthermore, it was recommended that the Department establish and implement procedures to review certified payrolls and investigate exceptions to prevailing wages.

Status

Unresolved. Due to the completion date of the prior year audit, we noted that certified payroll review procedures had yet to be implemented. We also noted that the prevailing wage rate clause was not included as part of the contracts tested in the current year.

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 is 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.

The Division's staff recently received further clarification on the prevailing wage rate clause to be included in future contracts and is currently drafting language which will need to be reviewed and approved by the Division's Deputy Attorney General.

Contact person: Brian Kau

Anticipated completion date: May 2010

**State of Hawaii
Department of Agriculture
Watershed Protection and Flood Prevention
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2009**

Finding No. 08-09: Noncompliance with Non-Segregated Facilities Special Provisions

In the prior year audit, we noted one of three contracts tested did not include the required Certification of Nonsegregated Facilities, Form SCS-AS-819.

It was recommended 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 exceeding 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.

Status

Resolved. During our current year audit, we noted the Department incorporated the Certification of Nonsegregated Facilities as an item on the contract checklist.