

Financial statements and report of independent certified public accountants

State of Hawaii, Department of Education

June 30, 2002

State of Hawaii
Department of Education

C O N T E N T S

	Page
I. INTRODUCTION	1
II. FINANCIAL SECTION	
Report of Independent Certified Public Accountants	3
Management’s Discussion and Analysis	5
Basic Financial Statements	
Government-wide Financial Statements	
Statement of Net Assets	13
Statement of Activities	14
Governmental Fund Financial Statements	
Balance Sheet	15
Reconciliation of the Balance Sheet-Governmental Funds to the Statement of Net Assets	16
Statement of Revenues, Expenditures, and Changes in Fund Balances	17
Reconciliation of the Statement of Revenues, Expenditures, and Fund Balances-Governmental Funds to the Statement of Activities	18
Fiduciary Fund Financial Statements	
Statement of Fiduciary Net Assets	19
Statement of Changes in Fiduciary Net Assets	20
Notes to Financial Statements	21
Required Supplementary Information Other Than Management’s Discussion and Analysis	
Budgetary Comparison Schedule – General Funds	37
Notes to Required Supplementary Information – Budgetary Reporting	38
Schedule of Expenditures of Federal Awards	39
Notes to the Schedule of Expenditures of Federal Awards	46

State of Hawaii
Department of Education

C O N T E N T S

	Page
III. COMPLIANCE AND INTERNAL CONTROL	
Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	48
Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance With OMB Circular A-133	50
Schedule of Findings and Questioned costs	52
Corrective Action Plan (provided by Department of Education, State of Hawaii)	71
Summary Schedule of Prior Audit Findings (provided by Department of Education, State of Hawaii)	88

March 31, 2003

Mr. Russ Saito
State Comptroller
State of Hawaii

Dear Mr. Saito:

This is our report on the financial audit of the Department of Education (DOE), State of Hawaii, for the year ended June 30, 2002. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the *Compliance Supplement for Single Audits of State and Local Governments*.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department of Education, State of Hawaii's financial statements for the year ended June 30, 2002, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Department of Education, State of Hawaii's financial statements.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the Department of Education, State of Hawaii, is entitled have been collected and accounted for in accordance with the laws, rules and regulations, administrative directives, policies, procedures of the State of Hawaii and the Federal Government.
3. To satisfy the audit requirements of OMB Circular A-133.
4. To determine whether the Department of Education, State of Hawaii, has complied with the provisions of the federal grant agreements and applicable laws, regulations and circulars with regard to grant activities.
5. To evaluate the adequacy of the DOE's internal controls in assuring that there is effective control over and proper accounting of revenues, expenditures, assets and liabilities.

Mr. Russ Saito
State Comptroller
State of Hawaii
March 31, 2003

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants and *Government Auditing Standards*, as issued by the Comptroller General of the United States. The scope of our audit included tests of the transactions and accounting records of the Department of Education, State of Hawaii, for the year ended June 30, 2002. In addition, we reviewed the internal controls to provide us with a basis to report whether the Department of Education, State of Hawaii, had complied with the material terms and conditions of its federal grant agreements.

ORGANIZATION OF THE REPORT

This report is presented as follows:

Financial Section

The financial statements of the Department of Education, State of Hawaii, for the year ended June 30, 2002, and our opinion on the financial statements.

Compliance and Internal Control

Our reports on compliance and internal control.

Schedule of Findings and Questioned Costs.

Corrective Action Plan.

Summary Schedule of Prior Audit Findings.

We wish to express our appreciation for the excellent cooperation and assistance extended by the officers and staff of the Department of Education, State of Hawaii.

Very truly yours,

Report of Independent Certified Public Accountants

State Comptroller
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of the Department of Education, State of Hawaii, as of and for the year ended June 30, 2002, which collectively comprise the Department's basic financial statements as listed in the contents. These financial statements are the responsibility of the management of the Department of Education, State of Hawaii. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note A, the financial statements of the Department of Education, State of Hawaii, are intended to present the financial position and changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department of Education, State of Hawaii. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2002, 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 financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education, State of Hawaii, as of June 30, 2002, and the 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 January 31, 2003 on our consideration of the Department of Education, State of Hawaii's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

State Comptroller
State of Hawaii

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2003 on our consideration of the Department of Education, State of Hawaii's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

As described in note A, the Department of Education, State of Hawaii has implemented a new financial reporting model, as required by the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as of July 1, 2001.

The management's discussion and analysis on pages 5 to 12 and budgetary comparison schedules on pages 37 and 38 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. 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 in relation to the basic financial statements taken as a whole



Honolulu, Hawaii
January 31, 2003

State of Hawaii
Department of Education

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2002

The following discussion and analysis of the Department of Education's financial performance provides an overall review of the Department's financial activities for the fiscal year ended June 30, 2002. The intent of this discussion and analysis is to provide a summarized explanation of the Department's financial performance as a whole; readers should also review the basic financial statements and notes to enhance their understanding of the Department's financial performance.

FINANCIAL HIGHLIGHTS

Key financial highlights for Fiscal Year 2002 are as follows:

- General revenues were \$1.349 billion, including general funds, reimbursements for special funded programs, and federal and other grants. Program revenues, including federal fund grants, general fund appropriations, and program reimbursements, totaled \$204 million.
- Total expenses were \$1.577 billion, of which 94%, or \$1.477 billion, was spent for instructional and school-level services.
- The Legislature appropriated \$43.3 million additional general funds to provide resources for the Department of Education to comply with the requirements of a contempt order from the federal court, regarding special education and related services. Further, beginning in Fiscal Year 2002 the Legislature transferred \$21.5 million and the responsibility for providing school-based behavioral health services from the Department of Health to the Department of Education.
- The Department of Education's total assets exceeded its liabilities by \$779 million (net assets). Land and depreciated capital assets (buildings and improvements, and equipment) comprise 97% of the net assets.
- Net assets decreased by \$23.8 million, primarily due to depreciation expense.

OVERVIEW OF THE FINANCIAL STATEMENTS

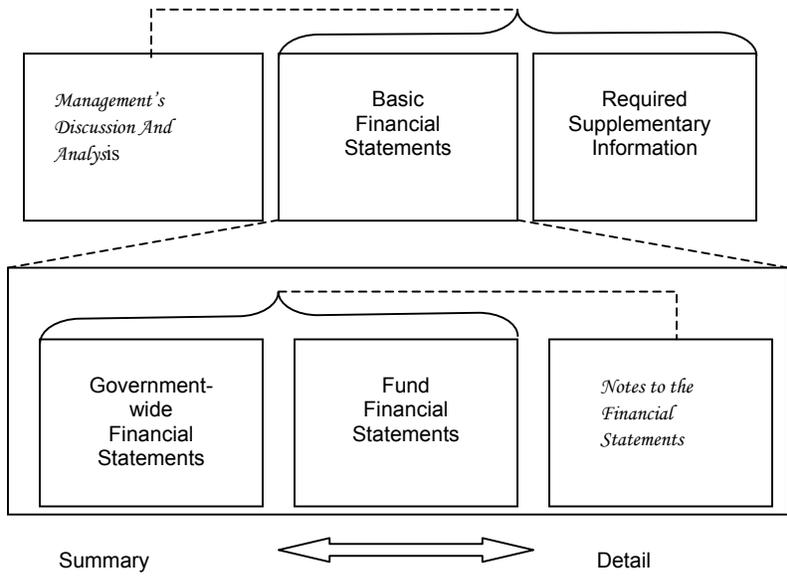
This annual report consists of three parts – *management's discussion and analysis* (this section), the *basic financial statements*, and *required supplementary information*.

The basic financial statements include two kinds of statements that present different views of the Department:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the Department’s *overall* financial position and results of operations.
- The remaining statements are *fund financial statements* that focus on *individual* parts of the Department, reporting the Department’s operations in more *detail* than the government-wide statements.
 - The governmental funds statements include most of the Department’s programs and services such as instruction, support services, operation and maintenance of facilities, student transportation, and extracurricular activities.
 - The fiduciary funds statement reports the funds that are held in trust for the students for school activities that take place outside of the formal class period and are not requirements for class work or credit.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. In addition, the statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements. Exhibit A-1 shows how the required parts of this annual report are arranged and relate to one another.

Exhibit A-1
Overview of the Financial Statements



GOVERNMENT-WIDE FINANCIAL ANALYSIS

Fiscal Year 2002 is the first year of implementation of Governmental Accounting Standards Board (GASB) Statement 34; accordingly, a comparative analysis of current and prior year balances is not included. However, such an analysis will be included in subsequent years.

Net assets. By far the largest portion of the Department's net assets (97%, \$779 million) reflects its investment in capital assets (e.g., land, buildings, equipment). (See Exhibit A-2.) The Department uses these capital assets to provide instructional and support services to students; consequently, these assets are not available for future spending. The unrestricted net assets of the Department are available for future use to provide program services.

Exhibit A-2 Statement of Net Assets

Assets	\$ in millions	Liabilities	\$ in millions
Cash	150.4	Current liabilities	113.5
Receivables	38.5	Accrued wages, employee benefits, workers' compensation claims	50.3
Property and equipment (net of depreciation)	<u>753.8</u>	Total Liabilities	<u>163.8</u>
TOTAL ASSETS	<u><u>942.7</u></u>	Net Assets	
		Investment in capital assets	753.8
		Unrestricted	25.1
		Total Net Assets	<u>778.9</u>
		TOTAL LIABILITIES AND NET ASSETS	<u><u>942.7</u></u>

Changes in net assets. As mentioned in the Financial Highlights, total net assets decreased by \$23.8 million (see Exhibit A-3). However, it is important to note that the Department did not outspend available funds. The State's budget guidelines do not allow cash expenditures in excess of available funds. The decrease was primarily due to the depreciation expense of \$42.4 million. Please refer to Note C for details of capital assets and depreciation by category. Depreciation expense does not require the use of cash; it is an accounting term that represents a process of allocation of the cost of assets over the estimated useful lives of the assets. This includes wear and tear, age, deterioration and obsolescence. Although depreciation is a commonly known term in commercial industry, GASB 34 requires all governmental agencies to record depreciation of capital assets, for the first time in history.

Exhibit A-3
Change in Net Assets

Revenues	\$ in millions
State Appropriations	1,349.2
Federal Funds	166.9
Other Revenues	37.2
Total Revenues	1,553.3
Expenditures	
School level instruction and support	1,029.4
Comprehensive student support	259.2
Instructional support	37.5
State and district administration	30.9
School support	168.5
School community service	19.4
Public libraries	25.2
Capital outlay	1.6
Other	5.4
Total Governmental Activities	1,577.1
Change in Net Assets	(23.8)
Net Assets at July 1, 2001	1,200.7
Net Assets at June 30, 2002	1,176.9

EXPLANATION OF MAJOR DEPARTMENTAL PROGRAMS

The State Budget is organized by major program areas. For the Department of Education, the major programs are:

- EDN 100 – School-Based Budgeting (instructional services, curriculum programs at-risk programs, fringe benefits, debt service)
- EDN 150 – Comprehensive Student Support Services (special needs assessment, special education services, school-based behavioral health services and other related services required for a free and appropriate public education, autism services, professional development)
- EDN 200 – Instructional Support (curriculum support, assessment, planning, information technology support)
- EDN 300 – State and District Administration (Board of Education, Superintendent, Complex Area Superintendents, budget, communications, civil rights compliance, internal audit, business services, human resources, information technology)
- EDN 400 – School Support (school food services, utilities, custodial services, repair and maintenance, student transportation)
- EDN 407 – Hawaii State Public Library System*
- EDN 500 – School Community Services (after school child care, adult education)

* Note: The Hawaii State Public Library System is included in the Department of Education’s combined financial statements since both the Library System and the Department of Education are administratively and legally supervised by the Hawaii State Board of Education.

Exhibit A-4 shows the revenues of the Department in summary form. The majority of our revenues come from State General funds, which represent State taxpayer monies. Other revenues come from federal grants, special funds to support specific programs such as cafeteria collections for school food services, and donations.

Exhibit A-4

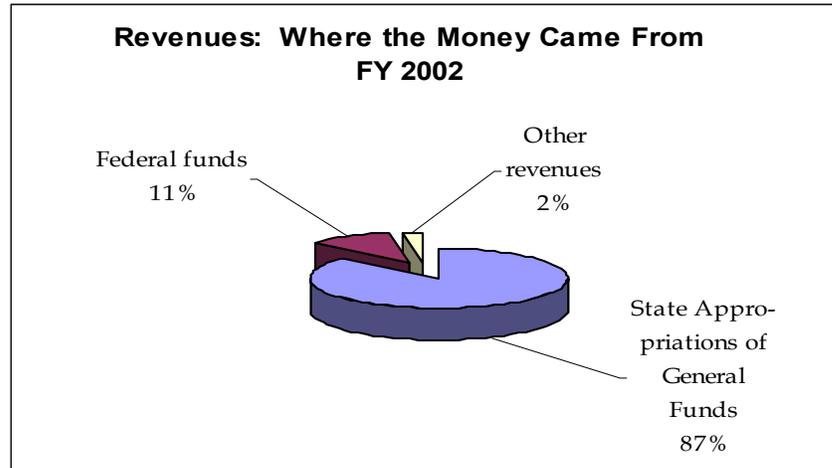
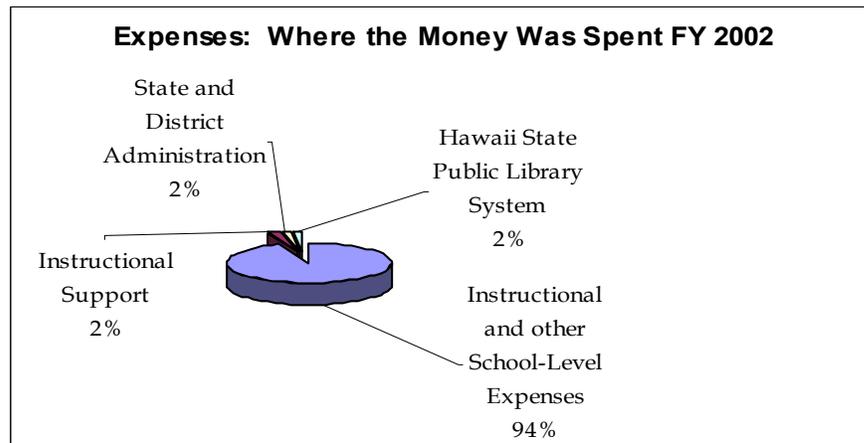


Exhibit A-5 shows the expenses of the Department in summary form. A total of 94% of the Department's expenditures are for school-level instructional and support programs in EDNs 100, 150, 400, and 500. Only 2% of the Department budget was spent on State and District Administration.

Exhibit A-5



GENERAL FUND BUDGETARY HIGHLIGHTS

- The general fund budget for Fiscal Year (FY) 2002 was restricted by the Governor by \$3,720,330 due to a significant shortfall between the actual and projected statewide revenue collections on which the FY 2002 statewide budgetary appropriations were based.

- The Department was required to provide funding from within the remaining appropriations for large expenses that were unfunded or underfunded in general fund appropriations, including charter schools, student transportation, school safety managers, items included in the teachers' collective bargaining agreement, and compliance with a federal consent decree for special needs students. These unfunded or underfunded needs of more than \$25 million, plus the Executive Administration's restriction, were met by internal restrictions of general funds and the use of certain federal fund revenues.
- The Department is permitted, by law, to "carryover" up to 5% of the appropriations for school level instruction and comprehensive school support services from one fiscal year to the next. The Department carried over \$31.6 million of the Fiscal Year 2002 general fund appropriation for expenditure in Fiscal Year 2003. This is reflected in the Budgetary Comparison Schedule (Required Supplementary Information) whereby expenditures for "school level instruction" and "comprehensive student support services" were lower than budget by \$31.7 million. Schools carry over funds to enable them to make longer-range fiscal plans, to save for major purchases for which funding may not be sufficient in a single year, and to provide for the opening of the next school year which occurs within weeks of the beginning of the fiscal year.

FIDUCIARY FUNDS

Net assets of fiduciary funds were \$12.6 million in FY 2002. As stated earlier, the fiduciary funds are held in trust for the students for school activities that take place outside of the formal class period and are not requirements for class work or credit. The funds are called "local school funds," which are monies collected and maintained by the school for the students or other sources that do not require deposit into the State Treasury. Examples include yearbook, newspaper fund, student government dues, P.E. uniform sale, and excursions. Receipts in Fiscal Year 2002 exceeded disbursements by \$670,992.

CAPITAL ASSET AND DEBT ADMINISTRATION

At the end of Fiscal Year 2002, the Department's financial statements included \$753.8 million in land, buildings and improvements, and equipment.

This year's capital improvements included the construction of new classrooms and other school campus facilities such as school administration offices, kitchens, libraries, restrooms, and gymnasiums. Please refer to Note C for details of capital assets.

The Department's long-term debt is managed by another agency of the State Executive Administration, the Department of Budget and Finance. General fund appropriations for interest payment and debt retirement are included in the Department's budget. Expenditures for interest payments were \$40 million; and \$53 million of debt was retired.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The State's economy has not significantly recovered from the tragic events of September 11, 2001, which negatively affected the local tourism industry. Impending geopolitical events may also severely impact tourism due to a possible continued decline in the leisure travel market. The Department's general fund appropriation is part of the State's budget for all other state agencies, which is primarily funded by State tax revenues. In light of reduced tax revenues, the 2002 State Legislature reduced the Department's Fiscal Year 2003 general fund appropriation by \$16 million. Although an increase of \$18 million was provided for services to special needs children required by the federal court, Board of Education budget requests totaling \$44.5 million were not funded for FY 2003. The Department's Fiscal Year 2003 budget was reduced by \$3 million by the Governor in February 2003.

FUTURE EVENTS THAT WILL FINANCIALLY IMPACT THE DEPARTMENT

The State's economy has not improved, and the global potential for conflict has resulted in lowered projections of state tax revenues. The Fiscal Year 2004 and 2005 increases for budget items approved by the Board of Education were not funded, and the base budget for each year was reduced by \$3 million at the beginning of the current Legislative Session. The Board of Education will be faced with difficult decisions in approving allocations of available funds for Fiscal Year 2004 and beyond.

Responsibility for the provision of services to students with autism spectrum disorders (ASD) has been transferred to the Department of Education from the Department of Health effective July 1, 2002. The cost of this program has grown significantly in the past few years, and funds transferred from the Department of Health were insufficient to provide the required services, by at least \$10 million. In March 2003, the Governor approved an additional transfer of \$14.6 million from the Department of Health to the Department of Education to fulfill the financial requirements of the autism services for Fiscal Year 2003. The Governor requested the Legislature to appropriate the additional \$14.6 million to the Department in each of the next two years, FY 2004 and FY 2005.

The Federal No Child Left Behind Act is an underfunded federal mandate. The Department estimates \$176 million in additional resources is needed for compliance in Fiscal Year 2004, and the amount will grow larger in Fiscal Year 2005 if Title I schools currently in need of improvement or corrective action do not make Adequate Yearly Progress (AYP) by 2005. Title I schools are those with the highest concentrations of poverty which are receiving federal fund support to help disadvantaged students meet the same high standards expected of all students. However, the performance goals specified by the Act call for the Department to implement the requirements for all students, not only Title I. The Act does not provide any funding to implement the requirements for non-Title I schools. Additional resources are needed to: recruit, train, and pay highly qualified professionals and paraprofessionals; provide extended school programs; provide student support services such as English for Second Language Learners (ESLL), special education, and high school reform; provide safe school environments; and implement the infrastructure required for testing, accountability analyses, and data collection. It will be extremely difficult to comply with the requirements of the No Child Left Behind Act within the timelines defined, without substantial additional resources and funding.

CONTACTING THE DEPARTMENT'S FINANCIAL MANAGEMENT

The financial report is designed to provide a general overview of the Department's finances for the public, and to demonstrate the Department's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Office of the Superintendent, Department of Education, P. O. Box 2360, Honolulu, Hawaii 96804.

State of Hawaii
Department of Education

STATEMENT OF NET ASSETS

June 30, 2002

ASSETS	<u>Governmental Activities</u>
Current Assets	
Cash (notes A7 and E)	\$ 150,104,237
Certificates of deposit (note A8)	311,927
Receivables	
Due from other agency	33,376,935
Due from federal government	4,745,734
Accounts receivable	<u>416,716</u>
Total current assets	188,955,549
Property and equipment (net of depreciation) (notes A6 and C)	<u>753,764,801</u>
TOTAL ASSETS	<u><u>\$ 942,720,350</u></u>
LIABILITIES AND NET ASSETS	
Current Liabilities	
Vouchers and contracts payable	15,431,394
Current portion of accrued wages and employee benefits (note A10)	46,613,983
Current portion of workers' compensation claims (note E)	8,005,856
Deferred revenues (note A9)	37,128,456
Due to State of Hawaii General Fund	5,607,649
Due to others	<u>713,443</u>
Total current liabilities	113,500,781
Accrued employee benefits (note A10)	26,718,206
Workers' compensation claims (note E)	23,582,386
Commitments and contingencies (note E)	-
Net assets	
Investment in capital assets	753,764,801
Unrestricted	<u>25,154,176</u>
Total net assets	<u><u>778,918,977</u></u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 942,720,350</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

STATEMENT OF ACTIVITIES

Year ended June 30, 2002

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program revenues</u>		<u>Net (expense) revenue and changes in net assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Governmental Activities</u>
Governmental Activities				
School level instruction and support	\$ 1,029,404,693	\$ 5,054,652	\$ 82,766,940	\$ (941,583,101)
Comprehensive student support	259,257,052	102,756	22,319,824	(236,834,472)
Instructional support	37,538,420	809,619	19,050,478	(17,678,323)
State and district administration	30,865,024	946,171	3,134,372	(26,784,481)
School support	168,486,857	19,116,261	37,283,192	(112,087,404)
School community service	19,366,220	1,964,760	1,541,525	(15,859,935)
Public libraries	25,238,963	1,745,843	1,284,383	(22,208,737)
Capital outlay	1,597,664	-	-	(1,597,664)
Other	5,460,711	-	7,029,384	1,568,673
	<u>\$ 1,577,215,604</u>	<u>\$ 29,740,062</u>	<u>\$ 174,410,098</u>	<u>(1,373,065,444)</u>
General revenues				
State allotted appropriations, net of lapses				<u>1,349,228,825</u>
Total general revenues and transfers				<u>1,349,228,825</u>
Change in net assets				(23,836,619)
Net assets at July 1, 2001, as restated (note G)				<u>802,755,596</u>
Net assets at June 30, 2002				<u>\$ 778,918,977</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

GOVERNMENTAL FUNDS
BALANCE SHEET

June 30, 2002

ASSETS	<u>General</u>	<u>Other Funds</u>	<u>Total Governmental</u>
Cash and cash equivalents	\$ 79,646,124	\$ 70,458,113	\$ 150,104,237
Certificates of deposit	-	311,927	311,927
Receivables			
Due from other agency	33,211,210	165,725	33,376,935
Due from federal government	-	4,745,734	4,745,734
Accounts receivable	-	416,716	416,716
	<u> </u>	<u> </u>	<u> </u>
TOTAL ASSETS	<u>\$ 112,857,334</u>	<u>\$ 76,098,215</u>	<u>\$ 188,955,549</u>
LIABILITIES AND FUND BALANCE			
Liabilities			
Vouchers and contracts payable	\$ 11,052,795	\$ 4,378,599	\$ 15,431,394
Accrued wages and employee benefits	36,644,536	3,293,068	39,937,604
Deferred income	-	37,128,456	37,128,456
Due to State of Hawaii General Fund	5,607,649	-	5,607,649
Due to others	-	713,443	713,443
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	53,304,980	45,513,566	98,818,546
Fund Balances			
Reserved for encumbrances	27,915,781	10,453,906	38,369,687
Reserved for continuing appropriations	31,636,573	36,329	31,672,902
Unreserved, reported in			
Special revenue funds	-	17,049,745	17,049,745
Capital projects funds	-	3,044,669	3,044,669
	<u> </u>	<u> </u>	<u> </u>
Total fund balances	<u>59,552,354</u>	<u>30,584,649</u>	<u>90,137,003</u>
	<u> </u>	<u> </u>	<u> </u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 112,857,334</u>	<u>\$ 76,098,215</u>	<u>\$ 188,955,549</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

RECONCILIATION OF THE GOVERNMENTAL FUND BALANCE
TO THE STATEMENT OF NET ASSETS

June 30, 2002

Total fund balance - governmental funds		\$ 90,137,003
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 not reported in the funds.	\$ 753,764,801	
Long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore not reported as expenditures in the governmental funds	(33,394,585)	
Long-term workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore not reported as expenditures in the governmental funds	<u>(31,588,242)</u>	<u>688,781,974</u>
Net assets of governmental activities		<u>\$ 778,918,977</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

June 30, 2002

	General	Other Funds	Total Governmental
Revenues			
State allotments, net	\$ 1,344,411,456	\$ 4,817,369	\$ 1,349,228,825
Federal funds	-	166,960,661	166,960,661
Other revenues	-	37,189,499	37,189,499
	1,344,411,456	208,967,529	1,553,378,985
Expenditures			
School level instruction	910,364,004	90,281,331	1,000,645,335
Comprehensive student support	236,819,607	22,488,371	259,307,978
Instructional support	18,314,568	19,783,835	38,098,403
State and district administration	25,994,673	3,717,515	29,712,188
School support	108,588,709	57,754,334	166,343,043
School community service	15,955,356	3,421,939	19,377,295
Public libraries	22,634,174	2,246,268	24,880,442
Capital outlay	-	1,783,567	1,783,567
Other	874,908	4,585,803	5,460,711
	1,339,545,999	206,062,963	1,545,608,962
Net change in fund balances	4,865,457	2,904,566	7,770,023
Fund Balances at July 1, 2001	54,686,897	27,680,083	82,366,980
Fund Balances at June 30, 2002	\$ 59,552,354	\$ 30,584,649	\$ 90,137,003

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

RECONCILIATION OF THE CHANGE IN FUND
BALANCE OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES

June 30, 2002

Net change in fund balances - total governmental funds		\$ 7,770,023
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. In the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays during the year.	\$(23,709,943)	
Long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	(3,158,950)	
Long-term workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	<u>(4,737,749)</u>	<u>(31,606,642)</u>
Change in net assets of governmental activities		<u><u>\$ (23,836,619)</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

STATEMENT OF FIDUCIARY NET ASSETS
FIDUCIARY FUNDS

June 30, 2002

	<u>Agency Funds</u>
ASSETS	
Cash and cash equivalents	<u>\$ 12,565,918</u>
Total assets	<u>12,565,918</u>
NET ASSETS	<u>\$ 12,565,918</u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
FIDUCIARY FUNDS

June 30, 2002

	<u>Agency Funds</u>
Additions	
Other revenues	<u>\$ 22,888,069</u>
Total additions	22,888,069
Deductions	
Expenditures	<u>22,217,077</u>
Total deductions	<u>22,217,077</u>
CHANGE IN NET ASSETS	670,992
Net assets at July 1, 2001	<u>11,894,926</u>
Net assets at June 30, 2002	<u><u>\$ 12,565,918</u></u>

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

1. Introduction

The Department of Education (DOE), State of Hawaii (State), administers the statewide system of public schools and public libraries. Additionally, the DOE is responsible for administering state laws regarding regulation of private school operations through a program of inspection and licensing and the professional certification of all teachers for every academic and non-college type of school. Federal grants received to support public school and public library programs are administered by the DOE on a statewide basis.

The accompanying financial statements of the DOE have been prepared in conformity with accounting principles generally accepted in the United States of America prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, Basic Financial Statements – Management’s Discussion and Analysis – for State and Local Governments. This Statement establishes new financial reporting requirements for state and local governments in the United States of America. They require new information and restructure much of the information that governments have presented in the past. Comparability with reports issued in prior years is affected. The DOE is required to implement these standards for the fiscal year ended June 20, 2002.

Other GASB Statements are required to be implemented in conjunction with Statement 34. Therefore, the DOE has implemented the following GASB Statements in the current fiscal year: Statement 37, Basic Financial Statements—Management’s Discussion and Analysis—for State and Local Governments: Omnibus and Statement 38, Certain Financial Statement Note Disclosures.

The DOE is part of the executive branch of the State. The financial statements of the DOE, are intended to present the financial position and changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2002, 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. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually, which includes the DOE’s financial activities.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

2. Reporting Entity

The DOE has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the DOE are such that exclusion would cause the DOE's financial statements to be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. The DOE has determined, based on the GASB criteria, that it has no component units.

3. Government-Wide and Fund Financial Statements

The government-wide financial statements, the statement of net assets and the statement of activities, report information of all of the non-fiduciary activities of the DOE. Governmental activities are normally supported by State allotments and intergovernmental revenues.

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

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 DOE's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide statements. Major individual governmental funds are reported as separate columns in the fund financial statements. Non-major funds are summarized into a single column.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation

a. Government-Wide Financial Statements

The government-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 the related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

b. Governmental Fund Financial Statements

The Governmental fund financial statements are reported using the current financial resources measurement focus and 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 DOE considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include federal grants. Some revenue items that are considered measurable and available to finance operations during the year from an accounting perspective are not available for expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with generally accepted accounting principles since they have been earned and are expected to be collected within sixty days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the DOE.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation and workers' compensation claims which are recorded as an expenditure when utilized or paid. The amount of accumulated vacation and reserve for workers' compensation claims at June 30, 2002 has been reported only in the government-wide financial statements.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Measurement Focus, Basis of Accounting and Financial Statement Presentation (continued)

c. Fiduciary Funds

Fiduciary Funds—The financial statement of fiduciary funds is reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

5. Fund Accounting

The financial activities of the DOE are recorded in individual funds, each of which is deemed to be a separate accounting entity. The DOE uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

GASB Statement 34 sets forth minimum criteria for the determination of major funds. The non-major funds are combined in a column in the fund financial statements.

a. Governmental Funds

General Fund – The general fund is the general operating fund of the DOE. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

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 expenditures for specified purposes.

Capital Projects Fund – Capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

The DOE reports the General Fund as a major governmental fund.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Fund Accounting (continued)

b. Fiduciary Funds

The DOE presents as Fiduciary Funds those activities that account for assets held in a trustee capacity or as an agent for individuals, private organizations, or other governmental units.

6. Capital Assets

Capital assets, which include property and equipment, are reported in the applicable governmental activities in the government-wide financial statements. Capital assets are defined by the State as land and those assets with estimated useful lives greater than one year with an acquisition cost greater than:

Land improvements	\$100,000
Buildings and building improvements	100,000
Furniture and equipment	5,000
Motor vehicles	5,000

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

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

Depreciation expense is recorded in the government-wide financial statements. The DOE utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. Generally, the useful lives are as follows:

Buildings and building improvements	30 years
Land improvements	15 years
Furniture and equipment	7 years
Motor vehicles	5 years

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

7. Cash

Cash includes amounts held in the State Treasury. The State Director of Finance is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). 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. Cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or participates in the State Treasury Investment Pool System. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account.

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

8. Certificates of Deposit

Certificates of deposit are stated at cost, which approximates market. Investments have original maturities that are greater than three months from the date of purchase.

9. Deferred Revenues

Deferred revenues at the fund level and government-wide level arise when the DOE receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the DOE has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and revenue is recognized. Deferred revenues at June 30, 2002 consists primarily of Federal grant funds.

10. Compensated Absences

Employees earn vacation at the rate of one and three-quarters working days for each month of service. Vacation days may be accumulated to a maximum of 90 days at calendar year end. Employees are entitled to receive cash payment for accumulated vacation upon termination. The governmental fund financial statements record expenditures when employees are paid for

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE A – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (continued)

10. Compensated Absences (continued)

vacation. The government-wide financial statements present the cost of accumulated unpaid vacation as a liability.

Balance at July 1, 2001	\$30,235,635
Vacation earned	9,855,983
Vacation leave payments	<u>(6,697,033)</u>
Balance at June 30, 2002	33,394,585
Less current portion	<u>(6,676,379)</u>
	<u><u>\$26,718,206</u></u>

Employees also earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit. Sick leave can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a DOE employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii. Accumulated sick leave as of June 30, 2002 relating to the DOE approximated \$443,000,000.

11. 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 expenses during the reporting period. Actual results could differ from those estimates.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE B – BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the Hawaii Revised Statutes and other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii. To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations.

However, Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to five percent of any appropriation for the school-based budgeting program and up to five percent of any appropriation for the comprehensive support services program at the end of a fiscal year. These carryover funds, to the extent not expended or encumbered, lapse at June 30 of the first fiscal year of the next fiscal biennium. As of June 30, 2002, general funds carried over from both programs stated above amounted to \$31,636,573.

For purposes of budgeting, the DOE's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America (US GAAP). Encumbrances represent executed but unperformed purchase orders or contracts. In the accompanying financial statements, encumbrances are recorded as expenditures for budgetary purposes and as reservations of fund balance for GAAP purposes. Since budgetary basis differs from GAAP, budget and actual amounts in the accompanying Required Supplementary Information – Budgetary Schedule is presented on the budgetary basis. A reconciliation of revenues in excess of (less than) expenditures and other financing sources (uses) on a budgetary basis at June 30, 2002, to revenues in excess of (less than) expenditures and other financing sources (uses) presented in conformity with GAAP is set forth in the Notes to the Required Supplementary Information.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE C – CAPITAL ASSETS

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Governmental activities				
Capital assets, not being depreciated				
Land	\$ 41,410,285	\$ –	\$ –	\$ 41,410,285
Total capital assets not being depreciated	41,410,285	–	–	41,410,285
Capital assets, being depreciated				
Building and improvements	1,268,432,329	10,380,422	–	1,278,812,751
Furniture and equipment	46,001,015	9,032,386	4,853,173	50,180,228
Total capital assets being depreciated	1,314,433,344	19,412,808	4,853,173	1,328,992,979
Less accumulated depreciation for:				
Building and improvements	544,161,651	38,121,148	–	582,282,799
Furniture and equipment	34,207,234	4,320,622	4,172,192	34,355,664
Total accumulated depreciation	578,368,885	42,441,770	4,172,192	616,638,463
Governmental activities, net	<u>\$ 777,474,744</u>	<u>\$(23,028,962)</u>	<u>\$ 680,981</u>	<u>\$ 753,764,801</u>

Current-period depreciation expense was charged to function as follows:

Governmental activities	
School level instruction	\$38,595,045
Comprehensive student support	237,412
Instructional support	1,427,666
State and district administration	350,273
School support	1,099,279
School community service	43,609
Public libraries	639,662
Other	48,824
	<u>48,824</u>
Total depreciation expense – governmental activities	<u>\$42,441,770</u>

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE D – RETIREMENT BENEFITS

Employees' Retirement System

Plan Description

All eligible employees of the State and Counties are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing, multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information for ERS. That report may be obtained from them.

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the payment of salary in lieu of vacation, or three highest paid years of service, excluding the payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively. All contributions, benefits and eligibility requirements are governed by Chapter 88.

Funding Policy

Most covered employees of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contributions to the ERS is comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE D – RETIREMENT BENEFITS (continued)

Employees' Retirement System (continued)

Funding Policy (continued)

The contribution requirement for all employers as of June 30, 2002, 2001, 2000 and 1999 were approximately \$167 million (100% contributed), \$164 million (5% contributed), \$172 million (13% contributed) and \$185 million (83% contributed), respectively.

Contributions for employees accounted for in DOE's general fund are paid from the State General Fund and are not reflected in the accompanying financial statements. The portion of the contributions related to DOE's special revenue funds are recorded as an expenditure of the special revenue funds in the financial statements.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all employees hired prior to July 1, 1996 who retire from State employment on or after attaining age 62 with at least ten years of service or age 55 with at least thirty years of service under the noncontributory plan and age 55 with at least five years of service under the contributory plan. Retirees credited with at least ten years of service excluding sick leave credit qualify for free medical insurance premiums; however, retirees with less than ten years must assume a portion of the monthly premiums. All service-connected disability retirees who retired after June 30, 1984, with less than ten years of service also qualify for free medical insurance premiums. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement of a portion of the basic medical coverage premiums.

For employees hired after July 1, 1996 and retire with fewer than twenty-five years of service, the State shall pay to a fund a monthly contribution equal to one-half of the retired employee's monthly Medicare or non-Medicare premium for certain medical benefits for retired employees with ten or more years of service; and seventy-five percent of the retired employee's monthly Medicare or non-Medicare premium for retired employees with at least fifteen but fewer than twenty-five years of service.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE D – RETIREMENT BENEFITS (continued)

Post-Retirement Health Care and Life Insurance Benefits (continued)

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The DOE's general fund share of the post-retirement benefits expense for the year ended June 30, 2002 was approximately \$207,218,000. The DOE's special revenue fund share of the post-retirement benefits expense for the year ended June 30, 2002 was approximately \$1,679,000 and is included in the financial statements.

NOTE E – COMMITMENTS AND CONTINGENCIES

Insurance

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

The DOE settles all claim settlements and judgments for DOE employees injured from its General Fund resources. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities will be reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

These liabilities are the DOE's best estimate based on available information. A reconciliation of changes in aggregate liabilities for claims are as follows:

Balance at July 1, 2001	\$26,850,493
Interest in reserve	12,995,525
Payments on claims	<u>(8,257,776)</u>
Balance at June 30, 2002	31,588,242
Less current portion	<u>(8,005,856)</u>
	<u><u>\$23,582,386</u></u>

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE E – COMMITMENTS AND CONTINGENCIES (continued)

Deferred Compensation Plan

In 1983, the State established a deferred compensation plan which enables state employees to defer a portion of their compensation. The State Department of Human Resources Development has the fiduciary responsibility of administering the plan. The deferred compensation is not available to beneficiaries until termination, retirement, death or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the State's general creditors in an amount equal to the fair market value of the deferred account for each participant.

Leases

The DOE leases equipment and office facilities on a long-term basis that are reported in the general and special revenue funds. The following is a schedule of minimum future rentals on noncancelable operating leases for the five years subsequent to June 30, 2002.

	<u>Amount</u>
Fiscal year ending June 30,	
2003	\$1,247,000
2004	1,075,000
2005	847,000
2006	571,000
2007	<u>213,000</u>
	<u>\$3,953,000</u>

Total rent expense for the year ended June 30, 2002 was approximately \$1,242,000.

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE E – COMMITMENTS AND CONTINGENCIES (continued)

Litigation

The DOE is a party to various legal proceedings. Although the DOE and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the DOE because any judgments against the DOE are judgments against the State and would be paid by legislative appropriation of the State General Fund and not by the DOE.

Concentrations of Credit Risk

The DOE maintains cash in the State Treasury as well as in a financial institution. Cash held in the financial institution totaled \$14,926,376 at June 30, 2002. Of this amount, \$5,290,950 is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by DOE's agent. The uncollateralized balance at June 30, 2002 is \$9,635,426.

NOTE F – FOOD DISTRIBUTION PROGRAM

The DOE receives food commodities from the U.S. Department of Agriculture, Food and Nutrition Service (FNS), under the Federal Food Distribution Program. The DOE School Food Services Branch distributes the food to qualifying schools, charitable organizations, and nonprofit summer camps for children. The total value of the amount of food which the DOE is entitled to receive is determined in part by the number of meals served under the National School Lunch Program. The DOE's allocation balance is reduced as the DOE receives the food commodities. The amount charged to the DOE allocation balance is based upon the FNS's cost to purchase the commodities. In addition to this allocation, the DOE may also receive "bonus" food commodities. The bonus commodities do not reduce the DOE's allocation balance.

The following is a summary of the value of the food commodities received by the DOE during the year ended June 30, 2002. The value of the bonus commodities is based upon the estimated costs provided by the FNS in the *Current Commodity File* report dated June 30, 2002.

	<u>Amount</u>
Basic allocation	\$3,483,593
Bonus commodities	<u>179,941</u>
	<u><u>\$3,663,534</u></u>

State of Hawaii
Department of Education

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2002

NOTE G – BEGINNING FUND BALANCE/NET ASSETS ADJUSTMENTS

The following reconciles the June 30, 2001 fund balance/net assets, as previously reported, to the beginning fund balance/net assets, as restated, to include adoption of new pronouncements.

	June 30, 2001, as previously Reported	Fund reclassification	Prior-period adjustment	June 30, 2001, as restated
Governmental funds and activities:				
Major funds				
General fund	\$ 54,686,897	\$ —	\$ —	\$ 54,686,897
Non-major funds				
Capital project funds	36,329			36,329
Special revenue funds	23,809,330	—	—	23,809,330
Previously reported as expendable trust funds				
Donated funds	—	3,834,424	—	3,834,424
Total governmental funds	78,532,556	3,834,424		82,366,980
Adoption of GASB Statements:				
Capital assets, net of accumulated depreciation	—	2,348,655,839	(1,571,181,095)	777,474,744
Accrued vacation	—	—	(30,235,635)	(30,235,635)
Workers' compensation	—	—	(26,850,493)	(26,850,493)
Total governmental funds and activities	78,532,556	2,352,490,263	(1,628,267,223)	802,755,596
Fiduciary funds:				
Previously reported as expendable trust funds				
Donated funds	3,834,424	(3,834,424)	—	—
Total fiduciary funds	3,834,424	(3,834,424)	—	—
Account groups:				
General fixed assets	2,348,655,839	(2,348,655,839)	—	—
Total account groups	2,348,655,839	(2,348,655,839)	—	—
TOTAL GOVERNMENT	\$2,431,022,819	\$ —	\$(1,628,267,223)	\$ 802,755,596

REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN
MANAGEMENT'S DISCUSSION AND ANALYSIS

State of Hawaii
Department of Education

REQUIRED SUPPLEMENTARY INFORMATION

BUDGETARY COMPARISON SCHEDULE
GENERAL FUNDS

June 30, 2002

	Budgeted amounts		Actual amounts (budgetary basis) (note A)
	Original	Final	
Revenues			
State allotted appropriations	\$ 1,300,317,554	\$ 1,342,924,048	\$ 1,342,924,048
Total revenues	1,300,317,554	1,342,924,048	1,342,924,048
Expenditures			
School level instruction	884,044,285	914,309,287	890,416,843
Comprehensive student support services	221,201,070	231,403,952	223,599,090
Instructional support	18,439,063	18,364,341	18,363,224
State and district administration	27,327,522	27,395,733	27,395,719
School support	108,613,109	111,762,122	111,761,051
School community service	16,635,104	15,779,992	15,779,944
Public libraries	21,445,594	22,696,814	22,695,759
Other	2,611,807	1,211,807	978,219
Total Expenditures	1,300,317,554	1,342,924,048	1,310,989,849
EXCESS OF REVENUES OVER EXPENDITURES	\$ -	\$ -	\$ 31,934,199

The accompanying notes are an integral part of this statement.

State of Hawaii
Department of Education

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING

June 30, 2002

NOTE A – EXPLANATION OF DIFFERENCES BETWEEN BUDGETARY ACTUAL
AND GAAP REVENUES AND EXPENDITURES

Excess of revenues over expenditures and other sources and uses – actual on budgetary basis	\$ 31,934,199
Reserve for encumbrances at year end	27,915,781
Expenditures for liquidation of prior year's encumbrances	(63,462,266)
Accrual adjustments and other	<u>8,477,743</u>
 EXCESS OF REVENUES OVER EXPENDITURES AND OTHER SOURCES AND USES – US GAAP BASIS	 <u><u>\$ 4,865,457</u></u>

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
U.S. Department of Agriculture (USDA):				
Direct Programs				
Food Donation	10.550	-	\$ 3,663,534	\$ -
Child Nutrition Cluster:				
School Breakfast Program	10.553	-	6,377,183	167,309
National School Lunch Program	10.555	-	25,702,291	523,086
Special Milk Program for Children	10.556	-	5,948	5,948
Summer Food Service Program for Children	10.559	-	605,668	603,668
			<u>32,691,090</u>	<u>1,300,011</u>
Child and Adult Care Food Program	10.558	-	4,771,490	4,771,490
State Administrative Expenses	10.560	-	562,481	-
			<u>41,688,595</u>	<u>6,071,501</u>
<i>Total U.S. Department of Agriculture (USDA)</i>				
U.S. Department of Commerce:				
Direct Program				
Telecommunications and Information Infrastructure Assist Program	11.552	-	37,607	-
			<u>37,607</u>	<u>-</u>
<i>Total U.S. Department of Commerce</i>				
U.S. Department of Defense:				
Direct Programs				
National Defense Authorization Act P.L. 102-484	N.A.	-	4,666,244	-
Subtotal Direct Programs carried forward			<u>\$ 4,666,244</u>	<u>\$ -</u>

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
Subtotal brought forward			\$ 4,666,244	\$ -
Pearl Harbor Summer Internship Program	N.A.		36,363	-
Passed Through from Department of Defense				
Joint Venture ED Forum	N.A.		446,923	-
<i>Total U.S. Department of Defense</i>			5,149,530	-
U.S. Department of Justice:				
Passed Through from Department of Human Services				
Lanakila Learning Center	16.549	00-JE-FX-0015	14,609	-
<i>Total U.S. Department of Justice</i>			14,609	-
U.S. Department of Labor (DOL):				
Direct Program				
School To Work Opportunity	17.249	-	256,015	-
Passed Through from State Department of Labor				
Workforce Development Project	17.255	G0100HICCD2	8,318	-
<i>Total U.S. Department of Labor (DOL)</i>			264,333	-
U.S. Department of Transportation:				
Passed Through from State of Hawaii – Department of Transportation				
Safe Community Youth Activity	20.600	J9 AL2K (03-S-01,02,03) J9 AL02 02 (04-S-01)	247,963	-
<i>Total U.S. Department of Transportation</i>			\$ 247,963	\$ -

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
National Endowment for the Humanities:				
Direct Program				
Library Services and Technology Act	45.310	-	\$ 554,992	\$ -
Passed Through from State Foundation on Culture and the Arts				
Artists-in-the-Schools	45.003	FY00-0082 FY01-0082 FY02-002	47,797	-
<i>Total National Endowment for the Humanities</i>			602,789	-
National Science Foundation:				
Passed Through from Maui Economic Development Board				
Hands-On Science for Maui (Project SEED)	47.076	ESI-9253304	5,787	-
<i>Total National Science Foundation</i>			5,787	-
Environmental Protection Agency:				
Passed Through from State Department of Health				
Water Quality Monitoring Program	66.460	C999655-01-2	36,491	-
<i>Total Environmental Protection Agency</i>			\$ 36,491	\$ -

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
U.S. Department of Education:				
Direct Programs				
FEMA - Volcanic Gases Project	N.A.	-	\$ 2,723	\$ -
Adult Education – State Administered Basic Grant Program	84.002A	-	1,522,785	-
Title I Grants to Local Education Agencies	84.010A	-	22,197,406	-
Migrant Education	84.011A	-	275,484	-
Consortium Incentive Grant	84.011B	-	129,213	-
Title I Program for Neglected and Delinquent Children	84.013A	-	132,040	-
Special Education Cluster:				
Special Education – State Grants, IDEA Part B	84.027A	-	18,029,391	-
Special Education – Preschool Grants, IDEA Preschool	84.173A	-	850,851	-
			<u>18,880,242</u>	-
Impact Aid – Maintenance and Operation	84.041	-	42,458,035	-
Emergency Immigrant Education	84.162A	-	417,370	-
Safe & Drug Free Learning Environment	84.184L	-	1,358,087	-
Robert C. Byrd Honors Scholarship	84.185A	-	159,000	-
Safe and Drug-Free Schools & Communities – State Grants	84.186A	-	1,652,241	-
State Educational Agency Bilingual	84.194Q	-	55,672	-
Training For All Teachers	84.195B	-	198,198	-
Education for Homeless Children and Youth – Grants for State and Local Activities	84.196A	-	132,045	-
Even Start Program	84.213C	-	844,935	-
Even Start Program-Migrant Education	84.214A	-	223,471	-
			<u>\$ 90,638,947</u>	<u>\$ -</u>
Subtotal Direct Programs carried forward			\$ 90,638,947	\$ -

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
Subtotal Direct Programs brought forward			\$ 90,638,947	\$ -
Smaller Learning Communities (OESE)	84.215L	-	160,999	-
Christa McAuliffe Fellowship Program	84.215U	-	31,924	-
Partnership in Character Education	84.215V	-	140,443	-
Native Hawaiian Special Education	84.221A	-	1,048,631	-
Goals 2000: Educate America Act – Development	84.276A	-	1,825,185	-
Eisenhower Mathematics and Science Education – State Grants	84.281A	-	1,535,458	-
Eisenhower - Stds, Assmt, Accountability	84.281C	-	86,319	-
Public Charter Schools	84.282A	-	3,092,359	2,919,900
After School Learning Center	84.287	-	3,421,287	-
Bilingual Education Cluster:				
Bilingual Education Project – Program Development and Implementation Grants	84.288S	-	309,964	
Bilingual Education Project Ho'olokahi	84.290U	-	162,981	
			<u>472,945</u>	-
All Can Learn Japanese Together	84.293B	-	75,457	-
Native Hawaiian Community Based Education Learning Centers	84.296A	-	316,621	-
Native Hawaiian Curriculum Development	84.297A	-	410,138	-
ESEA Title VI – Innovative Education Program Strategies	84.298A	-	1,961,477	-
National Challenge Grants for Technology in Education	84.303A	-	736,591	-
Technology Challenge Grants - Earmark	84.303K	-	893,097	-
Even Start-Statewide Family Literacy Program	84.314B	-	162,930	-
Technology Literacy Challenge Fund	84.318X	-	1,983,673	-
State Program Improvement Grant IDEA	84.323A	-	869,104	-
Deaf Blind Centers, P.L. 105-17	84.326C	-	39,460	-
SPED-TA & Dissemination/ST Tech Assist	84.326X	-	4,163	-
Comprehensive School Reform Demo Project	84.332A	-	396,278	-
Teacher Quality Enhancement Grants	84.336C	-	88,944	-
Reading Excellence Act	84.338A	-	371,540	-
Class Size Reduction	84.340A	-	7,016,435	-
Title I Accountability	84.348A	-	234,295	-
School Renovation, IDEA & Technology	84.352A	-	6,291	-
Hawaii Network Learning Communities	47.076	-	150,390	-
Common Core Data Survey Basic	N.A.	-	<u>58,254</u>	-
Subtotal Direct Programs carried forward			\$ 118,229,635	\$ 2,919,900

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
Subtotal Direct Programs brought forward			\$ 118,229,635	\$ 2,919,900
Passed Through from Office of the State Director for Vocational Education				
Vocational Education – Basic Grant to States	84.048	V048A990011 V048A000011 V048A010011	2,437,155	-
Non-traditional Training & Employment	84.048	V048A990011	21,997	-
Vocational Education – Tech Prep	84.243A	V243A990082 V243A000011 V243A010011	491,079	-
Passed Through from State Department of Human Services				
Rehabilitation Services – Basic Support	84.126A	MOA-DHS	88,282	-
Passed Through from Alu Like				
Alu Like – Project Kako’o FY01	84.259A	VE-00-01		
Alu Like – Project Laulima FY02	84.259A	VE-01-03		
Alu Like – Project Keoki FY01	84.259A	VE-00-04		
Alu Like – Project Keoki FY02	84.259A	VE-01-11		
Alu Like – Project Waveriders FY01	84.259A	VE-00-05		
Alu Like – Project Waveriders FY02	84.259A	VE-01-04		
Alu Like – Business, Arts and Communication Center	84.259A	VE-00-02		
Alu Like – Hawaii Alive Project	84.259A	UAF/HAP 46-50-001	446,268	-
Passed Through from University of Hawaii				
Gear Up Hawaii	84.334	P334S000195-01	343,026	
Native Hawaiian Special Education	84.221A	CO10147	948,599	-
<i>Total U.S. Department of Education</i>			\$ 123,006,041	\$ 2,919,900

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2002

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amount Provided to Subrecipient
U.S. Department of Health and Human Services (HHS):				
Direct Program				
Head Start State Collaboration Project	93.600	-	\$ 57,207	\$ -
Passed Through from State Department of Health				
Preparing For the Drug Free Years (PDFY)	93.359	ASO Log No Y0-267	87,872	-
Passed Through from State Department of Human Services				
Administration for Children and Families/Child Care and Development Block Grant	93.575	G0100HICCD2	285,695	-
Felix Training – Title IV – E Foster Care Program	93.658	9701HI1401	219,957	-
<i>Total U.S. Department of Health and Human Services (HHS)</i>			650,731	-
Corporation for National and Community Service:				
Direct Programs				
State Local & Community Health Program	93.938	-	296,158	-
Subtotal Direct Programs			296,158	-
Passed Through from State Department of Labor				
Nat'l & Comm Service-Serve America	94.004	97LSFHI303 00LSFHI101 00LSFHI101	58,220	-
Hawaii Service Learning Initiative-DLIR	94.004	00LCSH1012	187,173	-
<i>Total Corporation for National and Community Service</i>			541,551	-
TOTAL FEDERAL GRANT FUND EXPENDITURES			\$ 172,246,027	\$ 8,991,401

The accompanying notes on page 46 are an integral part of this schedule.

State of Hawaii
Department of Education

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2002

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Education, State of Hawaii, 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 combined financial statements.

NOTE 2 – NON-CASH ASSISTANCE

Expenditures for the Food Donation Program (CFDA No. 10.550) are based on the value of food commodities received.

REPORTS ON COMPLIANCE AND INTERNAL CONTROL

STATE OF HAWAII
DEPARTMENT OF EDUCATION

June 30, 2002

Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance
With *Government Auditing Standards*

State Comptroller
State of Hawaii

We have audited the financial statements of the Department of Education, State of Hawaii, as of and for the year ended June 30, 2002, and have issued our report thereon dated January 31, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department of Education, State of Hawaii's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including applicable provisions of Hawaii Public Procurement Code (Chapter 103D of Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance, which we have reported to management of the Department of Education, State of Hawaii, in a separate letter dated March 31, 2003.

Internal Control Over Financial Reporting

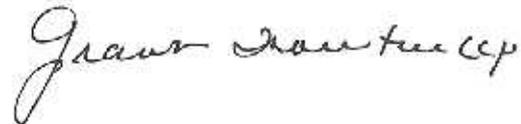
In planning and performing our audit, we considered the Department of Education, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Education, State of Hawaii's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Section II of

State Comptroller
State of Hawaii

the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Education, State of Hawaii's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Section II of the accompanying schedule of findings and questioned costs as items 2002-1, 2002-2, 2002-3, 2002-4 and 2002-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to the management of the Department of Education, State of Hawaii, in a separate letter dated January 31, 2003.

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



Honolulu, Hawaii
January 31, 2003

Report on Compliance With Requirements Applicable
to Each Major Program and Internal Control Over
Compliance in Accordance With OMB Circular A-133

State Comptroller
State of Hawaii

Compliance

We have audited the compliance of the Department of Education, State of Hawaii, 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, 2002. The Department of Education, State of Hawaii'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 of Education, State of Hawaii's management. Our responsibility is to express an opinion on the Department of Education, State of Hawaii'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 of Education, State of Hawaii'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 on the Department of Education, State of Hawaii's compliance with those requirements.

In our opinion, the Department of Education, State of Hawaii, 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, 2002. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB

State Comptroller
State of Hawaii

Circular A-133 and which are described in Section III of the accompanying schedule of findings and questioned costs as items 2002-8, 2002-11, 2002-12, 2002-13, 2002-16, 2002-17, 2002-18 and 2002-19.

Internal Control Over Compliance

The management of the Department of Education, State of Hawaii, is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Education, State of Hawaii's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department of Education, State of Hawaii's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in Section III of the accompanying schedule of findings and questioned costs as items 2002-6, 2002-7, 2002-9, 2002-10, 2002-14, 2002-15 and 2002-20.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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

Honolulu, Hawaii
January 31, 2003

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

STATE OF HAWAII
DEPARTMENT OF EDUCATION

June 30, 2002

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program</u>
10.550	Food Donation Child Nutrition Cluster:
10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children
N.A.	National Defense Authorization Act P.L. 102-484
84.002	Adult Education – State Administered Basic Grant Special Education Cluster:
84.027	Special Education – State Grants, IDEA Part B
84.173	Special Education – Preschool Grants, IDEA Preschool
84.041	Impact Aid – Maintenance and Operation
84.186	Safe and Drug-Free Schools and Communities – State Grants
84.282	Public Charter Schools
84.287	21 st Century Learning Center
84.338	Reading Excellence Act
84.340	Class-Size Reduction

Dollar threshold used to distinguish between type A and type B programs:

\$3,000,000

Auditee qualified as low-risk auditee?

__ yes √ no

Section II – Financial Statement Findings

2002-1 Local School Fund Bank Reconciliations

Chapter 9 of the FMS User Policy and Process Flow Guide requires schools to reconcile the bank statement with the school’s check register on a monthly basis. The appropriate school personnel should review and investigate reconciling items.

Monthly bank reconciliations are essential in maintaining an accurate cash balance. The bank reconciliation may also uncover possible bank and/or bookkeeping errors. Furthermore, failure to timely resolve reconciling items increases the chances of misstating the school’s funds.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

Of the 246 schools, we selected 138 local school fund account bank reconciliations for the month of June 2002 to be reviewed. We noted the following:

- Forty-six (46) schools did not have an appropriate review or approval signature and date on the bank reconciliation
- forty-eight (48) schools had a review or approval signature on the bank reconciliation, however the review or approval was not dated, therefore we were unable to determine whether the review or approval was performed within a timely manner
- three (3) schools were unable to provide us with a bank reconciliation after numerous requests
- reconciliation at twenty-two (22) schools included unidentifiable miscellaneous differences greater than \$5,000
- and three (3) schools were unable to provide supporting documentation for reconciling items that were greater than \$5,000; one of these schools had reconciling items that were not investigated in a timely manner, some reconciling items outstanding on their June 2002 bank reconciliations dated back to 1997.

To ensure the accountability, accuracy and propriety of a school's cash, we recommend that bank reconciliations be performed on a monthly basis with proper and timely reviews by the principal or designee. Also, all reconciling items should be resolved in a timely manner. Outstanding checks that are past the six-month void date should be canceled.

2002-2 Improving Compensating Controls over Local School Funds

Of the ten (10) schools we visited during our testing of the local school funds, we noted a lack of segregation of duties at all ten (10) schools. The school administrative services assistant or account clerk generally performed all the cash functions at these schools. When staffing limits the extent of segregation of duties, the principal or administrator should provide for compensating controls at each school or office. As stated in the Financial Management System (FMS) User Policy and Process Flow Guide, these compensating controls would include:

1. Conducting periodic unannounced cash counts of the school or office petty cash fund.
2. Verifying that the monthly reconciliations between the bank statement and the school's register are being performed. The reviewer should sign both documents if the reconciliation is completed.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

3. Inspecting checks outstanding for more than six months (“stale” checks), during the review of the monthly bank reconciliation. These checks should be canceled.
4. Checking if cash receipts are deposited daily. The dates on the Official Receipts Form 239(s) should be the same as the bank deposit slip date.
5. The principal or administrator should prepare a report of the reviews conducted during the year indicating the areas reviewed, the date of the reviews, and discrepancies found. Also, the report should be kept on file for audit purposes.

Although all of the above compensating controls should be present at these schools, some of them were not present; one school did not have any of the above in place. Without these compensating controls and the lack of segregation of duties, funds may be lost, unrecorded or misused.

We recommend that DOE ensure that schools perform the above compensating controls because staffing limitations do not provide for segregation of duties. Adequate compensating controls will minimize the chance of undetected errors or defalcations.

2002-3 Processing Disbursements of Local School Funds

According to the FMS User Policy and Process Flow Guide, purchase orders shall be used as a document which authorizes the purchase of materials, supplies and services. The purchase order shall be submitted to the principal for review and approval prior to the purchase. Reimbursements of local school funds may be made to individuals who received prior approval from the principal or designee to make the purchase.

The FMS User Policy and Process Flow Guide further states that the following procedures should be performed when processing invoices for payment:

1. All goods received must be checked immediately by authorized personnel for quantity of items ordered, serviceability and damage.
2. Affix approval to pay stamp on the original invoice.
3. Enter date invoice received and date goods/services received.
4. Check unit prices/extensions and totals.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

5. Check off items as received on school's copy of purchase order.

During our testing of local school fund disbursements, we noted the following:

- Thirty-five (35) instances at nine schools in which the purchase order was not submitted for approval prior to the purchase of goods or services; in one of these instances, the purchase order did not contain the authorizing signature of the principal or designee
- five (5) instances at three (3) schools, in which there was no date on the purchase order, therefore we were unable to determine whether the request to purchase was approved prior to the actual purchase of goods or services
- seven (7) instances at three (3) schools, where payments to vendors were processed without the required invoice or Form 99
- fifty-six (56) instances at six (6) schools, in which the "approval to pay" stamp was not affixed on the original invoice. There was no indication that the purchase was received by an authorized individual and properly approved for payment.

We recommend that all disbursements of local school funds be properly approved and all necessary documents be obtained prior to a purchase or payment, and the "approval to pay" stamp be affixed on the original invoice to ensure that proper approval for payment was made by an authorized individual. Approved purchase orders should contain the authorizing signature and the date the purchase order was approved.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

2002-4 Accrued Vacation

During our testing of accrued vacation, we noted eight (8) instances where the “Employee Leave Record” (Form 7) vacation balances as of June 30, 2002 did not agree with the DOE leave records. Based upon our discussions with DOE personnel, we understand that these differences exist for various reasons. For example, schools may not be submitting their “Application for Leave of Absence” (Form G-1 or Form 400A), to the payroll department on a regular basis. The Form G1 or Form 400A, which is used by employees to document request and approval of vacation, is the basis for which the payroll department updates the DOE’s records. In addition, there is no report of total accrued vacation hours that is generated by the payroll department and provided to each employee for reconciliation and certification purposes. This is a practice that has not been performed over the past few years.

We recommend that schools complete and submit all of the Form G1 or Form 400A records in a timely and accurate manner in order for the payroll department to have up-to-date supporting records. In addition, we also recommend that the payroll department send reports of total accrued vacation hours to each employee for reconciliation and certification. Errors that are noted during this process should be noted and corrections made as necessary. The reconciliation or certification should take place at least once a year. We believe that these procedures are necessary because the differences between the payroll department’s records and the schools’ Form 7 records may continue to exist and it will be uncertain whether employees are taking the appropriate number of vacation hours.

2002-5 Workers’ Compensation/Payroll

We noted the following issues relating to the DOE’s workers’ compensation for the fiscal year ended June 30, 2002. These issues were also noted in the prior year.

- Indemnity Payment Lag

Hawaii Revised Statutes (HRS) Section 386-92 states in part that if any temporary total disability benefits are not paid by the employer or carrier within ten days exclusive of Saturdays, Sundays and holidays, after the employer has been notified of the disability, and where the rights to benefits are not controverted in employer’s initial report of industrial injury or where temporary total disability benefits are terminated in violation of section 386-91, there shall be added to the unpaid compensation an amount equal to 20% thereof payable at the same time as, but in addition to, the compensation. Through our discussions with DOE Workers’ Compensation Group personnel, we understand that there is a significant lag between the time an indemnity payment is authorized to the time it is actually paid and reported in FMS, resulting in noncompliance with HRS Section 386-92. The DOE has paid

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

the additional 20% on a few occasions in the prior years to claimants and their related attorneys' fees due to late payments.

In addition, there currently exists no control procedure in place to determine whether indemnity payments made through the payroll are correct and timely. As a result of the payroll payment lag and the fact that there is no reconciliation between payroll records and the DOE Workers' Compensation Group records, DOE employees on workers' compensation may be receiving incorrect payments.

Although we have noted improvements in the processing of workers' compensation claims with respect to medical payments, we again recommend that the DOE Workers' Compensation Group administer all record keeping and payments of workers' compensation liability using one system in order to provide accurate and complete workers' compensation data on accumulated indemnity payments by claim. This system should allow DOE adjusters to obtain accumulated paid-to amounts and compare actual claims paid against initial computed gross reserves.

We recommend that the DOE reconcile payments from payroll records to the Workers' Compensation Group records in order to identify approved payments not paid yet and to determine the extent of the payment lag. We believe that these procedures are necessary to ensure proper payments and compliance with HRS Section 386-92.

Section III – Federal Award Findings and Questioned Costs

U.S. Department of Agriculture

2002-6 Food Donation Program (CFDA No. 10.550) – Reporting

In accordance with 7 CFR 250.14(f), the distributing agency shall determine if a subdistributing agency's (storage company) inventories are excessive (i.e., inventory levels should not exceed 6-month supply). In the event that there are excess inventories on hand, the distributing agency is required to complete and submit a semi-annual FNS-155 report to the USDA. Through our discussions with program personnel, we understand that the DOE did not complete or submit an FNS-155 because inventory levels were deemed adequate during the year. During our testing of reporting requirements, source documents to support the DOE's evaluation of whether there were excess inventories were not available for review because they were not kept on file. The reports that were kept on file did not provide enough documentation for us to determine if inventory levels were excessive.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

Furthermore, based upon our understanding of the current DOE procedures in place, the Commodity Distribution Assistant is responsible for monitoring the amount of commodities that are drawn from the USDA and is also responsible for determining whether there are any excess inventories on hand to report. There are no other individuals assisting in this process or to review whether the inventory levels as determined by the Commodity Distribution Assistant are adequate.

We recommend that source documents used to support the DOE's analysis of inventory levels be kept on file in accordance with record retention policies. In addition, someone other than the Commodity Distribution Assistant should review the inventory analysis performed during the year, to determine that inventory levels monitored by the Commodity Distribution Assistant appear adequate and proper in accordance with the DOE's needs. This review and approval, which should be documented, would provide for appropriate segregation of duties.

2002-7 Food Donation Program (CFDA No. 10.550) – Subrecipient Monitoring

In accordance with 7 CFR 250.19 and the DOE's Commodity Handbook – Inventory Controls, each distributing agency shall establish review procedures encompassing inventory controls. As part of the procedures currently in effect, all participating schools and organizations (both DOE schools and eligible private organizations) are required to submit a monthly inventory report to the School Food Services (SFS) Office at the end of each month. This "Inventory Report," (form SL-4A) is required to be received by the SFS Office by the 5th working day of the subsequent month.

During our testing of the "Inventory Report" (SL-4A), we noted the following exceptions:

- a. Eleven (11) instances where the SL-4A was submitted to School Food Services after the 5th working day of the month.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

- b. Two (2) instances where the SL-4A did not contain a received date, therefore we were unable to determine if the form was submitted within the required deadline.
- c. Two (2) instances where the School Food Service Manager/Dietitian did not sign the SL-4A.

We recommend that the DOE perform the necessary procedures to ensure that the form SL-4As are completed and submitted within the required deadline. Timely submission of these reports will assist the DOE to ensure that proper controls are in place over commodity inventories.

2002-8 Food Donation Program (CFDA No. 10.550) – Subrecipient Monitoring

7 CFR 250.19 requires the distributing agency to conduct an annual review of each storage facility it utilizes. During our testing of storage facilities monitoring, we noted that no reviews were performed for the storage companies utilized by the DOE during the fiscal year ended June 30, 2002. Based upon discussions with DOE personnel, we understand that it was uncertain who was responsible for conducting the reviews during the year due to internal reorganizations that took place. However, because no one is assigned to oversee that the reviews are performed or to review the reports when completed, the process was overlooked. Accordingly, it appears that the DOE does not have adequate internal controls in place over storage facility monitoring procedures.

We recommend that administrative procedures be implemented, which include a timetable of when the reviews should be performed and deadlines, and an indication of who is responsible for conducting the reviews. In addition, these reports should be reviewed by someone other than the preparer; such review should be documented. We believe that these procedures are necessary to ensure that storage facilities are properly reviewed at least on an annual basis and operating in compliance with program regulations.

2002-9 Child Nutrition Cluster: National School Lunch Program (CFDA No. 10.555) and School Breakfast Program (CFDA No. 10.553) – Activities Allowed or Unallowed

Meal reimbursement requirements over the National School Lunch and Breakfast Programs are set forth in 7 CFR Section 210. To be eligible for federal reimbursement, meals must be served to eligible children and must be supported by accurate meal counts and records indicating the number of meals served by category and type. The DOE has established policies and procedures for supporting accurate meal counts as defined in the Standards and Procedures for Free and Reduced Price Meals. These policies require School Food Service Managers to prepare and sign the daily and monthly “Computation of Daily/Monthly School Food Service Transactions,” Form SL-5, reports which are reviewed, approved and signed by the principal.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

The Standards and Procedures for Free and Reduced Price Meals specifies that:

1. The school food service manager shall prepare a daily Form SL-5 report after obtaining the daily edit check for meal claim from the school office with all information required. The total number of student meals claimed should not exceed the student attendance for that day and the total student meals claimed must not exceed the total approved free or reduced-priced students on file at the school.
2. The information regarding plate count on the back of the Form SL-5 shall be completed, and this should be referred to when there are discrepancies with the meal count.

During our testing of the National School Lunch and Breakfast Programs, we noted the following:

1. A total of ten (10) instances at two (2) schools in which either the daily or monthly SL-5 was not signed by the principal. There were also two (2) instances in which the SL-5 was signed but not dated and one (1) monthly SL-5 that was not submitted to the School Food Services within five working days.
2. One (1) schools' Form SL-5 contained mathematical errors.
3. Four (4) instances at three (3) schools in which the school did not complete all required information on the Form SL-5.
4. Three (3) instances at two (2) schools where the information on the daily edit check did not agree to the daily SL-5.
5. Five (5) instances at one (1) school in which amounts reported on the Form SL-5 did not agree to the daily point-of-service counts tally sheet.

We recommend that the daily and monthly Form SL-5 be properly completed and reviewed for accuracy and completeness as these documents are used to compile monthly lunch count reimbursement amounts submitted to the federal award agency. We also recommend that the review be documented. We believe these procedures are necessary to ensure that claims for reimbursement are properly supported by accurate records.

2002-10 Child Nutrition Cluster: National School Lunch Program (CFDA No. 10.555) and School Breakfast Program (CFDA No. 10.553) – Eligibility and Special Tests and Provisions

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

By December 15th of each school year, the school food authority must verify the current free and reduced-price eligibility of households based upon sampling of applications that the schools have approved for free and reduced-price meals. Annually, each school receives a “Verification Guidance” manual from the School Food Services Branch which provides instruction and guidelines on completing the verification process. The Verification Guidance states that the following procedures should be performed:

1. When determining the number of applications to verify, each school should verify 3% of the total number of eligible applications or five (5) applications, whichever is more, as of October 31. Applications should then be selected for verification using the “statistical sampling” method recommended by the federal award agency.
2. After verification is completed, a “Report on Verification of Free and Reduced-Price Meal Applicants” must be submitted to the School Food Services Branch by the first Friday in December.

Of the ten (10) schools we visited, we noted the following:

1. Two (2) schools did not verify the minimum number of applications as stated in the Verification Guidance.
2. Three (3) schools submitted the Report on Verification of Free and Reduced-Price Meal Applicants late. We noted that the reports were prepared between six (6) to twenty-eight (28) days after the due date. One (1) school submitted their report without the school official’s signature.
3. The number of applications that was reported on the Report on Verification of Free and Reduced-Price Meal Applicants at eight (8) schools did not agree to the actual number of applications kept on file at the school. One (1) school was unable to provide the applications that were verified.
4. The results of school’s verification that was reported on the Report on Verification of Free and Reduced-Price Meal Applicants at five (5) schools did not agree to the results noted on the verified applications on file.

We recommend that schools follow the Verification Guidance in performing application verification. We also recommend that the Report on Verification of Free and Reduced-Price Meal Applicants be completed accurately and submitted to the School Food Services Branch by the first Friday of December. Documentation to support the amounts on this report should be maintained by the respective school in accordance with record retention policies.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

U.S. Department of Education

2002-11 Adult Education Program (CFDA No. 84.002) – Cash Management

In accordance with OMB Circular A-133 Compliance Supplement, when funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. If the cash on hand at the end of each month is less than 3 days, cash balance is reasonable and available for immediate needs. We noted five (5) instances, out of six (6) sample months selected, where the number of working days cash on hand at the end of each month ranged between 4 to 9 days.

Upon further investigation of the cash balances on hand and the draw downs of the DOE, we noted that the cash balance as of June 30, 2002 includes program funds from prior grant awards that have closed out totaling \$ 22,166.60. This balance consists of the following grant years and amounts: FY93 - \$11,633.68, FY98 – \$8,173.79, and FY99 - \$2,359.13. Through discussions with DOE personnel, we understand that there were inquiries made in the past to the US DOE to obtain instructions on how to return the unused funds relating to the FY 93 grant, however a response was not received, and no follow-up by the DOE occurred.

We recommend that DOE communicate with the federal awarding agency to disclose instances when there are unused funds remaining from grants that are closed out. Upon receipt of instruction from the federal awarding agency, the DOE should perform the necessary procedures to return the excess funds. These procedures are necessary to ensure that current program cash balances are adequate to cover immediate needs and to ensure compliance with cash management requirements.

2002-12 Adult Education Program (CFDA No. 84.002) – Reporting

In accordance with special conditions that were placed by the US DOE as a result of a program audit conducted, the DOE was required to submit various reports to the US DOE. Among these reporting requirements were a corrective action plan and quarterly progress reports. We noted that quarterly progress reports that were due on December 31, 2001 and March 31, 2002 were submitted on June 28, 2002.

Based upon our review of correspondences between the DOE and US DOE, and through discussions with program personnel, we understand that the initial delay in submitting the quarterly progress reports was due to confusion regarding whether the corrective action plan, which was due on August 2, 2001, was approved. The DOE was waiting for technical assistance relating to the corrective action plan, as the plan would serve as a basis for the subsequent

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

progress reports. The corrective action plan deadline was subsequently extended to November 2, 2001, of which the DOE complied. However, the second and third quarterly progress reports were not completed or submitted within the deadline, and the DOE did not receive an extension for filing these reports.

We recommend that DOE perform procedures to ensure the preparation and submission of required reports in a timely manner to comply with the special reporting requirements.

2002-13 Special Education Cluster: State Grants, IDEA Part B (CFDA No. 84.027) – Cash Management

In accordance with OMB Circular A-133 Compliance Supplement, when funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. If the number of working days cash on hand at the end of each month is less than 3 days, cash balance is reasonable and available for immediate needs. We noted instances for two (2) months where the number of working days cash on hand at the end of the month ranged between 4 and 10 days. Based upon our discussions with DOE personnel, we understand that there were instances of overdrawn cash beyond the program's immediate needs during the year because of over estimating of advances to cover any unexpected expenditures.

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

We recommend that DOE only request enough funds to cover immediate needs or the program to ensure compliance with cash management requirements and to minimize the time elapsed between transfers of funds from the federal awarding agency and actual disbursement.

2002-14 Safe and Drug-Free Schools and Communities – State Grants (CFDA No. 84.186) – Allowable Costs

Purchases of materials, supplies and services are requested using the purchase order or purchase order worksheet. Requests for purchases should be reviewed and authorized by an individual other than the requester prior to the actual purchase of goods and services. The authorization ensures that only allowable costs are made with program funds and is documented on the purchase order or purchase order worksheet.

During our testing of non-payroll expenditures, we noted three (3) instances in which the purchase order/worksheets used to authorize the purchase of materials, supplies and services were prepared after the goods and services were ordered.

We recommend that proper authorizations for purchases be obtained and documented prior to the purchase of materials, supplies and services to ensure that purchases with program funds are allowable and in accordance with program requirements.

2002-15 Public Charter Schools (CFDA No. 84.282) – Allowable Costs

In accordance with OMB Circular A-87 and 34 CFR section 299.2, any administrative requirements adopted by a State must ensure that funds received are spent only for reasonable and necessary costs of the program. During the allowable costs testing over non-payroll costs for the Public Charter Schools Program, we noted two (2) instances of eleven (11) samples tested where the purchase order date occurred after the vendor invoice date. Requests for purchases should be reviewed and authorized by an individual other than the requester prior to the actual purchase of goods and services to ensure that only allowable costs are made with program funds.

We recommend that proper authorizations for purchases be obtained and documented prior to the purchase of materials, supplies and services to ensure that purchases with program funds are allowable and in accordance with program requirements.

2002-16 Public Charter Schools (CFDA 84.282) – Cash Management

In accordance with OMB Circular A-133 Compliance Supplement, when funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. If the number of working days cash on hand at the end

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

of each month is less than 3 days, cash balance is reasonable and available for immediate needs. We noted three (3) instances where the number of working days cash on hand at the end of each month ranged between 14 and 120 days. Based upon our discussions with Department personnel, we understand that there were instances of overdrawn cash beyond the Department's immediate needs during the year because of over estimating of advances to cover any unexpected expenditures

We recommend that DOE only request enough funds to cover immediate needs to ensure compliance with cash management requirements and to minimize the time elapsed between transfers of funds from the federal awarding agency and actual disbursement.

2002-17 Public Charter Schools (CFDA No. 84.282) – Procurement and Suspension and Debarment

OMB A-133 Compliance Supplement rules on procurement and suspension and debarment compliance requirement states that non-Federal entities are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred. Covered transactions include procurement contracts for goods or services equal to or in excess of \$100,000 and all non-procurement transactions, which includes subawards granted to subrecipients.

Contractors receiving individual awards for \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred. The non-federal entities may rely upon the certification unless it knows that the certification is erroneous. Non-federal entities may, but are not required to, check for suspended and debarred parties which are listed in the *List of Parties Excluded From Federal Procurement or Nonprocurement Programs*, issued by the General Services Administration (GSA).

Through discussions with program personnel, we noted that during the subrecipient application process, the DOE did not obtain certifications from any charter school subrecipient or perform any screening of the applicants or its principals in accordance with the procurement and suspension and debarment rules stated above.

We recommend that the administrators of the Public Charter Schools Program create and implement procedures to ensure that applicants and subrecipient organizations are not suspended or debarred parties of the federal government. This can be obtained by obtaining certifications from each applicant or subrecipient as well as reviewing the list provided by the GSA stated above.

2002-18 Public Charter Schools (CFDA No. 84.282) – Subrecipient Monitoring

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

In accordance with OMB Circular A-133 subrecipient monitoring compliance requirement, a pass-through entity is responsible for the following:

- Identifying to the subrecipient the federal award information and applicable compliance requirements.
- Monitoring the subrecipient's activities to provide reasonable assurance that the subrecipient administers federal awards in compliance with federal requirements.
- Ensuring required audits are performed and requiring the subrecipient to take prompt corrective action on any audit findings.
- Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable federal regulations.

Monitoring activities may take various forms, such as reviewing reports submitted by the subrecipient, performing on-site visits to the subrecipient to review financial and programmatic records and observe operations, arranging for agreed-upon procedures engagements for certain aspects of subrecipient activities, reviewing the subrecipient's single audit or program-specific audit results and evaluating audit findings and the subrecipient's corrective action plan.

As part of DOE's evaluation on the performance of subrecipients, schools were required to submit a year-end performance report to the DOE for review and approval. In addition, DOE's program policies require on-site reviews of subrecipients. Of the ten schools selected for review, the DOE could not provide documentation that the DOE performed on-site visits during the year. As a result, we could not determine whether the on-site visits were performed.

We recommend that the DOE document all on-site visits, including the procedures performed, results of procedures and corrective action required, if applicable. Documentation of the on-site visits should include review and approvals by someone other than the preparer to ensure propriety. We believe these procedures are necessary to ensure compliance with subrecipient monitoring requirements as stated above.

2002-19 21st Century Learning Centers (CFDA No. 84.287) – Cash Management

In accordance with OMB Circular A-133 Compliance Supplement, when funds are advanced, recipients must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement. If the cash on hand at the end of each month is less than 3 days, cash balance is reasonable and available for immediate needs. We noted two (2) months where DOE was not in compliance with the above requirement. The number of working days cash on hand at the end of these months ranged from 5 to 6 days. Based upon our

State of Hawaii
Department of Education

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

June 30, 2002

discussions with DOE personnel, we understand that there were instances in which cash was overdrawn beyond the program's immediate needs during the year because of the difficulties accounting personnel experienced in estimating the cash needs to cover payroll expenses. Most of the program's payroll expenses result from the utilization of part-time employees, which resulted in fluctuation of actual expenses from one pay period to another.

We recommend that the DOE perform procedures to obtain more accurate estimates of the program's immediate cash needs in order to be in compliance with OMB Circular A-133's cash management requirements. We recommend that program personnel communicate actual hourly payroll information to accounting personnel on an on-going basis. Accounting personnel should then use this information to estimate the program's immediate cash needs. Because there is a two-week payroll lag for part-time employees, hours worked related to their payroll expenses should be readily available in advance.

2002-20 Reading Excellence Act (CFDA No. 84.338) – Allowable Costs

Purchases of materials, supplies and services are requested using the purchase order or purchase order worksheet. Requests for purchases should be reviewed and authorized by an individual other than the requester prior to the actual purchase of goods and services. The authorization ensures that only allowable costs are made with program funds and is documented on the purchase order or purchase order worksheet.

During our testing of expenditures, we noted two (2) instances in which the purchase order/worksheets used to authorize the purchase of materials, supplies and services were prepared after the goods and services were ordered.

We recommend that proper authorizations for purchases be obtained and documented prior to the purchase of material, supplies and services to ensure that purchases with program funds are allowable and in accordance with program requirements.