Grant Thornton

Financial Statements and Report of Independent Certified Public Accountants

Department of Education, State of Hawaii

Year ended June 30, 2008

Submitted by
The Auditor
State of Hawaii

Audit – Tax – Advisory

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

T 808.536.0066
F 808.523.8590
www.GrantThornton.com

May 28, 2009

Ms. Marion Higa
Office of the Auditor
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audit of the Department of Education, State of Hawaii (DOE), as of and for the year ended June 30, 2008. 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*.

Objectives of the Audit

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DOE's financial statements as of and for the fiscal year ended June 30, 2008, and to comply with the requirements of OMB Circular A-133.

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; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2008.

Organization of the Report

This report is presented in six parts as follows:

- Part I — The basic financial statements and related notes of the DOE as of and for the fiscal year ended June 30, 2008, and our opinion on the basic financial statements.
- Part II — Our report on internal control over financial reporting and on compliance and other matters.
- Part III — Our report on compliance with requirements applicable to each major program and on internal control over compliance.
- Part IV — The schedule of findings and questioned costs.
- Part V — Corrective action plan as provided by the DOE.
- Part VI — The summary schedule of prior audit findings.

Grant Thornton

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DOE.

Very truly yours,

Grant Thornton LLP

Table of Contents

		Page
PART I	**FINANCIAL SECTION**	
	Report of Independent Certified Public Accountants	7
	Management's discussion and analysis	9
	Basic financial statements	
	Government-wide financial statements	
	Statement of net assets	20
	Statement of activities	21
	Fund financial statements	
	Balance sheet – governmental funds	22
	Reconciliation of the governmental funds balance sheet to the statement of net assets	23
	Statement of revenues, expenditures, and changes in fund balances – governmental funds	24
	Reconciliation of the change in fund balances of governmental funds to the statement of activities	25
	Statement of revenues and expenditures – budget and actual – general fund	26
	Statement of revenues and expenditures – budget and actual – federal fund	27
	Statement of assets and liabilities – agency funds	28
	Notes to financial statements	29
	Supplementary information	
	Schedule of expenditures of federal awards	45

Table of Contents

		Page
PART II	**AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS**	
	Report of Independent Certified Public Accountants on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Basic Financial Statements Performed in Accordance with *Government Auditing Standards*	51
PART III	**AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE**	
	Report of Independent Certified Public Accountants on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	54
PART IV	**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**	58
PART V	**CORRECTIVE ACTION PLAN**	
	Response of the Department of Education, State of Hawaii	89
PART VI	**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (Provided by the Department of Education, State of Hawaii)**	135

PART I

FINANCIAL SECTION

Report of Independent Certified Public Accountants

Audit – Tax – Advisory

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

T 808.536.0066
F 808.523.8590
www.GrantThornton.com

To the Auditor
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information as well as the budgetary comparison for the general and federal funds of the Department of Education, State of Hawaii (DOE), as of and for the year ended June 30, 2008, which collectively comprise the DOE's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DOE's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DOE's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

As discussed in note A, the financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

As discussed in note F to the financial statements, an error resulting in an overstatement of the workers' compensation claims reserves as of June 30, 2007, was discovered by management of the DOE in the current year. Accordingly, an adjustment of $22,095,255 has been made to net assets as of July 1, 2007 to correct the error.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 20, 2009, on our consideration of the DOE's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 9 through 18 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the DOE'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 of the DOE. 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.

Grant Thornton LLP

Honolulu, Hawaii
May 20, 2009

Department of Education
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2008

The following management's discussion and analysis provides an overview of the Department of Education's (Department) financial activities for the fiscal year ended June 30, 2008. Readers should also review the basic financial statements and notes to enhance their understanding of the Department's financial performance.

FINANCIAL HIGHLIGHTS

Key government-wide financial highlights for Fiscal Year (FY) 2007-08 compared to the prior FY 2006-07 are as follows:

- General fund revenues were $2.326 billion in FY 2007-08, an increase of 3% compared to $2.262 billion in FY 2006-07. Program revenues totaled $281.1 million in FY 2007-08, a decrease of 2% compared to $286.2 million in FY 2006-07.

- Total FY 2007-08 expenses were $2.333 billion, an increase of 6% over the prior fiscal year. Of the total FY 2007-08 expenses, 92% or $2.136 billion, was spent for school-related expenditures, and 2% or $57.8 million was spent on capital outlays. In comparison, FY 2006-07 expenses totaled $2.203 billion, of which 90% or $1.976 billion was spent for school-related services and 5% or $102.2 million was spent on capital outlays.

- Total assets exceeded liabilities as of June 30, 2008 by $1.127 billion (net assets), compared to $1.059 billion as of the prior fiscal year end, an increase of 6%. The increase in net assets was primarily due to increased legislative appropriations and additions to capital assets.

- Capital assets comprised 95% of total net assets as of June 30, 2008, compared to 98% as of the prior fiscal year end.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements consist of two sections: management's discussion and analysis (this section), and basic financial statements and notes. These sections are described below.

The basic financial statements include government-wide and fund financial statements, which provide different views of the Department:

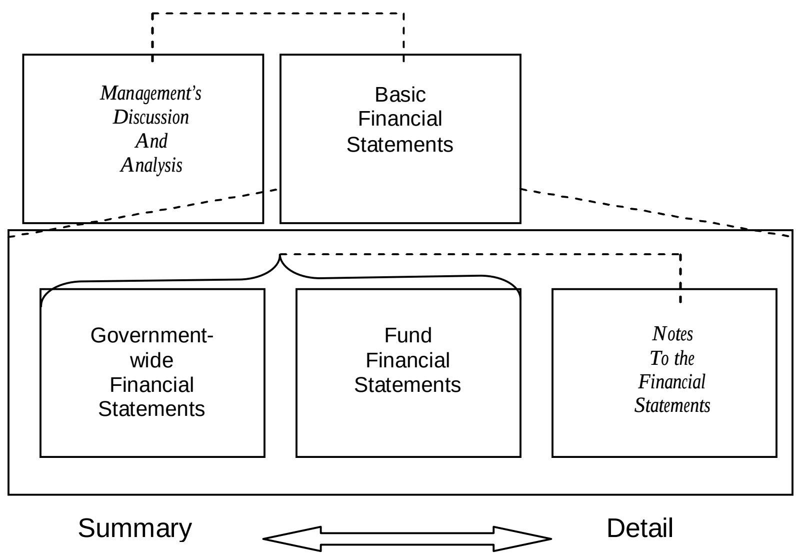
- *Government-wide financial statements* provide both *long-term* and *short-term* information about the Department's *overall* financial position and results of operations. The statements are presented on an accrual basis of accounting and consist of the Statement of Net Assets and the Statement of Activities.

- *Fund financial statements* focus on *individual* parts of the Department and report operations in more detail than the government-wide statements. 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 and are presented on a modified accrual basis of accounting. Fiduciary funds statement reports on agency funds (or "local school funds" as the term is used in our schools), which are held in a custodial capacity for students' school activities that take place outside of the formal class period and are not requirements for class work or credit. Certain activities, such as depreciation expense, are included in the government-wide financial statements but not the fund financial statements. These activities are highlighted in the financial statement's *Reconciliation of the Change in Fund Balances of Governmental Funds to the Statement of Activities.*

Notes are included in the financial statements to explain financial statement information and provide more detailed data. This section 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



GOVERNMENT-WIDE FINANCIAL ANALYSIS

The following discussion highlights management's understanding of the key aspects of the Department's financial activities.

Net Assets. The Department's largest portion of net assets is capital assets (e.g., land, buildings, equipment), which are unavailable for future spending. The Department's unrestricted net assets are available for future use to provide program services. (Balances as of June 30, 2007 regarding the liability for workers' compensation have not been adjusted for restatement.)

Exhibit A-2
Government-Wide
Statement of Net Assets
Fiscal Years 2008 and 2007
(Amounts in millions)

	Governmental activities		2008 – 2007	
	2008	2007	Increase (decrease)	% Change
Assets				
Current	$ 352.6	$ 320.6	$ 32.0	10%
Non-current (capital assets, net of depreciation)	1,066.0	1,035.9	30.1	3
TOTAL ASSETS	$1,418.6	$1,356.5	$ 62.1	5%
Liabilities				
Current	$ 219.5	$ 214.4	$ 5.1	2%
Non-current	72.3	83.0	(10.7)	(13)
Total liabilities	291.8	297.4	(5.6)	(2)
Net Assets				
Investment in capital assets	1,066.0	1,035.9	30.1	3
Restricted	24.1	23.3	0.8	3
Unrestricted	36.7	(0.1)	36.8	(36,800)
Total net assets	1,126.8	1,059.1	67.7	6
TOTAL LIABILITIES AND NET ASSETS	$1,418.6	$1,356.5	$ 62.1	5%

Overall Financial Position. The Department's overall financial position has improved as of June 30, 2008 compared to the prior fiscal year end. Net assets have increased by $67.7 million, primarily due to higher current and capital asset balances. In addition, the liability for workers' compensation was reduced, based on an actuarial review of the Department's reserves for those claims. Please refer to note F – Long-Term Liabilities for further information on the workers' compensation liability.

Changes in Net Assets. Total government-wide net assets increased by $45.6 million. Please refer to Exhibit A-3. (Results for FY 2007-08 regarding workers' compensation have not been adjusted for restatement.)

Exhibit A-3
Government-Wide
Changes in Net Assets
Fiscal Years 2008 and 2007
(Amounts in millions)

	Governmental activities		2008 Compared to 2007	
	2008	2007	Increase (decrease)	% Change
Revenues				
Program revenues:				
Charges for services	$ 43.0	$ 38.5	$ 4.5	12%
Operating grants and contributions	238.7	246.5	(7.8)	(3)
General revenues:				
State allotted appropriations, net of lapses	1,916.2	1,880.0	36.2	2
Nonimposed employee fringe benefits	409.2	381.0	28.2	7
Unrestricted investment earnings	0.3	1.1	(0.8)	(73)
Total	2,607.4	2,547.1	60.4	2
Expenses				
School-related	2,135.8	1,975.7	160.1	8
State and complex area administration	89.7	79.0	10.7	14
Public libraries	49.5	45.7	3.8	8
Capital outlay	57.8	102.2	(44.4)	(43)
Total	2,332.8	2,202.6	130.2	6
Transfers out	(229.0)	(225.1)	(3.9)	2
Change in net assets	$ 45.6	$ 119.4	$ (73.8)	(62%)

Overall Results of Operations. As shown above, the Department's results of operations for FY 2007-08 have resulted in an increase in net assets of $45.6 million representing an improvement in the Department's financial position. School-related expenditures increased by 8% compared to the prior fiscal year; however, those costs were well within the total revenue levels. Although capital outlays were lower, numerous capital projects were completed or were in progress during FY 2007-08. Please refer to the "Capital Asset and Debt Administration" section below for further details. The change in net assets of $45.6 million in FY 2007-08 was $73.8 million lower than that of FY 2006-07. As noted in the "Governmental Funds" financial statements, "state allotments" include revenues from various sources. The lower change in net assets in FY 2007-08 compared to FY 2006-07 was primarily due to the fact that "state allotments" for capital projects decreased by $71.6 million, from $242.5 million in FY 2006-07 to $170.9 million in FY 2007-08. In addition, general fund expenditures (excluding collective bargaining increases already appropriated by the State Legislature and approved by the Governor) were higher in FY 2007-08 than the prior year, due to higher school maintenance costs and higher school utilities costs due to increased fuel prices. This was partially offset by the fact that federal fund expenditures for the No Child Left Behind Act (NCLB) and other federal grants in FY 2007-08 were lower by approximately $10 million compared to FY 2006-07, due to the timing of grant needs over each respective grant period.

Individual Funds. Within the "Governmental Funds" financial statements, for the various fund sources (including general, federal, capital projects and other funds), FY 2007-08 has resulted in positive fund balances as of June 30, 2008. Restrictions or commitments of fund balances are designated on the "Governmental Funds" balance sheet as "reserved for encumbrances" and "reserved for continuing appropriations." Please refer to note G – Fund Balance for more information on those fund balances. The Department does not expect these restrictions to significantly affect the availability of fund resources for future use.

Budget Results. Variations of **"**Final" compared to "Original" budgeted amounts as reported on the *Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – General Fund* are primarily due to legislative appropriations for collective bargaining increases. For the general fund, the Department is allowed to carryover up to 5% of any appropriation at the end of the fiscal year. As of June 30, 2008, general funds carried over totaled to $41.0 million, representing 2% of appropriations. Variances as reported on the Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – Federal Fund are primarily due to actual Federal Fund receipts lower than estimated. For federal funds, since most grants stipulate a 27-month expenditure period, expenditures during a specific fiscal year may exceed revenues, due to the timing of expenditures compared to receipts. The Department expended $4.2 million more federal funds than it received during FY 2007-08; this merely reflects the timing of expenditures versus grants that may have been received during the prior year.

EXPLANATION OF MAJOR DEPARTMENTAL PROGRAMS

The State Budget is organized by major program areas. The Department's major programs are:

Program #	Program Title	Program Description
EDN 100	School-Based Budgeting	Instructional services, curriculum programs, at-risk programs.
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, and professional development.
EDN 200	Instructional Support	Curriculum support, assessment, systems accountability, and school leadership training.
EDN 300	State and Complex Area Administration	Board of Education, Superintendent, Complex Area Superintendents, budget, communications, civil rights compliance, internal audit, business services, human resources, and information technology.
EDN 400	School Support	School food services, utilities, repair and maintenance, and student transportation.
EDN 407	Hawaii State Public Library System	The Hawaii State Public Library System is included in the Department's combined financial statements since both are administratively and legally supervised by the Hawaii State Board of Education.
EDN 500	School Community Services	After school care and adult education.
EDN 600	Charter Schools	Public charter schools.
EDN 915	Debt Service Payments	Principal and interest payments on long-term debt.
EDN 941	Retirement Benefits Payments	Retirement benefit payments.
EDN 943	Health Premiums Payments	Health premium payments.

Exhibit A-4 summarizes the Department's revenue. Revenues are primarily from state general funds (taxpayer monies). Other revenues are from federal grants, special funds to support specific programs such as cafeteria collections for school food services, and donations.

Exhibit A-4

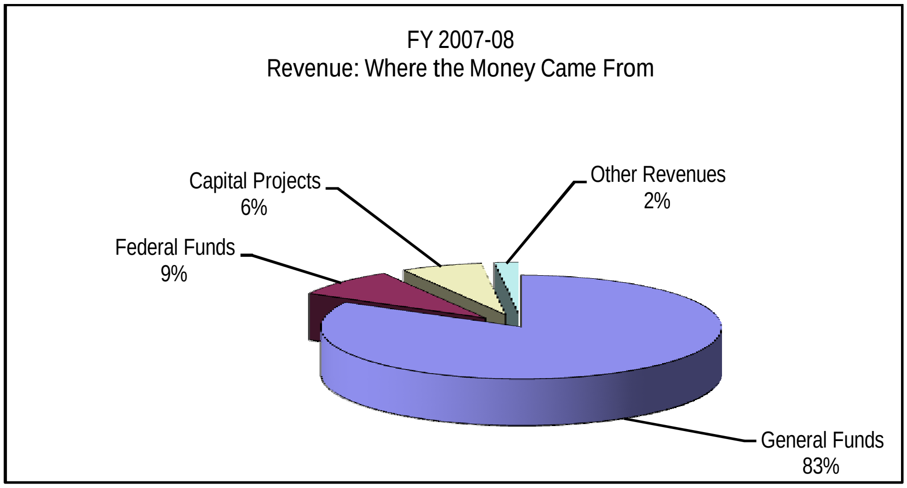
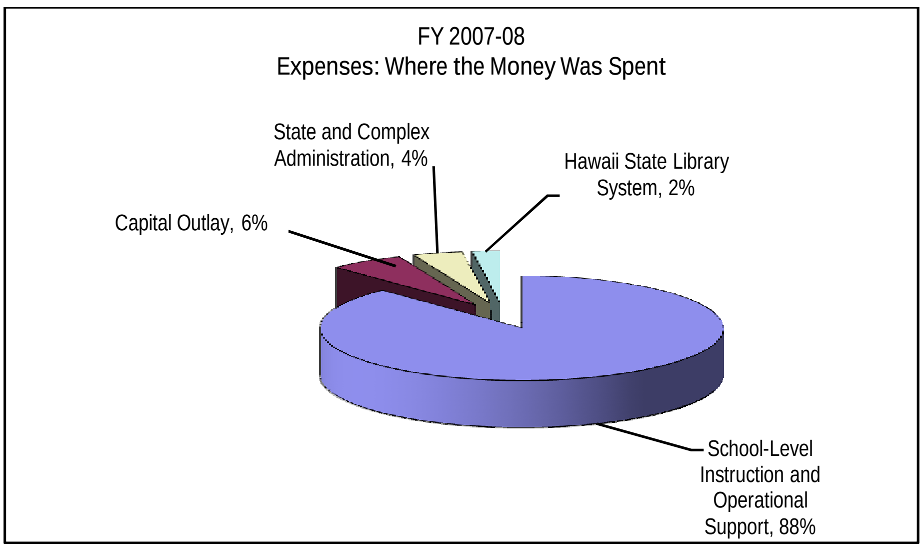


Exhibit A-5 summarizes the Department's expenses. A total of 88% of Department expenditures are for school-level instruction and related programs in EDN 100, 150, 400, 500, 600, 915, 941 and 943, while only 4% are for State and complex area administration.

Exhibit A-5



GENERAL FUND BUDGETARY HIGHLIGHTS

The Department was appropriated general funds of $2,142.7 million in FY 2007-08.

State law permits the Department to "carryover" up to 5% of general fund appropriations from one fiscal year to the next. The Department carried over $41.0 million in FY 2007-08 general fund appropriations for expenditures in FY 2008-09. Carryover funds enable schools to make long-range fiscal plans, save for major purchases for which single year funding may not be sufficient, and provide funds to start the next school year. Under the Department's single school calendar, schools start their school year in July statewide, within weeks of the beginning of the fiscal year.

AGENCY FUNDS

Agency funds or "local school funds" are held for students in a custodial capacity and do not require deposit into the State Treasury. The funds contain monies collected and maintained by schools for students. Examples include yearbook, newspaper fund, student government dues, physical education uniform sales, and excursions. The funds are used for school activities that take place outside formal class periods and are not required for class work or credit.

Agency fund net assets were $19.1 million in FY 2007-08, representing a 6% increase from the prior fiscal year.

CAPITAL ASSET AND DEBT ADMINISTRATION

The Department's capital improvement program (CIP) strives to provide facilities that are well placed, sufficient in number, flexible, functional, and creatively designed to accommodate population changes, support educational programs, and promote health and safety of students, employees, and the public. The Departments of Accounting and General Services, Land and Natural Resources, and Budget & Finance assist the Department with various aspects of capital improvement.

Buildings, building improvements, and land improvements less than $100,000 are not reported as capital assets. Please refer to note E – Capital Assets for details of capital assets. FY 2007-08's capital improvements are summarized as follows:

<u>Representative Highlights of Major CIP Projects Completed:</u>

Major Buildings: Mauka Lani Elementary School - 8-Classroom Building, Waianae High School - 8-Classroom Building, Ewa Beach Elementary School - 6-Classroom Building, Sunset Beach Elementary School - Administration Building, Leihoku Elementary School - Administration Building and Library

Portable Classrooms (quantity): Kaala Elementary School (1), Leilehua High School (3), Mililani High School (2), Moanalua High School (2), Solomon Elementary School (4), Mililani Middle School (3), Mililani Ike Elementary School (2), Campbell High School (5), Waipahu Elementary School (3), Kahuku High and Intermediate School (1), Kamehameha III Elementary School (2)

Representative Highlights of Major Repair and Maintenance Work Completed:

Multi-Component Repair and Maintenance Projects: Mililani High School, Laupahoehoe High & Elementary School, Kapaa High School, Kohala Elementary School

Electrical Upgrades: Makawao Elementary School, Building A, Iao Intermediate School, Building A & H, Dole Middle School

Reroofing: Kauai High School - Building J, Castle High School - Building BB, Waiakea High School - Buildings I, Q & R, Farrington High School - Buildings AW2 & AW6, Kailua High School - Buildings B, F, H & J

Other Significant Work: Kaimuki High School - Building X, Replace Air Conditioning Equipment, Aliamanu Intermediate School - Replace Campus Waterlines, Ewa Elementary School - Fire Alarm and Electrical Upgrade, Maui High School - Rewire Public Address System, Pohakea Elementary School - Building A, Replace Sewer Line

Repairs and maintenance (R&M) funds were primarily used to fund projects that ranged from informally bid projects of less than $100,000, to major renovation work that cost several million dollars. Statewide, $73.5 million was expended in FY 2007-08 on R&M projects that were funded by CIP appropriations.

Whole School Classroom Renovations Statewide

$40 million in general fund appropriations for whole school classroom renovations was released by the Governor in FY 2007-08. As of June 30, 2008, $25.6 million has been expended for consultant design services and construction, and $14.4 million was encumbered but not yet expended. Another $100 million for whole school classroom renovations appropriated by the 2008 legislature was in total, released by the Governor as of November 2008.

Status of final phase of whole school classroom renovations for 96 schools as of June 30, 2008:

14	Schools Completed from FY 2006-07 through FY 2007-08
6	Under Construction
21	Bidding Completed, Pending Award or Notice to Proceed
20	Design Completed, Pending Bid Phase
32	Design Completed, Additional Appropriation Required for Construction
3	Deferred Due to Closure or Change in School Status
96	Total Schools

The following whole school classroom renovation projects were completed during FY 2007-08: Nanakuli High and Intermediate School, Kapalama Elementary School, Wilson Elementary School, Pearl Harbor Kai Elementary School, Helemano Elementary School, Wheeler Middle School, Aikahi Elementary School, Mokapu Elementary School, Waimea Elementary School, Naalehu Elementary School, and Waimea Canyon Middle School.

The Department's long-term debt is managed by the Department of Budget and Finance; however, general fund appropriations for interest payment and debt retirement are included in the Department's budget. Interest payments and debt retired were $226.6 million in FY 2007-08, resulting in a 9.1% increase from the prior fiscal year.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The State's unemployment rate is at a 26-year high, with the statewide seasonally adjusted unemployment rate being 6.1% for the month of January 2009, compared to the seasonally adjusted national unemployment rate of 7.6% for the same period. One year ago, the State's seasonally adjusted unemployment rate stood at 3.0%, while the seasonally adjusted national unemployment rate was 4.9%.

Cumulative tax collections for the first five months of FY 2008-09 exceeded $2.2 billion, but were $101.9 million less than the corresponding period last year. General excise and use taxes, which are the largest source of revenue and a good measure of economic growth, decreased 6.6% in the same period.

The Council on Revenues in January 2009 estimated that the State general fund growth rate would be minus 3.0% in FY 2008-09, and 1.0% for FY 2009-10. Actual State general fund tax collections declined by 2.5% in the first five months of FY 2008-09 over the corresponding 2007-08 period. Lower general excise and use tax collections were the primary factors underlying this weak performance.

In addition, in 2008, tourist arrivals declined by 10.6%, with only 6.7 million visitors to the State. This decline was the steepest since the State began keeping statistics in 1927, and was the first time since 2004 that arrivals dropped below 7 million. Furthermore, visitor spending declined by $1.2 billion in 2008 compared to 2007.

Governor Linda Lingle and the State Legislature are attempting to address the declines in State revenues and their impact on State budgets. The Governor has already implemented several fiscal restrictions in FY 2008-09 in order to balance the budget.

FUTURE EVENTS THAT WILL FINANCIALLY IMPACT THE DEPARTMENT

Oil prices peaked in the summer of 2008 and are now at significantly lower costs per barrel. This sharp decline in the price of oil has translated into significantly lower prices for gasoline and electricity. However, this decline in the price of oil came about due to global financial crisis. This situation has caused several countries to take drastic actions.

The State has been adversely affected by the events that are occurring locally, nationally and globally. Several large construction projects throughout the State have been stymied. The State's unemployment rate has been rising. In addition, in the opinion of several local economists, the State is not expected to see any meaningful recovery until 2010.

In anticipation of budgetary constraints, the Department has reviewed options for adjustments, and has presented alternatives to the Board of Education for approval.

The Department continues its implementation of the weighted student formula, giving schools increased budgetary decision-making flexibility, authority, and accountability. The Committee on Weights, established by statute, reviews the weighted student formula annually, and makes recommendations to the Board of Education as to improvements or changes to the formula.

In accordance with the No Child Left Behind Act, the Department has made substantial progress in reading and mathematics proficiencies, at levels consistent with the State's plan to meet full proficiencies by the year 2013-14.

The Department's financial reporting goal is to provide its financial information to school-level personnel and the public in a transparent manner. There is a critical need for more financial reports that are easily understood by non-fiscal personnel, and more easily used for financial management. Accordingly, the Department has developed detailed specifications required to replace its aging financial systems, and has presented this information to the State Legislature for review and to explore funding options.

On February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act (ARRA) of 2009. The Department expects substantial federal funding to be received. Current estimates indicate approximately $76 million to be received as additional funding for existing federal grants, i.e. for Title I, educational technology, and for the Individuals with Disabilities Education Act (IDEA). Additional funding for the State Fiscal Stabilization Fund portion of ARRA total to $192 million, which are to be divided among higher education (University of Hawaii); lower education (Department of Education); and other governmental services. The Department is working with the Board of Education to implement expenditure plans for these funds, in accordance with the provisions of ARRA.

CONTACTING THE DEPARTMENT'S FINANCIAL MANAGEMENT

The financial report is designed to provide the public with a general overview of the Department's finances and 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 Fiscal Services, Department of Education, P.O. Box 2360, Honolulu, Hawaii 96804. For general information about the Department, please refer to the Department's website at doe.k12.hi.us.

Department of Education
State of Hawaii

STATEMENT OF NET ASSETS

June 30, 2008

ASSETS	Governmental Activities
CURRENT ASSETS	
Cash	$ 341,263,591
Receivables	
Due from federal government	10,289,929
Accounts receivable	861,777
Due from other agency	252,624
Total current assets	352,667,921
CAPITAL ASSETS, net of accumulated depreciation	1,066,003,551
TOTAL ASSETS	$ 1,418,671,472
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
Vouchers and contracts payable	$ 61,757,042
Accrued wages and employee benefits	120,673,757
Accrued compensated absences	14,323,493
Workers' compensation claims reserve	10,499,819
Deferred revenues	6,160,400
Due to State of Hawaii General Fund	5,443,448
Due to others	628,944
Total current liabilities	219,486,903
ACCRUED COMPENSATED ABSENCES, less current portion	36,041,523
WORKERS' COMPENSATION CLAIMS RESERVE, less current portion	36,315,319
Total liabilities	291,843,745
NET ASSETS	
Investment in capital assets	1,066,003,551
Restricted	24,079,393
Unrestricted	36,744,783
Total net assets	1,126,827,727
TOTAL LIABILITIES AND NET ASSETS	$ 1,418,671,472

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

STATEMENT OF ACTIVITIES

Fiscal Year ended June 30, 2008

Functions/programs	Expenses	Program revenues: Charges for Services	Program revenues: Operating Grants and Contributions	Net revenue (expenses) and change in net assets: Governmental Activities
Governmental activities				
School-related	$ 2,135,845,907	$ 37,741,389	$ 236,683,615	$ (1,861,420,903)
State and complex area administration	89,747,212	2,468,367	724,895	(86,553,950)
Public libraries	49,545,798	2,812,820	1,323,178	(45,409,800)
Capital outlay	57,810,236	-	-	(57,810,236)
Total governmental activities	$ 2,332,949,153	$ 43,022,576	$ 238,731,688	(2,051,194,889)
General revenues				
State allotted appropriations, net of lapses				1,916,224,859
Nonimposed employee fringe benefits				409,165,082
Unrestricted investment earnings				321,291
Total general revenues				2,325,711,232
Other financing sources (uses)				
Transfers out				(228,898,093)
Change in net assets				45,618,250
Net assets at July 1, 2007, as previously reported				1,059,114,222
Reduction of workers' compensation liability (note F)				22,095,255
Net assets at July 1, 2007, as restated				1,081,209,477
Net assets at June 30, 2008				$ 1,126,827,727

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2008

ASSETS	General	Federal	Capital projects	Other	Total
Cash	$ 168,251,265	$ 33,752,519	$ 88,091,962	$ 51,167,845	$ 341,263,591
Receivables					
Due from federal government	-	10,289,929	-	-	10,289,929
Accounts receivable	-	-	-	861,777	861,777
Due from other agency	-	-	-	252,624	252,624
TOTAL ASSETS	$ 168,251,265	$ 44,042,448	$ 88,091,962	$ 52,282,246	$ 352,667,921
LIABILITIES AND FUND BALANCES					
Liabilities					
Vouchers and contracts payable	$ 40,101,528	$ 7,760,939	$ 12,708,007	$ 1,186,568	$ 61,757,042
Accrued wages and employee benefits	113,782,098	5,412,772	230,218	1,248,669	120,673,757
Deferred revenues	-	6,160,400	-	-	6,160,400
Due to State of Hawaii General Fund	5,443,448	-	-	-	5,443,448
Due to others	-	628,944	-	-	628,944
Total liabilities	159,327,074	19,963,055	12,938,225	2,435,237	194,663,591
Fund balances					
Reserved for encumbrances	100,101,225	18,037,264	100,175,427	4,453,958	222,767,874
Reserved for continuing appropriations	27,979,567	-	-	-	27,979,567
Unreserved	(119,156,601)	6,042,129	(25,021,690)	45,393,051	(92,743,111)
Total fund balances	8,924,191	24,079,393	75,153,737	49,847,009	158,004,330
TOTAL LIABILITIES AND FUND BALANCES	$ 168,251,265	$ 44,042,448	$ 88,091,962	$ 52,282,246	$ 352,667,921

The accompanying notes are an integral part of this statement.

Department of Education
State of Hawaii

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS

June 30, 2008

Total fund balances - governmental funds		$ 158,004,330
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Capital assets	$ 2,105,468,479	
Less accumulated depreciation	(1,039,464,928)	1,066,003,551
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported in the governmental funds.		(50,365,016)
Workers' compensation reported in the statement of net assets do not require the use of current financial resources and therefore are not reported in the governmental funds.		(46,815,138)
Net assets of governmental activities		$ 1,126,827,727

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

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

Fiscal Year ended June 30, 2008

	General	Federal	Capital projects	Other	Total
Revenues					
State allotments, net	$ 2,154,516,769	$ -	$ 170,873,172	$ -	$ 2,325,389,941
Intergovernmental revenues	-	232,571,347	-	-	232,571,347
Other revenues	-	-	-	49,504,208	49,504,208
	2,154,516,769	232,571,347	170,873,172	49,504,208	2,607,465,496
Expenditures					
School-related	1,807,080,745	228,869,638	-	34,808,754	2,070,759,137
State and complex area administration	85,180,009	1,582,433	-	2,157,420	88,919,862
Public libraries	38,046,772	1,327,330	-	2,437,210	41,811,312
Capital outlay	-	-	155,557,638	-	155,557,638
	1,930,307,526	231,779,401	155,557,638	39,403,384	2,357,047,949
Excess (deficiency) of revenues over expenditures	224,209,243	791,946	15,315,534	10,100,824	250,417,547
Other financing sources (uses)					
Transfers out	(226,612,463)	-	(2,285,630)	-	(228,898,093)
NET CHANGES IN FUND BALANCES	(2,403,220)	791,946	13,029,904	10,100,824	21,519,454
Fund balances at July 1, 2007	11,327,411	23,287,447	62,123,833	39,746,185	136,484,876
Fund balances at June 30, 2008	$ 8,924,191	$ 24,079,393	$ 75,153,737	$ 49,847,009	$ 158,004,330

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

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

Fiscal Year ended June 30, 2008

Net change in fund balances - total governmental funds		$ 21,519,454
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets are depreciated over their estimated useful lives.		
Capital assets recorded in the current period	$ 98,986,336	
Loss on disposal of capital assets	(1,238,934)	
Less current-period depreciation	(67,637,434)	30,109,968
Change in 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.		(3,993,971)
Change in 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.		(2,017,201)
Change in net assets of governmental activities		$ 45,618,250

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL FUND

Fiscal Year ended June 30, 2008

	Budgeted amounts		Actual on budgetary basis	Variance favorable (unfavorable)
	Original	Final		
Revenues				
State allotments	$ 2,095,753,496	$ 2,142,724,003	$ 2,142,724,003	$ -
Expenditures				
School-related	2,057,668,031	2,101,420,901	2,062,552,690	38,868,211
State and complex area administration	51,773,405	52,891,429	52,571,065	320,364
Public libraries	30,556,588	32,031,199	30,185,970	1,845,229
	2,139,998,024	2,186,343,529	2,145,309,725	41,033,804
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	$ (44,244,528)	$ (43,619,526)	$ (2,585,722)	$ 41,033,804

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -
BUDGET AND ACTUAL (BUDGETARY BASIS) - FEDERAL FUND

Fiscal Year ended June 30, 2008

	Budgeted amounts		Actual on budgetary basis	Variance favorable (unfavorable)
	Original	Final		
Revenues				
Federal grants	$ 263,571,777	$ 369,118,155	$ 220,834,085	$ (148,284,070)
Expenditures				
School-related	262,116,533	367,047,264	223,786,709	143,260,555
State and complex area administration	90,000	311,025	18,107	292,918
Public libraries	1,365,244	1,759,866	1,273,203	486,663
	263,571,777	369,118,155	225,078,019	144,040,136
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	$ -	$ -	$ (4,243,934)	$ (4,243,934)

The accompanying notes are an integral part of this financial statement.

Department of Education
State of Hawaii

STATEMENT OF ASSETS AND LIABILITIES - AGENCY FUNDS

June 30, 2008

ASSETS

Cash and cash equivalents	$ 19,129,293
TOTAL ASSETS	$ 19,129,293

LIABILITIES

Due to student group and others	$ 19,129,293
TOTAL LIABILITIES	$ 19,129,293

The accompanying notes are an integral part of this statement.

NOTE A – FINANCIAL REPORTING ENTITY

1. Introduction

The Department of Education of the State of Hawaii (DOE), 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 DOE is a part of the executive branch of the State of Hawaii (State). The financial statements of the DOE are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the DOE. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2008, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. 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.

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. The Governmental Accounting Standards Board (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.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the DOE have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the GASB.

1. Government-Wide and Fund Financial Statements

The government-wide financial statements report all assets, liabilities, and activities of the DOE as a whole. The fiduciary funds are excluded from the government-wide financial statements because the DOE cannot use those assets to finance its operations. Governmental activities are primarily 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

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

1. Government-Wide and Fund Financial Statements (continued)

function. State allotments are reported as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, generally it is the 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.

2. 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.

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'

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

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

b. Governmental Fund Financial Statements (continued)

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, 2008 has been reported only in the government-wide financial statements.

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.

3. Fund Accounting

The financial transactions of the DOE are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and non-major funds are combined in one column. Major funds are funds which have total assets, liabilities, revenues or expenditures of the fund that are at least ten percent of the same element for all funds of its fund type or at least five percent of the same element for all governmental funds combined.

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 for.

Special Revenue Funds – Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes. Special revenue funds include the federal fund which accounts for grants received from the federal government, directly or indirectly.

Capital Projects Fund – The capital projects fund, which includes amounts related to the capital improvement program, is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

3. Fund Accounting (continued)

b. Fiduciary Fund Type

Agency Funds – Agency funds are used to account for assets held by the DOE on behalf of outside parties, or on behalf of individuals. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

4. Cash

Cash and cash equivalents include certificates of deposit with original maturities of three months or less. It also includes amounts held in the State Treasury. The State Director of Finance (Director) is responsible for safekeeping of all moneys paid into the State Treasury (cash pool). The Director 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's investment pool as of June 30, 2008 included auction rates securities collateralized by student loans. During 2008, a number of these auctions failed and companies without the ability to hold such securities until maturity have taken significant losses. As of June 30, 2008, the State recorded an adjustment for the decrease in fair value for these investments. The DOE's allocated share of the adjustment was approximately $1,115,000. This amount was recorded in the government-wide financial statements as a reduction in cash in the statement of net assets and unrestricted investment earnings in the statement of activities. In the governmental funds this amount was recorded as a reduction in cash in the balance sheet and other revenues in the statement of revenues, expenditures and changes in fund balances – other funds.

Information relating to custodial credit risk of cash deposits and interest rate risk, credit risk, custodial risk, and concentration of credit risk of investments in the State Treasury is available on a statewide basis and not for individual departments or agencies.

5. Capital Assets

Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

5. Capital Assets (continued)

Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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 and certain land improvements. The DOE has adopted the following capitalization policy:

Asset type	Minimum capitalization amount	Estimated useful life
Land	All	Not applicable
Land improvements	$100,000	15 years
Buildings and improvements	$100,000	30 years
Furniture and equipment	$5,000	7 years
Motor vehicles	$5,000	5 years
Public library materials	All	5 years

6. 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 consist primarily of federal grant funds.

7. Accumulated Vacation

Employees are credited with vacation at the rate of 96 to 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.

8. Appropriations

Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are generally allotted annually. General fund allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, unless the DOE receives permission to carryover such funds. The law permits the DOE to carryover up to five percent of general fund appropriations, for school level instruction and comprehensive school support services, from one fiscal year to the next.

NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)

9. Program Revenues

Program revenues are derived directly from the programs of the DOE or from parties outside of the DOE and are categorized as charges for services, operating grants and contributions, or capital grants and contributions.

Charges for services – Charges for services include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided. Revenues in this category include fees charged for meals served, educational classes, use of facilities, transportation services, and use of library materials.

Operating grants and contributions – Program-specific operating and capital grants and contributions include revenues arising from mandatory and voluntary non-exchange transactions with other governments, organizations, or individuals that are restricted for use in a particular program. Governmental grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

10. Intrafund and Interfund Transactions

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

11. Risk Management

The DOE is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

12. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE C – BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration, and revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and federal funds are derived primarily from acts of the State Legislature and from 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 fiscal 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 such as those related to the federal funds.

However, Section 37-41.5 of the Hawaii Revised Statutes allows the DOE to carryover up to five percent each of any appropriation at the end of the fiscal year except for appropriations to fund certain financing agreements. 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, 2008, general funds carried over amounted to approximately $40,980,000, representing 5% of appropriations.

For purposes of budgeting, the DOE's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The DOE's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrances of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grant accruals and deferrals. These differences represent a departure from GAAP.

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

	General	Federal
Excess (deficiency) of revenues over expenditures – actual on a budgetary basis	$ (2,585,722)	$ (4,243,934)
Reserved for encumbrances at fiscal year end	100,101,225	18,037,264
Expenditures for liquidation of prior fiscal year encumbrances	(79,689,554)	(24,519,793)
Net accrued revenues and expenditures	(20,229,169)	11,518,409
Budgeted transfers out (in)	226,612,463	–
Excess (deficiency) of revenues over (under) expenditures – GAAP basis	$224,209,243	$ 791,946

NOTE D – CASH AND CASH EQUIVALENTS

1. Custodial Credit Risk

   Cash and deposits with financial institutions are collateralized in accordance with State statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

   The DOE also maintains cash in banks which is held separately from cash in the State Treasury. As of June 30, 2008, the carrying amount of total bank deposits was approximately $11,123,000 and the corresponding bank balances were approximately $23,440,000. Of this amount, approximately $42,024,000 is insured by the Federal Deposit Insurance Corporation and collateralized with securities held by the DOE's agent.

2. Interest Rate Risk

   As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

3. Credit Risk

   The State's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating.

4. Custodial Risk

   For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping, certain types of securities to collateralized repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

5. Concentration of Credit Risk

   The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

NOTE E – CAPITAL ASSETS

The changes in capital assets were as follows:

	Balance June 30, 2007	Additions	Deductions	Balance June 30, 2008
Governmental activities				
Capital asset, not being depreciated				
Land	$ 84,201,746	$ –	$ –	$ 84,201,746
Land improvements	6,014,060	–	–	6,014,060
Construction in progress	65,498,618	77,440,326	78,887,154	64,051,790
Total capital assets not being depreciated	155,714,424	77,440,326	78,887,154	154,267,596
Capital assets, being depreciated				
Land improvements	83,353,902	34,107,635	–	117,461,537
Buildings and improvements	1,638,008,489	47,403,550	–	1,685,412,039
Furniture and equipment	70,257,912	12,700,628	4,332,436	78,626,104
Public library materials	63,479,852	6,221,351	–	69,701,203
Total capital assets being depreciated	1,855,100,155	100,433,164	4,332,436	1,951,200,883
Less accumulated depreciation for:				
Land improvements	57,333,933	5,038,711	–	62,372,644
Buildings and improvements	819,912,327	46,560,782	–	866,473,109
Furniture and equipment	51,690,980	9,329,383	3,093,502	57,926,861
Public library materials	45,983,756	6,708,558	–	52,692,314
Total accumulated depreciation	974,920,996	67,637,434	3,093,502	1,039,464,928
Governmental activities, net	$1,035,893,583	$110,236,056	$80,126,088	$1,066,003,551

Depreciation expense was charged to functions as follows:

	Governmental activities
School-related	$59,195,417
State and complex area administration	747,471
Public libraries	7,694,546
Total depreciation expense	$67,637,434

NOTE F – LONG-TERM LIABILITIES

The change in the long-term liabilities during the fiscal year ended June 30, 2008 was as follows:

	Accrued compensated absences	Workers' compensation claims
Balance at July 1, 2007, as previously reported	$46,371,045	$ 66,893,192
Reduction of workers' compensation liability	–	(22,095,255)
Balance at July 1, 2007, as restated	46,371,045	44,797,937
Additions	23,295,995	12,064,598
Reductions	19,302,024	10,047,397
Balance at June 30, 2008	$50,365,016	$ 46,815,138
Due within one year	$14,323,493	$ 10,499,819

During 2008, DOE engaged the services of an actuary to assist in determining its workers' compensation liability. The actuary compared actual loss history to the DOE's liability reserve methodology, and concluded that the DOE's claim-by-claim reserves were more than adequate, and that the liability should be reduced. Based on the total actuarial computations, the DOE workers' compensation liability as of the prior year ended June 30, 2007 was reduced by $22,095,255.

The compensated absences and workers' compensation liabilities have been paid primarily by the general fund in the past.

NOTE G – FUND BALANCE

1. Reserved for Encumbrances

   Reserved for encumbrances represent the portion of the fund balance that is segregated for expenditure on vendor performance.

2. Reserved for Continuing Appropriations

   Reserved for continuing appropriations represent unencumbered allotment balances that have been released and made available for encumbrance or expenditure and are legally segregated for a specific future use.

NOTE H– LEASE COMMITMENTS

The DOE leases equipment from third party lessors under various operating leases expiring through 2015. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2008 were as follows:

	Amount
Year ending June 30,	
2009	$ 6,500,000
2010	4,700,000
2011	3,900,000
2012	2,900,000
2013	1,400,000
2014-2019	2,200,000
	$21,600,000

Total rent expense related to the above leases for the year ended June 30, 2008 amounted to approximately $8,100,000.

NOTE I – RETIREMENT BENEFITS

1. Employees' Retirement System

Substantially all eligible employees of the DOE are required by Chapter 88, Hawaii Revised Statutes (HRS), 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 financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

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

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 vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service excluding the vacation payment.

NOTE I – RETIREMENT BENEFITS (continued)

1. Employees' Retirement System (continued)

On July 1, 2007, a new hybrid contributory plan became effective pursuant to Act 170, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 after 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. All members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006, are required to join the hybrid plan.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the DOE hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the DOE is required to contribute to both options at an actuarially determined rate. The portion of the contributions related to the DOE's general and special revenue funds are recorded as an expenditure of the respective funds in the financial statements. Actual and required contributions by the DOE for the fiscal year ended June 30, 2008, 2007, and 2006 were approximately $166,507,000, $156,527,000, and $148,810,000, respectively. The contribution rates for the fiscal years ended June 30, 2008, 2007, and 2006 were 13.75%.

2. Post-Retirement Health Care and Life Insurance Benefits

Plan Description:

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

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

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with less than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

NOTE I – RETIREMENT BENEFITS (continued)

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

Plan Description (continued):

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

State Policy:

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

The DOE's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2008 was approximately $107,291,000, and is included in the basic financial statements.

The DOE's share of the expense for post-retirement health care and life insurance benefits for the fiscal years ended June 30, 2007 and 2006 were approximately $96,990,000 and $71,321,000, respectively.

State's CAFR includes Required Information:

The State's CAFR includes financial disclosure and required supplementary information on the State's pension and non-pension retirement benefits.

3. Deferred Compensation Plan

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

NOTE I – RETIREMENT BENEFITS (continued)

3. Deferred Compensation Plan (continued)

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

NOTE J – RISK MANAGEMENT

The DOE is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally is at risk for the first $250,000 per occurrence of property losses and the first $4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is $100 million ($40 million for earthquake and flood) and the annual aggregate for general liability losses per occurrence is $10 million. The State also has an insurance policy to cover medical malpractice risk in the amount of $20 million per occurrence with no annual aggregate limit. The State is generally self-insured for automobile claims.

The DOE is self-insured for workers' compensation and automobile claims. The DOE's estimated reserve for losses and loss adjustment costs include the accumulation of estimates for losses and claims reported prior to fiscal year end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The DOE believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

NOTE K – COMMITMENTS AND CONTINGENCIES

1. Construction Contracts

The DOE is committed under contracts awarded and orders placed for construction, expenses, supplies, etc. These commitments amounted to approximately $108,869,000 as of June 30, 2008.

2. 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.

NOTE L – 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. 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 fiscal year ended June 30, 2008. 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, 2008.

	Amount
Basic allocation	$2,224,011
Bonus commodities	61,618
	$2,285,629

NOTE M– TRANSFERS FOR DEBT SERVICE

Act 213, SLH 2007, Section 85 provided a general fund appropriation to pay for debt service on general obligation bonds issued for the DOE and transferred to the financial administration program of the State Department of Budget and Finance. Appropriation for debt service amounted to $226,612,463 for the year ended June 30, 2008.

In July 2008, the DOE transferred $236,896,511 to the financial administration program of the State Department of Budget and Finance pursuant to Act 158, SLH 2008, Section 85.

SUPPLEMENTARY INFORMATION

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal year ended June 30, 2008

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures [1]	Amount provided to subrecipient
U.S. Department of Agriculture				
Food Donation [2]	10.550	--	$ 2,285,629	$ -
Child Nutrition Cluster:				
School Breakfast Program	10.553	--	7,771,860	459,016
National School Lunch Program	10.555	--	25,900,426	1,381,892
Special Milk Program for Children	10.556	--	8,384	8,384
Summer Food Service Program for Children	10.559	--	576,905	574,905
Subtotal Child Nutrition Cluster			34,257,575	2,424,197
Agriculture Program-Waialua	10.226	--	5,823	-
Child and Adult Care Food Program	10.558	--	5,588,327	5,510,101
State Administrative Expense for Child Nutrition	10.560	--	805,924	-
Team Nutrition Training Program	CNTN-05-HI-1	--	109,871	-
Total U.S. Department of Agriculture			43,053,149	7,934,298
U.S. Department of Defense				
National Defense Authorization Act P.L. 102-484	650009	--	2,229,149	-
Troops To Teachers - DOD FY08	000913	--	104,709	-
Passed-through State Department of Defense Joint Venture Education Forum	000913	HQOSPACOM	2,804,291	-
Total U.S. Department of Defense			5,138,149	-
U.S. Department of Commerce				
Coastal Services Center	11.473	--	27,566	-
Total U.S. Department of Commerce			$ 27,566	$ -

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2008

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Interior				
Passed-through State Governor's Office				
Economic, Social and Political Development of the Territories	15.875	GR 270 094	$ 46,702	$ -
Total U.S. Department of the Interior			46,702	-
U.S. Department of Transportation				
Passed-through State Department of Transportation				
State and Community Highway Safety	20.600	AL07-02 (09-S-01)	12,861	-
		AL07-02 (09-S-01)	7,848	
		AL07-01 (10-S-01)	1,336	
		AL07-02 (07-S-01)	48,163	-
Total U.S. Department of Transportation			70,208	-
National Science Foundation				
Education and Human Resources	47.076	--	202,161	-
Total National Science Foundation			$ 202,161	$ -

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2008

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Education				
Adult Education - State Grant Program	84.002	--	$ 1,983,074	$ -
Improving Basic Programs Operated by Local Education Agencies (Title I, Part A)	84.010	--	42,320,782	-
Migrant Education - State Grant Program	84.011	--	859,511	-
Title I - Program for Neglected and Delinquent Children	84.013	--	177,944	-
Special Education	84.027	--	38,186,721	-
Impact Aid	84.041	--	56,935,998	-
MEP Consortium Incentive Grant	84.144	--	90,829	-
Byrd Honors Scholarships	84.185	--	156,000	-
Safe and Drug-Free School and Communities - State Grants	84.186	--	1,314,227	-
Education for Homeless Children and Youth	84.196	--	189,332	-
Even Start - State Educational Agencies	84.213	--	376,346	-
Even Start - Migrant Education	84.214	--	343,392	-
Fund for the Improvement of Education	84.215	--	1,641,508	-
Charter Schools	84.282	--	330,630	325,510
21st Century Community Learning Centers	84.287	--	4,407,482	-
State Grants for Innovative Programs	84.298	--	781,723	-
Education Technology State Grants	84.318	--	2,761,049	-
Special Education - State Personnel Development	84.323	--	823,823	-
Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	84.326	--	821,403	-
Advanced Placement Program	84.330	--	5,112	-
Comprehensive School Reform Demonstration	84.332	--	44,952	-
Reading First State Grants	84.357	--	2,724,518	-
Native Hawaiian Education	84.362	--	2,010,893	-
Expanding Pathways to Hawaii's Leadership	84.363	--	255,452	-
English Language Acquisition Grants	84.365	--	1,989,495	-
Mathematics and Science Partnerships	84.366	--	857,496	-
Improving Teacher Quality State Grants	84.367	--	12,998,314	-
Pacific Assessment Consortium	84.368	--	850,000	-
Grants for State Assessments	84.369	--	3,479,361	-
Common Core of Data Survey Project	500000-04	--	13,503	-
NAEP State Coordinator	650040-03	--	161,118	-
			179,891,988	325,510
Passed-through Office of the State Director for Vocational Education				
Career and Technical Education	84.048	V048A050011	270,435	-
		V048A060011	1,560,109	-
		V048A070011	1,515,809	-
			3,346,353	-
Tech-Prep Education	84.243	V243A050011	108,665	-
		V243A050011	80,529	-
			189,194	-

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2008

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
Passed-through State Department of Human Services Rehabilitation Services -Vocational Rehabilitation				
Grants to States	84.126	MOA-DHHS	$ 69,241	$ -
Safe and Drug-Free Schools and Communities State Grants	84.186	S186B020012	(180)	-
		DHS-04-OYS-1633 S3	(3,310)	-
			(3,490)	-
Passed-through Alu Like, Inc.				
Native Hawaiian Vocational Education	84.259	S362A0310013	6,287	-
		VE-06-01	13,249	-
		VE-06-04	10,269	-
		VE-06-02	23,828	-
		VE-06-08	69,808	-
			123,441	-
Passed-through University of Hawaii				
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	P334S050013	97,452	-
		P334S050013	621,642	-
			719,094	-
Native Hawaiian Special Education	84.221	CO10147-mod#4	(159,400)	
	84.221	CO10147-mod#5	1,603,631	-
			1,444,231	
Passed-through Georgia State Department of Education				
Enhanced Assessment GRT - Georgia DOE FY07	84.368	5368A060005	115,239	-
Passed-through Idaho State Department of Education				
Enhanced Assessment GRT - Idaho DOE FY07	84.368	5368A060012	14,551	-
			129,790	-
Passed-through State Department of Health				
Peer Education Counselors PEP	ASO 07-120	ASO 07-120	(15,574)	-
Nutrition Education Program	DOH 08-003	DOH 08-003	90	-
FSNE Program-Waimanalo	DHS-06-4137	DHS-06-4137	9,764	-
			(5,720)	-
Total U.S. Department of Education			$ 185,904,122	$ 325,510

Department of Education
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Fiscal year ended June 30, 2008

Federal grantor/pass-through grantor and program title	Federal CFDA number[3]	Pass-through entity identifying number	Federal expenditures[1]	Amount provided to subrecipient
U.S. Department of Health and Human Services				
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Other Important Health Problems	93.938	--	$ 525,103	$ -
Passed-through State Department of Human Services				
Temporary Assistance for Needy Families	93.558	DHS-06-BESSD-3118 SA1	76,616	-
		DHS-06-BESSD-3118 SA1	132,659	
Temporary Assistance for Needy Families	93.558	BESSD-3117	1,854,313	-
			2,063,588	-
Child Care and Development Block Grant	93.575	G0100HICCD2	343,709	-
Parent Project Fences FY08	93.590	POS-08	1,862	-
Paths Program - County of Hawaii FY07	495000	DHS-07-OYS-4134	18,348	-
Teen Pregnancy Prevention Trng-DHS FY06	650703	DHS-06-BESSD-3048 SA1	1,940	-
Teen Pregnancy Prevention Trng-DHS FY07	650703	DHS-06-BESSD-3048 SA1	81,964	-
Total U.S. Department of Health and Human Services			3,036,514	-
Corporation for National and Community Service				
Passed-through State Department of Labor				
Learn and Serve America - School and Community Based Programs	94.004	03KSPHI001	47,702	-
Total Corporation for National and Community Service			47,702	-
TOTAL FEDERAL GRANT FUND EXPENDITURES			$ 237,526,273	$ 8,259,808

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

[2] Expenditures for the Food Donation Program (CFDA 10.550) are based on the value of food commodities received.

[3] Other identifying number used if no CFDA number available.

PART II

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

Grant Thornton

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

Audit – Tax – Advisory

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

T 808.536.0066
F 808.523.8590
www.GrantThornton.com

To the Auditor
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information as well as the budgetary comparison for the general and federal funds of the Department of Education of the State of Hawaii (DOE), as of and for the fiscal year ended June 30, 2008, which collectively comprise the DOE's basic financial statements, and have issued our report thereon dated May 20, 2009, which included an explanatory paragraph describing the restatement of the net assets as of July 1, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in items 2008-01 to 2008-04 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we considered items 2008-01 to 2008-04 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the DOE's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 2008-06 and 2008-15.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Education, others within the entity, the Office of the Auditor, 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.

Grant Thornton LLP

Honolulu, Hawaii
May 20, 2009

PART III

AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

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

Audit – Tax – Advisory

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

T 808.536.0066
F 808.523.8590
www.GrantThornton.com

To the Auditor
State of Hawaii

Compliance

We have audited the compliance of the Department of Education of the State of Hawaii (DOE) with the types of compliance requirements described in the Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The DOE'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 DOE's management. Our responsibility is to express an opinion on the DOE'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 DOE'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 DOE's compliance with those requirements.

As described in item 2008-07 in the accompanying schedule of findings and questioned costs, the DOE did not comply with requirements regarding Allowable Costs that are applicable to its Title I Part A, Special Education, Impact Aid, Career and Technical Education, 21st Century Community Learning Centers, Native Hawaiian Education, Grants for State Assessments, and Improving Teacher Quality. Compliance with such requirements is necessary, in our opinion, for the DOE to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the DOE complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2008-08 and 2008-12 to 2008-17.

Internal Control Over Compliance

The management of the DOE is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the DOE's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DOE's internal control over compliance.

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2008-07 to 2008-16, and 2008-18 to be significant deficiencies.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 2008-08, 2008-09, and 2008-11 to be material weaknesses.

The DOE's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DOE's response and, accordingly, we express no opinion on it.

To the Auditor
State of Hawaii

This report is intended solely for the information and use of management, the Board of Education, others within the entity, the Office of the Auditor, 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.

Grant Thornton LLP

Honolulu, Hawaii
May 20, 2009

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Education
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Fiscal year ended June 30, 2008

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified.

Internal control over financial reporting:

- Material weakness(es) identified? — _√_ yes   __ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? — __ yes   _√_ none reported

Noncompliance material to financial statements noted? — __ yes   _√_ no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? — _√_ yes   ___no
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? — _√_ yes   __ none reported

Type of auditor's report issued on compliance for major programs: Qualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? — _√_ yes   __ no

Department of Education
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Fiscal year ended June 30, 2008

Identification of major programs:

CFDA number	Name of federal program
10.558	Child and Adult Care Food Program
84.002	Adult Education
84.010	Improving Basic Programs Operated by Local Education Agencies (Title I, Part A)
84.041	Impact Aid
84.048	Career and Technical Education
84.362	Native Hawaiian Education
84.367	Improving Teacher Quality State Grants
84.369	Grants for State Assessments
84.287	21st Century Community Learning Centers
84.027	Special Education

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

Finding 2008-01 – Error Corrections

Criteria: The Committee of Sponsoring Organizations of the Treadway Commission's "Internal Control – Integrated Framework" defines internal control as a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

The term "reliability" as used with financial reporting objectives involves the preparation of financial statements that are fairly presented in conformity with generally accepted or other relevant and appropriate accounting principles and regulatory requirements for external purposes. Fair presentation is defined as:

- The accounting principles selected and applied have general acceptance.
- The accounting principles are appropriate in the circumstances.
- The financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation.
- The information presented in the financial statements is classified and summarized in a reasonable manner, that is, it is neither too detailed nor too condensed.
- The financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, that is, limits that are reasonable and practical to attain in financial statements.

Condition/Context: Although improvements were made during the current year, continued efforts in implementing additional improvements are still needed in the Accounting Section. The Accounting Section continues to be challenged mainly due to the lack of sufficient staff resources. Due to lack of sufficient resources, during the current year the Accounting Section utilized the services of an accounting firm to assist in the preparation for the current year's audit. Although this helped to facilitate the completion of the audit, several errors were identified as a result of our audit procedures. In addition, because DOE has separate accounting records from the State, timely reconciliations between the two accounting records are necessary to ensure both records are complete and accurate. As of March 2009, reconciliations between the two accounting systems have been prepared for the fiscal year ended June 30, 2008, however there was no indication of the review of these reconciliations, and adjustments for reconciling items have not yet been posted.

As previously reported, communication between the Accounting Section and other sections and branches within the DOE (e.g., Vendor Payment, Payroll, Facilities Development, and Facilities Maintenance) continues to need improvement to ensure that the DOE's financial statements report the proper financial position and changes in financial position of the DOE. Since the DOE keeps its records on a cash and encumbrance basis, accurate and timely information is needed by the Accounting Section in order to prepare accruals for receivables (e.g., due from the federal government, and other receivables) and payables (e.g., vouchers and contracts payable, wages and employee benefits, compensated absences, workers' compensation claims, and other payables). Accurate and timely information is also necessary to ensure capital asset transactions, including construction in progress activity, is recorded and disclosed in the financial statements properly.

Cause: The above finding was caused primarily by the lack of a detailed review of the information prepared for the current year audit, and lack of sufficient staff resources and training.

Effect: As a result of our audit procedures, adjustments were proposed, which management recorded, to reflect the correction of certain assets, liabilities, revenues, and expenses. In addition, we proposed certain other audit adjustments, which management elected not to record, as they were not deemed material, individually and in the aggregate, to the financial statements taken as a whole. Depending on a number of factors, amounts reported in the future maybe materially misstated.

Recommendation: We continue to recommend that management ensure that all transactions in the DOE's financial statements are properly reported in accordance with accounting principles generally accepted in the United States of America. We also continue to recommend that the Accounting Section continue to assess its control processes, procedures and resources in the accounting and financial management area.

Training should be provided to the Accounting Section personnel on external financial reporting requirements in order for them to assess whether or not they will be able to fulfill the external reporting requirements without outside assistance. If outside assistance is still considered necessary, management should exercise greater care in the review of the work performed.

We recommend that significant accounts on the statement of net assets and the balance sheet be reconciled in a timelier manner. In addition, reconciliations between the DOE's accounting records and the State's accounting records should be prepared and reviewed in a timelier manner in order to ensure that adjustments, if any, are identified timely and recorded. Timely reconciliations could be assured by establishing a realistic schedule and having completion monitored by a designated individual. All such reconciliations should also be reviewed by a designated individual to ensure accuracy and completeness, and to verify that reconciled items have been properly addressed. This review should be evidenced by having the reviewer initial the reconciliation.

We also recommend that the Accounting Section develop policies and procedures to ensure that analytical procedures are performed on the statement of activities and the statement of revenues, expenditures and changes in fund balances to identify large or unusual fluctuations for investigation. These analytical review procedures could include the comparison of current year to prior year results, budget to actual results, and the review of other statistical reports.

The function of the Office of Fiscal Services should be one of financial management as well as maintaining the internal control of the DOE. Internal Audit should be used to assist in the monitoring of the internal control of the DOE. Management should determine whether these functions and objectives are being achieved and, if not, whether they can be achieved with its current resources, or whether additional resources are needed.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2008-02 – Accounting for Compensated Absences

Criteria: GASB Statement 16, Accounting for Compensated Absences, requires that vacation leave and benefits with similar characteristics should be recorded as a liability when earned by employees if the following conditions are satisfied:

- Compensated absence is earned on the basis of services already performed by employees.
- It is probable that the compensated absence will be paid in a future period.

Condition/Context: The vacation and sick leave balance of the DOE are reported to the State Comptroller annually. We selected 16 individuals for detailed testing of the recorded amounts of accrued vacation. 14 of the 16 (approximately 88%) sample items we examined contained errors. Due to the process used to accumulate the data to be reported, several errors were noted (e.g., incorrect pay rates, improper hours used and retired employees still being reported). The errors found in the sample items examined totaled $18,959. $12,707 of the error was attributed to one individual who retired on June 30, 2007 being included. Based on these errors, we estimated a projected overstatement of the vacation balances of approximately $6,100,000.

Cause: The above finding was caused primarily by a lack of management oversight and the manual process used to accumulate the information.

Effect: Due to the results of the errors found, we proposed an audit adjustment of approximately $6,100,000. As the adjustment was based on a projected or estimated amount, management elected not to record such proposed adjustment. Depending on a number of factors, amounts reported to the State Comptroller in the future may be materially misstated.

Recommendation: We continue to recommend that the amounts of vacation and sick leave balances be reviewed and validated against personnel and payroll records to ensure accuracy and completeness before reporting the balances to the State Comptroller.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2008-03 – Improving Compensating Controls for Inadequate Segregation of Duties over Agency Funds and Processing of Transactions

Criteria: Agency funds are used to account for assets held by the DOE on behalf of outside parties or on behalf of individuals. These funds are also known as local school funds.

Segregation of Duties

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.
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.

Processing Disbursements

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 receive 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 of the original invoice.
3. Enter date invoice received and date goods/services received.
4. Check unit prices/extensions and totals.
5. Check off items as received on school's copy of purchase order.

Processing Receipts

According to the FMS User Policy and Process Flow Guide, a cash receipt book must be maintained by each school that receives monies. An official receipt must be completed including information as to date, name of payee, purpose of collection, amount, method of payment and reference to organization.

Section 296-32 of the Hawaii Revised Statutes allows the DOE to receive and manage appropriate gifts, grants and bequests for the purpose of public education. The FMS User Policy and Process Flow Guide requires that schools maintain a report of all gifts, grants and bequests by date, name of donor, description, purpose and amount for which it is to be used. The revised Form 434, Rev. 9/94 is used for this purpose. In addition, any such amounts greater than $500 must be presented to and accepted by the Superintendent. The schools are required to maintain a file of letters, memorandum or copies of checks for all gifts, grants and bequests received by the school.

Condition/Context: The school administrative services assistant (SASA) or account clerk generally performed most, if not all, the cash functions at schools. Of the three schools we visited during our testing of local school funds, we noted a lack of segregation of duties at these schools. However, the principals or designee prepared the Administrator's Check List which documented the reviews conducted indicating the areas reviewed the date of the reviews, and discrepancies found.

Processing Disbursements

During our testing of a sample of 30 local school fund disbursements, we noted the following:

- Six (6) instances in which the purchase order was not submitted for approval prior to the purchase of goods or services; in two of these instances, the purchase order did not contain the authorizing signature of the principal or designee.
- Two (2) instances 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.
- Two (2) instances, where payments were processed without the required invoice or Form 99.

Processing Receipts

During our testing of a sample of 30 local school fund receipts, we noted the following:

- Twenty-one (21) instances where the official receipt was not properly completed in accordance with the FMS User Policy Guide.
- Two (2) instances where gifts, grants and bequests were not reported on the revised Form 434, Rev. 9/94.
- Two (2) instances where the files did not contain a letter from the Superintendent acknowledging the amount of gifts, grants and bequests received.

Cause: The above finding was caused primarily by a lack of management oversight and lack of sufficient staff resources and training.

Effect: In the absence of compensating controls, the lack of segregation of duties may result in funds being lost, unrecorded or misused.

Recommendation: We continue to recommend that the 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.

We recommend that all disbursements of local school funds be properly approved and all necessary documents be obtained prior to purchase or payment, and the “approval to pay” stamp be affixed on the original invoices 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.

We recommend that all receipts of local school funds be properly processed and approved and all required documentation be maintained in accordance with the FMS User Policy and Process Flow Guide.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2008-04 – Agency Fund Bank Reconciliations

Criteria: Agency funds are used to account for assets held by the DOE on behalf of outside parties or on behalf of individuals. These funds are also known as local school funds.

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.

According to the FMS User Policy and Process Flow Guide, the process of monthly bank reconciliation is not complete until the principal ensures the following have been performed:

1. Bank reconciliations are done monthly.
2. Investigate all items which have been outstanding for an unusual period of time.
3. Review the bank statement for any unusual entries.
4. Agree that the bank reconciliation amounts matches to the Checking Ledger Report balance.
5. Review the Check Register for any unusual adjustments.
6. Indicate that review of bank reconciliations has been performed by signing or initialing and dating the bank statement.

Condition/Context: Although improvement has been made in this area, improvement is still needed. Certain schools did not provide reconciliation for their local school funds in a timely manner. Of the 268 local school funds, we selected approximately 100 local school fund account bank reconciliations for the month of June 2008 to be reviewed. We noted approximately forty (40) schools where either the cash on hand or investment balances on the reconciliations did not agree to the Principal's Financial Report as of June 30, 2008. Certain schools had cash and investment balances on the Principal's Financial Report that were understated by approximately $21,000, while other schools had cash and investment balances that were overstated by $24,000. The net difference of the 40 schools was $3,000. We also noted the following:

- Four (4) schools where the June 30, 2008 bank reconciliation was prepared after July 31, 2008.
- Forty (40) schools where there was no prepared date, therefore we were unable to determine whether the reconciliation was performed timely.
- Approximately twenty-five (25) schools did not have an appropriate review or approval signature and date on the bank reconciliation.

- Approximately fifteen (15) 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 in a timely manner.
- Approximately twenty-five (25) schools for which there were reconciling items outstanding longer than six months.

Cause: The above finding was caused primarily by a lack of management oversight.

Effect: Inaccurate amounts could have been reported for the DOE's agency funds.

Recommendation: To ensure the accountability, accuracy and propriety of a school's cash balances, 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 investigated.

The lack of timely periodic account reconciliations, including the thoroughness of subsequent review and approval of such reconciliations, could affect the accuracy of financial information provided to management. Furthermore, the probability that additional errors will occur and go undetected is greatly increased. Finally, when accounts have not been reviewed and reconciled timely, attempts to perform account analyses can become a time-consuming and costly process.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2008-05 – Risk Financing

Criteria: GASB Statement 30, Risk Financing Omnibus, requires that claims liabilities, including IBNR (incurred but not reported claims), should be based on the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. Claims liabilities should include specific, incremental claim adjustment expenditures/expenses.

Condition/Context: The DOE reported a liability for its workers' compensation claims in the amount of $66,893,192 as of June 30, 2007. The DOE was not able to provide sufficient evidential matter supporting the adequacy of the amounts accrued for this estimate, nor were we able to satisfy ourselves as to the adequacy of the reported amount of this liability by other auditing procedures. As such, the scope of our 2007 audit was restricted and our 2007 report on the audited financial statements was qualified. Accordingly, we made certain recommendations to the DOE to address Finding 2007-05.

In the current year, in response to prior-year recommendations, the DOE utilized the services of an outside loss reserve specialist in reviewing the reasonableness of the DOE's loss reserve estimate. The results of the review indicated that the balance as of June 30, 2007 was overstated. The net assets of the DOE as of July 1, 2007 were restated to reflect the correction of an overstatement of the reported workers' compensation liability in the amount of $22,095,255.

The DOE also engaged the outside loss reserve specialist to perform a review of the DOE's reserve methodology for workers' compensation. The results of the review were reported in the outside loss reserve specialist report dated December 24, 2008. The objectives of the DOE's reserve methodology of the review were to determine whether the following:

- Reserve methodology meets best practices.
- Day-to-day use of the methodology is in accordance with procedures.
- Reserve practice results are promoting accurate reserves for future payment.

The outside loss reserve specialist found that overall the reserve methodology meets best practices. However, areas were found where methodology revisions would increase the likelihood of setting accurate claim reserves and follow best practices. The recommendations are contained in Exhibit 1 to the report dated December 24, 2008. The outside loss reserve specialist found that of a review of the sample of 100 claims that the adjusters are consistently applying the DOE's reserve methodology.

Cause: The DOE utilized a model that was developed in 1998.

Effect: An adjustment was made to net assets as of July 1, 2007 for the overstatement of the workers' compensation liability of $22,095,255. The accuracy of the loss reserves and the extent and timeliness of the manner in which claims liabilities are settled could be jeopardized.

Recommendation: We recommend that the DOE consider implementing the recommendations made by the outside loss reserve specialist to increase the likelihood of setting accurate claim reserves and follow best practices.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Finding 2008-06 – Procurement

Criteria: Hawaii Revised Statute § 103D Hawaii Public Procurement Code

Condition/Context: The following instances of noncompliance were noted:

- One out of fifteen contracts tested for procurement compliance did not comply with the procurement code.
    - Hawaii Administrative Rules 3-122-45.01 provides the evaluation committee shall consist of at least three government employees with sufficient qualification in the areas of goods, services or construction to be procured. Only two of the members of the evaluation committee were State employees.

Cause: The above condition was primarily cause by management oversight.

Effect: Contractors not selected may question the validity of the contract awarding process.

Recommendation: We recommend that the DOE exercise greater care in adhering to the Hawaii Revised Statues § 103D. Employees involved in the procurement process should be advised and trained in the Hawaii Procurement Code. Compliance with the State Procurement Code may minimize the risk of future problems, potential claims, or possible loss of funding.

View of the responsible official and planned correction actions: Refer to response of Affected Agency.

Section III – Federal Award Findings and Questioned Costs

Finding 2008-07 – Allowable Costs and Cost Principles – Payroll Certifications

U.S. Department of Education

Title I, Part A (84.010); Special Education (84.027); Impact Aid (84.041); Career and Technical Education (84.048); 21st Century Community Learning Centers (84.287); Native Hawaiian Education (84.362); Grants for States Assessments (84.369); Improving Teacher Quality State Grants (84.367)

Award Year: July 2006 – September 2007; July 2007 – September 2008

Criteria: OMB Circular 8(h) states "Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first-hand knowledge of the work performed by the employee." Further, "Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation.…" Personnel activity reports must be prepared at least monthly and must coincide with one or more pay periods.

Condition/Context: We noted certain internal control and compliance issues with payroll related costs. Samples sizes ranged from two through 25 for each major program tested, depending on the ratio of payroll to non-payroll costs.

We noted four instances totaling $1,439 in Native Hawaiian Education, Grants for State Assessments, and Improving Teacher Quality where the Department was unable to provide timesheets, payroll certifications, or other documentation for substitute teachers' time spent on federal programs.

We noted five instances totaling $5,133 in Title I, Special Education, Impact Aid, and Improving Teacher Quality where payroll certifications covered periods longer than six months.

In Special Education, we noted one instance where a payroll certification was not signed in a timely manner. The certification was for service performed during December 2007, but was not signed until January 13, 2009.

For Career and Technical Education, we noted one instance where an employee's certification covered a four month time period. Since this employee's time was charged to multiple programs, a time distribution report covering no more than one month should have been prepared.

In 21st Century Community Learning Centers, we noted one instance where an employee's certification was signed in August 2007 but covers the period from July 2007 to December 2007. Regulations require certifications to be made "after-the-fact."

Lastly, we noted one instance in Improving Teacher Quality where an employee was charged to the wrong program during the months of May and June 2008. Management detected the errors while reviewing monthly payroll reports in January 2009.

Cause: The above conditions were primarily due to management and personnel oversight.

Effect: The documentation required for personnel costs charged to federal programs is in place to help ensure proper oversight and expenditure of federal funds for personnel costs. Failure to comply with this requirement prevents these controls from operating effectively.

Questioned costs: $14,595, calculated as the total payroll amount that was erroneously charged to Improving Teacher Quality. Management subsequently corrected the charges by transferring the costs to general funds in January 2009.

Recommendation: We recommend management be more diligent in completing the required certifications in a timely manner.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-08 – Cash Management

U.S. Department of Education

Adult Education (84.002); Title I, Part A (84.010); Special Education (84.027); Career and Technical Education (84.048); 21st Century Community Learning Centers (84.287); Native Hawaiian Education (84.362); Grants for States Assessments (84.369); Improving Teacher Quality State Grants (84.367)

Award Year: 2006 – September 2007; July 2007 – September 2008

Criteria: 2007 Office of Management and Budget Circular A-133 Part 6 *Internal Controls*. Also, 31CFR 205.33 states that, "A State must minimize the time between the drawdown of Federal funds from the Federal government and their disbursement for Federal program purposes. A Federal Program Agency must limit a funds transfer to a State to the minimum amounts needed by the State and must time the disbursement to be in accord with the actual, immediate cash requirements of the State in carrying out a Federal assistance program or project. The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs and the proportionate share of any allowable indirect costs. States should exercise sound cash management in funds transfers to subgrantees in accordance with OMB CircularA-102."

Condition/Context: We noted numerous instances in eight of the ten major programs tested where an estimated payroll amount is being claimed for reimbursement for payroll costs incurred but not yet posted to the DOE's financial management system. While proper support for the estimates were maintained, these amounts were not reconciled to actual amounts in a subsequent drawdown request.

We noted six instances in the Special Education program totaling $2,238,000 where estimated amounts were claimed for other expenditures to be paid out. The DOE was unable to provide documentation for these estimates and could not provide support that these amounts were disbursed within a reasonable amount of time after receipt. We also noted one instance in Special Education where the Department failed to net its current drawdown request with excess cash. This resulted in an overdraw of approximately $1,600,000.

We also noted numerous instances where other amounts on letter of credit worksheets were unsupported or did not agree to documentation provided.

Lastly, we noted nine of 18 letters of credit tested in Improving Teacher Quality, Grants for State Assessments, and Title I where worksheets did not contain proper evidence of reviews.

Cause: The above conditions were caused primarily by management oversight due to high turnover in the Accounting Section of the Office of Fiscal Services.

Effect: The DOE's lack of supporting documentation for estimated other expenditures and cash adjustments do not comply with the objectives of the requirements for cash management – to drawdown amounts for only actual and/or immediate needs of the program.

As described in the first paragraph of Conditions/Context, estimated payroll amounts are not reconciled to actual. Since actual payroll amounts are not reported on the DOE's financial management system in which reimbursement claims are derived from until the following month, this may potentially cause a situation where excess cash may be held by the program for up to 30 days. Without a proper reconciliation, we were unable to determine whether amounts drawn were actually expended within a reasonable amount of time.

Failure to improve cash management procedures may lead to future restrictions on drawdowns. For example, the US DOE may require some or all of the affected programs to be placed on a program specific Treasury-State Agreement, in which the US DOE would subject the programs to scheduled cash draws and increased scrutiny.

Questioned costs: None.

Recommendations: The 2006 and 2007 audits noted similar findings. Prior auditors recommended the DOE "should improve its cash management procedures to increase the predictability of disbursements and time drawdowns of federal funds to comply with the U.S. Department of Education's requirement to expend funds within three working days."

We further recommend that the DOE consider some of the following measures in addressing this issue.

- Develop and implement a written policy related to cash drawdowns to maintain consistency among programs.
- Maintain a schedule when cash draws are to be made. For example, one program could draw every other Monday, another program every other Wednesday, and so forth.
- Implement a policy where estimated payroll amounts greater than $50,000 (or other amount as appropriate) are reconciled to actual as soon as information is available.
- Require all adjustments that affect claims for reimbursement include notations for reasons for adjustment.

- For large programs that claim large estimated payroll expenditures, schedule the cash draws to coincide with pay dates, to improve the accuracy of payroll claims.
- Improve cash management files to include support for all columns on the drawdown worksheet. Notations should be made to any deviations from attached support.
- Maintain adequate documentation to support estimated other expenditure amounts. This includes original request from program staff and managers, purchase orders and/or invoices, and a follow-up on whether the funds claimed were expended within the required three business days.
- Ensure that all worksheets that support drawdowns are reviewed for accuracy and compliance and such reviews are appropriately documented.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-09 – Oversight of Charter Schools

U.S. Department of Education

Title I, Part A (84.010); Special Education (84.027); Improving Teacher Quality State Grants (84.367)

Award Year: 2006 – September 2007; July 2007 – September 2008

Criteria: 34 CFR 80.40 states, "Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity."

Hawaii Revised Statutes (HRS) 302-B outlines requirements and responsibilities of charter schools.

Condition/Context: We noted that the Department does not adequately monitor the charter schools' use of federal funds.

Allocations of federal funds are made from the Department to the Charter School Administrative Office, which then distributes the funds to the individual charter schools. Start-up and certain conversion charter schools use accounting systems independent of that used by the Department. This makes fiscal oversight difficult for Department officials.

A charter school review panel ("panel") was created by Act 115 of the 2007 Legislative Session to address the issues of charter school accountability. HRS Section 302B-14 requires charter schools to "conduct annual self-evaluations that shall be submitted to the panel within sixty working days after the completion of the schools year." This process is limited to an evaluation of the charter school's organizational viability, among other things. Section 302B-1 defines organizational viability as a charter school that "complies with applicable federal, state, and county laws and requirements," among other things.

The Department's oversight of charter school funds is limited to a review of a fiscal requirement report that contains a budget plan for the upcoming fiscal year. After federal funds are distributed to the charter schools via the Charter School Administrative Office, the Department does not ensure applicable compliance requirements are met.

Although charter schools are exempt from certain state laws, charter schools receiving federal funds are not exempt from federal compliance requirements.

Cause: Program officials cite their lack of authority over charter schools.

Effect: This lack of oversight creates the potential for misappropriation and abuse of federal funds.

Questioned costs: None.

Recommendation: Although state law delegates general charter school oversight to the charter school review panel, final oversight should be maintained within the Department's applicable program sections.

We recommend that program officials implement policies and procedures to ensure that charter schools receiving federal funds are in compliance with federal requirements.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-10 – Eligibility

U.S. Department of Education
Title I, Part A
CFDA No: 84.010
Award Year: 2007 – 2008

Criteria: 20 USC 6315 states that Title I funds are to be used to provide services and benefits to eligible children residing in or enrolled in eligible school attendance areas. Once funds are allocated to eligible schools, a school operating a targeted assistance program must use Title I funds only for programs that are designed to meet the needs of children identified by the school as failing or most at risk of failing, to meet the State's challenging student academic achievement standards. In general, eligible children are children who are economically disadvantaged, children with disabilities, migrant children, and limited English proficient children.

Condition/Context: During our testing of 25 students for compliance with eligibility requirements, management was unable to provide us with applications for three students' free and reduced lunch status.

Cause: Management noted that the paper applications were misplaced.

Effect: Without proper documentation, management cannot support a child's free and reduced lunch status that would qualify the children for federal benefits.

Questioned costs: None.

Recommendation: We recommend that management be more diligent in maintaining students' applications.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-11 – Matching, Level of Effort, and Earmarking

U.S. Department of Education
Adult Education
CFDA: 84.002
Award Year: 2007 – 2008

Criteria: According to 20 USC 9222(b), each State eligible agency providing adult education shall provide a non-federal contribution of at least 25% of the total amount of funds expended for adult education in the state.

Condition/Context: The Department does not monitor matching, level of effort and earmarking requirements throughout the year.

Cause: The above condition was caused primarily by management oversight.

Effect: Failure to monitor its matching, level of effort, and earmarking requirements may cause the Department to be in noncompliance at year end.

Questioned costs: None.

Recommendation: We recommend that the Department implement procedures to ensure that matching, level of effort, and earmarking calculations are monitored throughout the year. This may include the use of a standard worksheet that is maintained throughout the year by one or more individuals, and reviewed by management at the end of the period.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-12 – Equipment and Real Property Management

U.S. Department of Education
Career and Technical Education
CFDA: 84.048
Award Year: 2007 – 2008

Criteria: OMB Circular A-102 Common Rule requires States to use, manage, and dispose of equipment acquired under a Federal grant in accordance with State laws and procedures.

Condition/Context: The Department failed to record in State inventory records three items totaling $48,862 purchased with federal funds during fiscal year 2008. Total program equipment additions amounted to $614,885 for fiscal year 2008.

Cause: The above condition was caused by the failure of program staff to notify the Departmental office that handles the inventory and property records.

Effect: Failure to include purchases on inventory records prevents officials from monitoring States' assets.

Questioned costs: None.

Recommendation: We recommend that the Department implement procedures to ensure that inventory personnel are notified of invoices containing eligible equipment. State asset tags should be distributed when equipment is recorded in inventory records.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-13 – Special Tests and Provisions – Required Level of Expenditures

U.S. Department of Education
Impact Aid
CFDA No. 84.041
Award Year: 2007-2008

Criteria: 34 CFR 222.53 (d) states that, "an LEA is to account for the use of section 8003(d) funds by demonstrating that, for each fiscal year, the amount of expenditures for special education and related services provided to the federally connected children with disabilities is at least equal to the amount of section 8003(d) funds received or credited for that fiscal year." The LEA must calculate an average daily attendance (ADA) expenditure amount for all federally connected children with disabilities claimed during the year. If the amount of section 8003(d) funds received exceeds the ADA expenditure amount an overpayment is established. "This overpayment may be reduced or eliminated to the extent that the LEA can demonstrate that the average per pupil expenditure for special education and related services provided to federally connected children with disabilities exceeded its average per pupil expenditure for serving non-federally connected children with disabilities."

Condition/Context: The Department was unable to provide us with documentation to support the required level of expenditures.

We also noted that the Department lacks controls to adequately monitor its requirements over special tests and provisions.

Total Impact Aid expenditures were approximately $56,936,000 for the fiscal year ended June 30, 2008.

Cause: The above conditions were caused primarily by management oversight and lack of sufficient staff resources.

Effect: Noncompliance and failure to monitor this requirement may lead to a reduction or discontinuation of future federal funding.

Questioned costs: None.

Recommendation: The Department should consider implementing an integrated database of federally and non-federally funded children with disabilities to ensure that data is easily accessible and monitored throughout the year.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-14 – Allowable Costs – Native Hawaiian Education – Unallowable Costs of Entertainment

U.S. Department of Education
Native Hawaiian Education
CFDA No. 84.362
Award Year: 2007-2008

Criteria: OMB Circular A-87 *Cost Principles for State, Local, and Indian Tribal Governments* Attachment B 14 states "costs of entertainment…such as tickets to shows…are unallowable."

Condition/Context: A Maui District school expended approximately $88,500 in Native Hawaiian Education funds to send a sixth grade class to New York City and Washington D.C. in support of the school's program objectives designed to "enrich the children's experiences by placing them in other real-world environments where they can see, touch, and interact with primary sources of information on careers, action on current issues, and cultural/national history." Expenditures consisted of airfare, ground transportation, and per diem.

We noted charges made for 31 tickets to "The Lion King" and to "Stomp" totaling $6,200. OMB Circular A-87 prohibits show tickets from being charged to federal programs, unless pre-approved by the awarding agency.

Cause: School personnel were unaware of this restriction.

Effect: Expenditure of federal funds for unallowable activities may subject the program to increased scrutiny over its expenditures, possible loss of future funding and return of funds for unallowable costs.

Questioned costs: $6,200, calculated as 31 tickets at $135 and $65 each.

Recommendation: We recommend that the Department ensure that federal funds are not expended for costs that are unallowable. Prior federal approval should be obtained for any potential questionable costs.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-15 – Procurement, Suspension, and Debarment

U.S. Department of Education

Title I, Part A (84.010); Career and Technical Education (84.048); 21st Century Community Learning Centers (84.287); Grants for States Assessments (84.369); Improving Teacher Quality State Grants (84.367)

Award Year: 2007 – 2008

Criteria: March 2007 Office of Management and Budget Circular A-133 Part 3 I. *Procurement and Suspension and Debarment*; Hawaii Revised Statutes (HRS) 103D; Hawaii Administrative Rules (HAR) 3-120-4 and 3-122-75.

The Department is required to "use the same State policies and procedures used for procurements from non-Federal funds." Pursuant to HRS and HAR, the Department is required to "cite on the purchase order or on the contract, the authority waiver as "Exempt from Chapter 103D, HRS, pursuant to section 3-120-4(b) (cite exemption number from exhibit)." In addition, the Department is required to obtain no less than three quotes for purchases between $5,000 and $15,000; for purchases between $15,000 and $50,000 the three quotes must be written.

Condition/Context: We selected a sample of 25 procurement items for each of the seven major programs for which this requirement was applicable for a total of 175 items tested. We noted noncompliance regarding the Department's failure to obtain the required three quotations for purchases exceeding $5,000 from vendors not on the State's approved vendor list.

A summary of programs and total instances and amounts involved is as follows:

Adult Education	1 instance	$8,874
Title I	1 instance	$9,229
Career and Technical Education	2 instances	$11,212
21st Century Community Learning Centers	3 instances	$21,146
Grants for State Assessments	2 instances	$29,750
Improving Teacher Quality	1 instance	$27,455

Cause: The above conditions were primarily due to management and personnel oversight.

Effect: The Hawaii Procurement Code, HRS 103D, was developed in part to ensure that public money is expended using the best interests of the public and that funds are expended in an equitable manner. The conditions noted above resulted in noncompliance with HRS 103D.

Questioned costs: None.

Recommendation: We recommend that the Department be more diligent in complying with applicable procurement requirements.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-16 – Period of Availability

U.S. Department of Education

Special Education (84.027); Native Hawaiian Education (84.362); Improving Teacher Quality State Grants (84.367)

Award Year: 2007 – 2008

Criteria: 34 CFR 76.703 & 76.709: SEAs must obligate funds during the 27 months, extending from July 1 of the fiscal year for which the funds were appropriated through September 30 of the second following fiscal year.

Condition/Context: For Native Hawaiian Education and Improving Teacher Quality State Grants, we noted cash balances of $59,525 and $48,521, respectively, remained after the fiscal year 2006 grant award periods of availability ended on September 30, 2007.

We also noted that an expenditure related to services rendered in 2002 was charged to the Special Education 2007 grant year in the amount of $289.

Cause: Fiscal personnel failed to apply payments made within the period of availability to the proper grant year.

Effect: Balances held in excess of amounts necessary could result in noncompliance with cash management requirements.

Questioned costs: $289.

Recommendation: We recommend that the Department prepare timely adjustments within the period of availability to charge the proper grant award.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-17 – Special Tests and Provisions – Highly Qualified Teachers and Paraprofessionals

U.S. Department of Education
Title I, Part A
CFDA No. 84.010
Award Year: 2007-2008

Criteria: 34 CFR 200.55 requires that each State that receives funds under subpart A of this part, and each LEA in that State, must ensure that all public elementary and secondary school teachers in the State who teach core academic subjects, including teachers employed by an LEA to provide services to eligible private school students under Sec. 200.62, are highly qualified as defined in Sec. 200.56.

Condition/Context: Per review of the 2007 – 2008 school year "Annual Financial Plans," school "Progress Reports," and school "Trend Reports" we noted that none of the ten schools selected for testing met the requirement that 100% of its teachers teaching core classes be "highly qualified."

Cause: The above conditions were primarily due to a shortage of qualified teachers available to fill positions.

Effect: Noncompliance with this requirement will prevent the schools from reaching their full potential in delivering quality education to the children of the State of Hawaii.

Questioned costs: None.

Recommendation: The Department has noted that they have been working with the U.S. DOE in implementing a plan to alleviate this condition.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

Finding 2008-18 – Indirect Costs

U.S. Department of Education

Title I, Part A (84.010); Improving Teacher Quality State Grants (84.367)

Award Year: 2007-2008

Criteria: 2008 OMB Circular A-87 *Cost Principles for State, Local, and Indian Tribal Governments* Attachment E D3 requires management to certify that all costs that are claimed for the indirect cost proposal are allowable and in accordance with federal regulations.

Condition/Context: The Department failed to include the required certification in its indirect cost proposal for fiscal year ended June 30, 2008.

In addition, correspondence dated July 18, 2008 from the U.S. DOE to the Department required the Department to reduce fiscal year 2008 indirect cost billing under federal awards to reconcile with the adjusted 2008 indirect cost rates. The Department's Internal Auditor was to provide an attestation to U.S. DOE that the reconciliation was properly accomplished. The Department failed to submit the required attestation.

After bringing the above conditions to the attention of management, the Department requested and was granted an extension to April 9, 2009 for its attestation submission to U.S. DOE.

Total indirect costs claimed for all federal programs for year ended June 30, 2008 was approximately $2,152,000.

Cause: The above condition was caused primarily by management oversight. Furthermore, the Internal Audit department was unaware of such a correspondence from U.S. DOE.

Effect: Failure to comply with federal regulations regarding indirect cost proposals may subject the Department to future restrictions and increased scrutiny on the claiming of indirect costs. This may further lead to unnecessary administrative costs.

Questioned cost: None.

Recommendation: We recommend the Department ensure that the required certifications are completed and maintained on file. The Department should also be more diligent in responding to requests from U.S. DOE on a timely basis.

Views of the responsible official and planned corrective actions: Refer to Response of Affected Agency.

PART V

CORRECTIVE ACTION PLAN

(Provided by the Department of Education, State of Hawaii)

LINDA LINGLE
GOVERNOR

PATRICIA HAMAMOTO
SUPERINTENDENT

STATE OF HAWAI'I
DEPARTMENT OF EDUCATION
P.O. BOX 2360
HONOLULU, HAWAI'I 96804

OFFICE OF THE SUPERINTENDENT

May 14, 2009

Grant Thornton LLP
1132 Bishop Street, Suite 2500
Honolulu, HI 96813-2864

Ladies and Gentlemen:

The Single Audit of the State of Hawaii Department of Education (HIDOE) for the fiscal year ended June 30, 2008 was completed and ready for submission before the March 31, 2009 federal deadline. However, two 30-day extensions were requested and granted by our cognizant agency, the U.S. Department of Education.

The extension requests were due to a late notification from the State of Hawaii of a change in the State's policy on a write-down of investment assets, which was received on Friday, March 27, 2009. Due to this change in policy, the HIDOE was required to perform calculations on its investment pool assets, and these calculations required Grant Thornton to audit these calculations.

The prior year's audit was not completed until August, 2008. By that time, the 2007-08 fiscal year had already ended. Therefore, repeat findings have occurred.

We are pleased with the unqualified opinion on the Department's financial statements. The prior year's qualified opinion and workers' compensation reserve liability issue have been resolved in this current audit.

Your audit findings and recommendations have been reviewed and a corrective action plan has been prepared. In accordance with OMB Circular A-133, on the following pages contain the **Corrective Action Plan** for the year ended June 30, 2008 and **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2007.

Very truly yours,

Patricia Hamamoto

Patricia Hamamoto
Superintendent

PH:JMB:dy

Attachments

FINANCIAL STATEMENT FINDINGS

2008-01 Error Corrections *(Pages 60 to 62)*

Corrective Action Plan

The financial audit report by Grant Thornton LLP for the prior fiscal year ended June 30, 2007 was not completed and issued until August 14, 2008, which was after the end of the current audited fiscal year ended June 30, 2008. Therefore, several findings in the 2007 audit are repeated in the 2008 audit report.

*As mentioned in the prior year 2007 audit report, several factors and circumstances contributed to the challenges in the Department of Education's Accounting Section. **Attachment A** is a graphical depiction of the events that have occurred, affecting the 2007 and 2008 audits. These factors and circumstances are also listed below:*

- *Retirement of six (6) key seasoned veterans in Accounting, (representing over one-third of the positions) with a combined total of over 175 years of Department of Education accounting experience.*
- *Hiring of new staff that had to focus on day-to-day processing.*
- *Delays in hiring additional replacement staff.*
- *Termination of employment of one account clerk, and the resulting vacancy not filled for over one year.*
- *Absence of another accountant position for over one year.*
- *Other conditions resulting in the absences of two other accountants.*
- *Complexity of Capital Improvement Program (CIP) accounting and coordination due to responsibilities transferred from the Department of Accounting & General Services (DAGS).*
- *Strains placed on the new staff due to the vacancies without staffing relief.*
- *Resignations of two accounting supervisors, in April 2008.*
- *Resignations of four accountants: three in April and one in June 2008.*

The Department has taken action by hiring temporary personnel into the vacant positions, and has now replaced several personnel vacancies with new hires. In addition, retiree accountants on contract are assisting the Accounting Section by providing consultation, training and support.

The following paragraphs highlight the improvements made in 2008, and actions being taken to address the specific areas mentioned in the auditor's recommendations:

<u>Timeliness of audit completion</u>: The prior year 2007 audit report was not completed and issued until August 14, 2008, which was five (5) months past the Federal deadline of March 31, 2008. At that time, the Department obtained three deadline extensions from its cognizant agency, the U.S. Department of Education. For the current year 2008 audit, with newly-hired staff, with assistance from an external accounting firm, and the recently-hired Accounting Director working with the auditors, the audit report is being submitted on-time, on or about the Federal deadline of March 31, 2009.

<u>Assessment of control processes, procedures and resources</u>: The Department has developed process flow maps of its current processes and procedures in accounting, vendor payment, payroll and fixed assets inventory, and will be implementing improvements to increase efficiencies and effectiveness. In addition, for year-end accruals of expenditures, efforts will be focused on detailed review of the data, to ensure accuracy of the accruals. The Department is also saddled with outdated computer systems. Most of the audit findings could be remedied or addressed with up-to-date computerization and "dashboard" financial management reports. The Department's current financial system was developed almost 20 years ago, and is now obsolete, written in COBOL language. We have developed comprehensive documentation on requirements to replace the financial system, and are determining the financial feasibility of investing in current web-based financial software, as a replacement.

<u>Reconciliation of accounts</u>: During the prior year audit, the Accounting Section did not reconcile its bank accounts in a timely manner. That situation has been completely corrected in the current year audit. Regarding other reconciliations, since the Department has separate accounting records from the State Department of Accounting & General Services (DAGS), more than 800 appropriation reconciliations must be prepared and maintained, including approximately 700 for the Capital Improvement Program (CIP). Due to massive staff turnover in the Accounting Section in 2008, those reconciliations were backlogged. We have since taken corrective action. In order to address the backlog, we engaged the services of an accounting firm to assist with the reconciliations.

In preparation for the 2009 audit, the Accounting Section is already preparing updated reconciliations. In accordance with the auditor's recommendations, the Accounting Section will implement effective procedures and processes to ensure that appropriation reconciliations are completed regularly, and are reviewed and initialed by supervisors, to maintain reconciled balances with the DAGS Financial Accounting & Management Information System (FAMIS) on an accurate and timely basis. It is imperative that the Department's records are reconciled with DAGS, since the DAGS FAMIS records are used to prepare the State Consolidated Annual Financial Report (CAFR), of which the Department of Education is one of the largest components. All newly-hired staff accountants have already been trained on the reconciliation process. The accounting supervisors will check for accuracy, completeness, and that adjustments are properly made in a timely manner.

<u>Analytical procedures</u>: The Accounting Section will develop Standards of Practice (SPs) to ensure that analytical procedures are performed on the financial statements and supporting information, to identify large or unusual fluctuations for review and resolution. As recommended by the auditors, these analytical procedures will include comparisons of current year to prior year results; budget-to-actual results; and review of statistical reports.

<u>Property and equipment:</u> The Accounting Section will continue to work with the Office of School Facilities and Support Services (OSFSS) to ensure that the capital asset workpapers, including Capital Improvement Program (CIP) assets and construction in progress, will be properly accounted for, in preparation for the next fiscal year ended June 30, 2009. This will include detailed reviews of the CIP projects, to ensure that completed projects are transferred to depreciable assets in a timely manner.

<u>Detailed review of audit workpapers</u>: As mentioned earlier, the prior year 2007 audit was not completed until August 2008, which was already past the fiscal year end of June 30, 2008 pertaining to this current audit. With the audit preparation time for the current audit starting already behind schedule, coupled with the lack of sufficient staff resources, the Accounting Section engaged the services of an accounting firm to provide assistance. Unfortunately, due to the timelines required, the Accounting Section did not have sufficient time to review the accounting firm's workpapers in detail. For next year's audit, the Accounting Director and the Accounting Section supervisors will perform a detailed review of workpapers prepared for the annual audit. As recommended by the auditors, the Department will make a determination as to whether these functions can be achieved with its current resources, or whether other assistance will be sought.

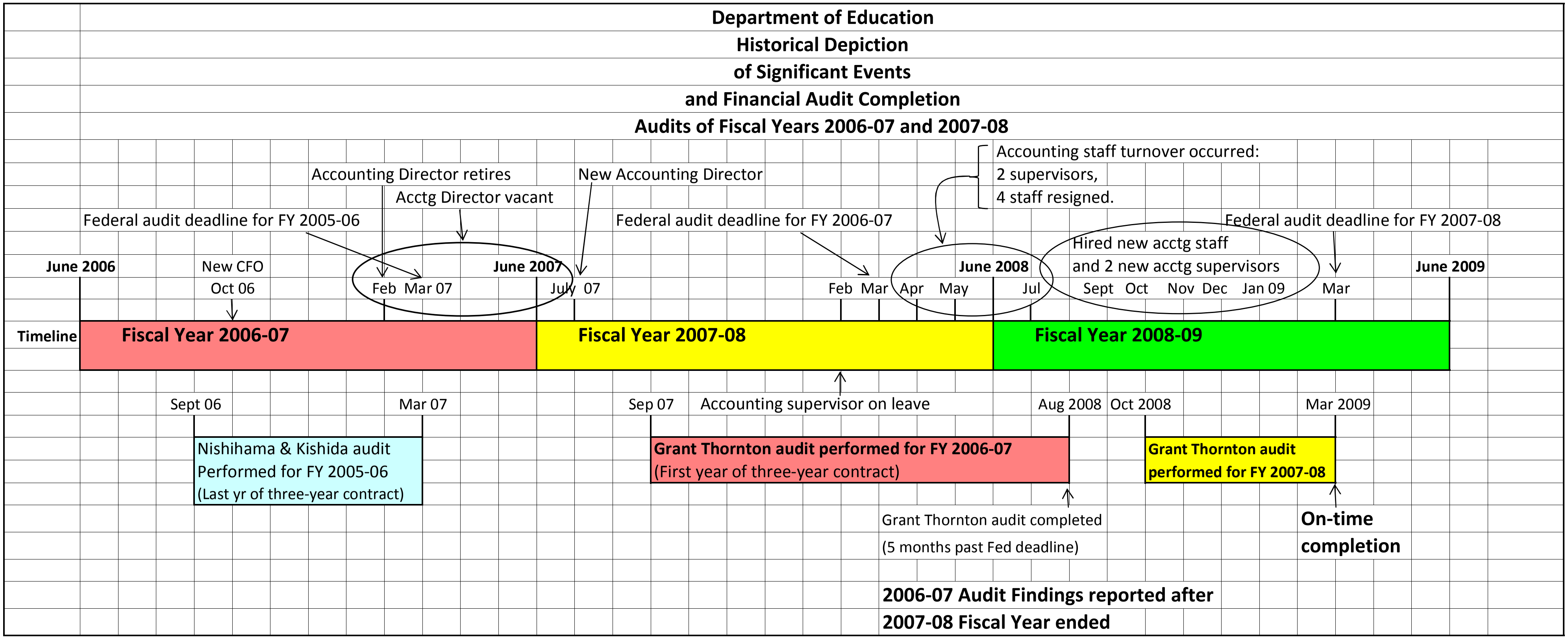
Contact Persons: Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Roy Tomasu, Fiscal Specialist III
Accounting Section
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: March 31, 2010

*(Please also refer to **<u>Attachment A</u>** for a historical depiction of significant events affecting the financial audit.)*

Attachment A



2008-02 Accounting for Compensated Absences *(Page 63)*

Corrective Action Plan

The financial and compliance audit report by Grant Thornton LLP for the prior fiscal year ended June 30, 2007 was not completed and issued until August 14, 2008, which was after the end of the current audited fiscal year ended June 30, 2008. Therefore, several findings in the 2007 audit are repeated in the 2008 audit report.

The Department's corrective action plan for employee sick and vacation leave consists of three major initiatives:

1. Clearing of employee leave processing backlog

As reported in the prior year, the Department has contracted the services of a certified public accounting and consulting firm to assist with clearing the backlog of processing employee leave accounting reports. The existing employee leave accounting system was developed in the 1980s and has not been modified since its inception.

Updating employee leave records in the Department is a difficult time-consuming process, because of the large number of employees in the Department and the complex variety of leave accrual rules which must be followed for different types of employees to comply with various union contract provisions. In most other state agencies, employees simply earn 14 hours of sick and vacation leave each month, which may be prorated based on the actual number of days the employee is on paid status during the month. In the Department of Education, there are basically 4 categories of employees with different leave accrual rules:

(a) 10-month certificated employees, or teachers, who are credited with 18 days of sick leave at the beginning of each school year.

(b) 10-month classified employees, like Educational Assistants, who are credited with 144 hours of sick leave at the beginning of each school year.

(c) 12-month certificated/classified employees, who earn the normal 14 hours of sick leave and vacation leave each month.

(d) 12-month teachers and registrars, who earn 21 days of sick leave and 14 days of vacation leave each year.

With the assistance of the CPA consulting firm, we continue to make substantial progress towards clearing of the backlog of processing employee leave accounting reports.

2. Conversion to a new KRONOS time and attendance and payroll system

As reported in the prior year, the Department is in the process of converting to a new KRONOS time and attendance and payroll system. The new system is expected to streamline the procedures for employee leave balances, and will be able to provide updated information in a timely manner. The time and attendance portion is being implemented in a phased approach, with full implementation by April 2009. The payroll portion is in the process of being tested, and its implementation date is anticipated to be during fiscal year 2009-10. The overall project has been challenging due to the complexity of payroll for the various classifications of our employees, due to collective bargaining negotiated pay characteristics that vary significantly by employee classification.

3. Fiscal year-end accrual of vacation leave balances

It should be noted again here that the financial and compliance audit report by Grant Thornton LLP for the prior fiscal year ended June 30, 2007 was not completed and issued until August 14, 2008, which was after the end of the current audited fiscal year ended June 30, 2008. Therefore, several findings in the 2007 audit are repeated in the 2008 audit report.

Due to the fact that some schools had not yet converted to the KRONOS time and attendance system during the audit period, numerous employee vacation and sick leave balances have been maintained on the statewide antiquated manual recordkeeping system, on hard copy forms. The Department initiated a quarterly leave balance worksheet, on which schools and offices are certifying as to the accuracy of the manually-kept employee leave balance records. In certain instances, due to the backlog of leave recordkeeping at schools, certifications were not received in the central office in a timely manner. Accordingly, for some of those employee leave balances tested in the audit sample, the reasons for the errors were due to data for pay rates, leave hours, and also data for one "retired employee"(retired in 2008), that were effective for the prior year, and not updated for the current fiscal year. The Department had developed an in-house customized computer program to calculate the leave balance accruals. This program should have been reviewed to ensure that up-to-date data is obtained to calculate the leave balance accruals for schools that had not yet converted to the KRONOS time and attendance system.

In order to ensure the accuracy of the year-end calculations, the Department's Accounting Section will continue to take a more active role in determining the calculation methodology; coordinating the payroll data retrieval; and verifying the accuracy of the accrual calculations. For the next year's audit, since all schools will be converted to the KRONOS time and attendance system, we do not anticipate any significant amount of errors compared to this current 2008 audit. In addition, the Accounting Director and Accounting Section supervisors will review the information for accuracy prior to submitting the accrual workpapers to the auditors.

Contact Persons: *Edwin Koyama, Accounting Director*
Administrative Services Branch
Office of Fiscal Services

Roy Tomasu, Fiscal Specialist III
Accounting Section
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date:	*Clearing of backlog:*	*(est.) December 2010*
	Year-end accrual:	*March 31, 2010*

2008-03 ***Improve Compensating Controls for Inadequate Segregation of Duties over Agency Funds and Processing of Transactions*** *(Pages 64 to 66)*

Corrective Action Plan

Beginning with school year 2007-08, the Department implemented an Annual Checklist for Compliance of Local School Fund Procedures for all schools. Each school is required to certify that specific steps have been completed, such as:

- *Bank reconciliations completed;*
- *Annual Principal Financial Report completed and signed;*
- *Administrator's Checklist completed and signed;*
- *Money Raising and Donations are summarized and accounted for;*
- *Training sessions attended;*
- *Cash receipts and disbursements are accounted for;*
- *Petty cash accounted for; and*
- *Fixed assets inventory updated.*

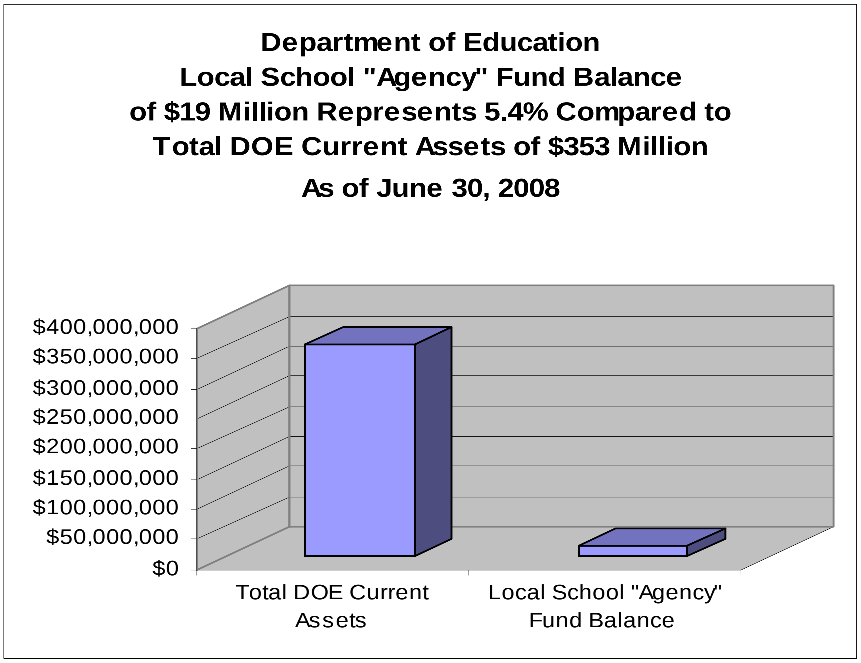
This Checklist is required to be submitted to the Department's Internal Audit Office by August 15 of every year. Schools that do not submit copies of the completed Checklists are placed on a site visit list. The Department's Internal Audit Office will visit those schools on a random basis, to investigate the reasons for the non-response, and will also perform random site visits of other schools to assess compliance (post-audit), as well as to review corrective action plans from prior audits.

These procedures will result in strengthened internal controls, and are expected to result in substantial reductions in the occurrences of these local school fund audit findings.

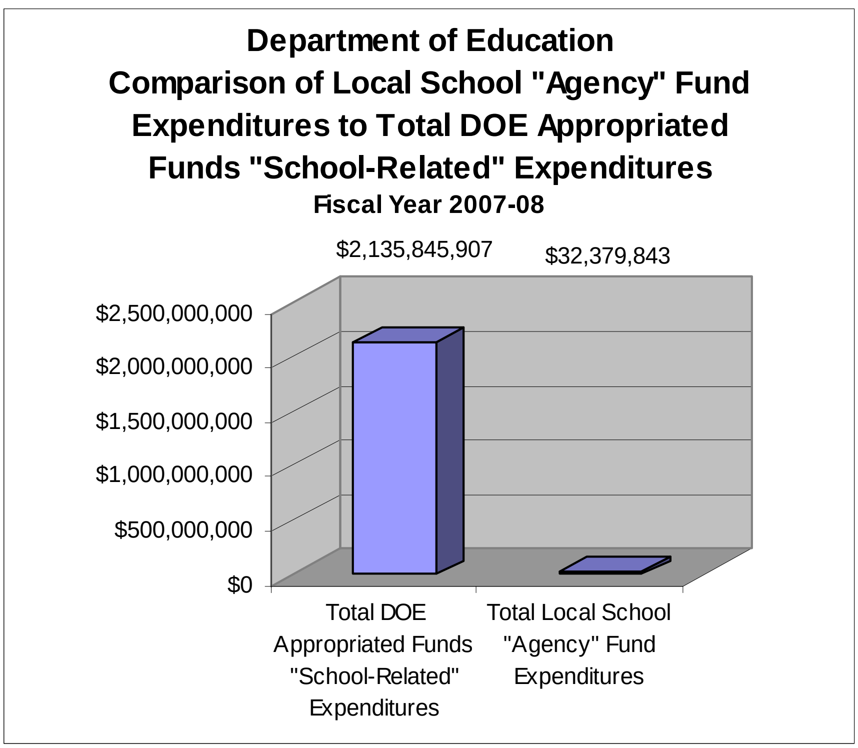
In addition, the Department now has Complex Area Business Managers (CABMs) in each of the fifteen (15) complex areas. The CABMs assist the Complex Area Superintendents in monitoring all 257 schools across the State of Hawaii, and they assist schools to comply with fiscal procedures, including local school "agency" funds.

Contextual information
The Department appreciates the auditor's findings pertaining to local school "agency" funds. Since those are "liquid" assets, they are of "high risk" and the findings must be given urgent attention. In addition, since these "agency" funds are held by schools on behalf of student activity transactions, the Department recognizes that it has a fiduciary responsibility to account for these transactions properly. Concurrently, however, we also believe the findings should be considered in appropriate context, in comparison to the total Department current assets, and expenditures under its purview.

The Department's local school "agency" fund balance of $19 million represents 5.4 percent compared to the total Department current assets of $353 million as follows:



In addition, the Department's local school "agency" fund expenditures of $32 million represents 1.5 percent compared to the total Department appropriated fund "school-related" expenditures of $2.1 billion, as follows:



*Please see **Attachment B** for details of each Complex Area Business Manager as contact persons, for the specifics of additional corrective action plans for each of the 15 complex areas across the state, with anticipated completion dates.*

*Contact Persons: Please refer to **Attachment B**.*

*Anticipated Completion Dates: Please refer to **Attachment B.***

Improving Compensating Controls for Inadequate Segregation of Duties over Agency Funds **Attachment B**

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Farrington-Kaiser-Kalani	**May K. Price**	All schools have been provided a copy of the "Administrator's Checklist" for Non-Appropriated Local School Account. Principals will be reminded to use checklist which addresses all compensating controls. SASAs have been requested to monitor completion of the checklist. The CABM will visit each school to monitor the use the "Administrator's Check List."	4/2009
Kaimuki-McKinley-Roosevelt	**Elden Nakamura**	According to FMS User Policy 9.7 **Compensating Internal Accounting Controls** When staffing limits the extent of separation of duties, the principal or designee shall provide for compensating controls at each school or office. (Administrator's Check List)	
		For Kaimuki-McKinley-Roosevelt Complex Area Schools, a revised Administrator's Checklist was presented to SASA's, Account Clerks, and Clerks that attended the Bank Reconciliation Training for Honolulu District Schools on February 23rd, 2009and February 25th, 2009.	2/25/2009
		In addition, with the support of the Complex Area Superintendent, the Kaimuki-McKinley-Roosevelt Complex Area Business Manager will present the revised Administrator's Checklist to the complex area principals at the Complex Principals' Meetings in April. The importance of adequate compensating controls will be stressed to minimize the chance of errors and the misappropriation of funds.	April 2009
		Beginning March 16, 2009, bank reconciliations will be submitted to the Complex Area Business Manager for review. The Complex Area Business Manager will review the following: 1. Bank reconciliations are done monthly. 2. The bank reconciliation amount matches the check register. 3. Stale dated checks (checks over 6 months old) are written off with a journal voucher. 4. Review the bank statement for any unusual entries. 5. Review the check register for any unusual adjustments. 6. Looking to see that the principal or designee signs/approves the bank reconciliation and bank statement.	3/16/2009 4/16/2009 5/15/2009 6/15/2009 7/15/2009

Improving Compensating Controls for Inadequate Segregation of Duties over Agency Funds **Attachment B**

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Aiea-Moanalua-Radford	**Adrienne Freitas**	Business Manager or designee will periodically make unannounced visits to the schools to perform the Administrator's Checklist.	07/01/2009 and beyond: continuous
Leilehua-Mililani-Waialua	**Judy Skeen Gray**	Conduct site visits to assess current practices. Meet with school Administrator and SASA to review current practices. Provide school with options on assignment of duties to available office personnel in order to segregate cash functions and train on procedures as needed.	06/30/2009
Campbell-Kapolei	**Michael N. Tanaka**	Emailed to each principal and SASA the Administrative Checklist to document duties and frequency of activity required. For schools with only a SASA and one account clerk, CABM or ASA will visit school semi-annually to perform compensating controls.	6/30/2009 and beyond: continuous
Pearl City-Waipahu	**Lawrence Suan**	Complex area schools are to keep on file an Administrators Check List. There will be a hard copy of this list in office with <u>dates of review for compensating controls</u> for agency funds. Document to be signed by school Principal on a quarterly basis. Employees who process various agency fund functions will be identified and sign off as well. We will verify that this document is on file at complex area schools. Use of Form 434 (Report of Gifts, Grants and Bequests). A file of supporting documentation (letters, memorandum, check copies, etc.) for all donations received should be maintained. The acceptance letters to Superintendent for donations of $500.00 should be on file as well. Journal Vouchers are to be supported with source documents and signed by an <u>*authorized designated employee.*</u> A list of <u>*Authorized Check Signers*</u> for agency funds will be kept on file. All signers listed should current school personnel. Mini-audits of agency fund functions and documents – deposits (WIZ Receipts), disbursements (Purchase Orders), "bad checks" listing (Form 411) among others to test for FMS compliance have done at complex area schools. Efforts to complete for all complex area schools are ongoing.	Verification of agency fund controls for all complex area schools: 06/30/2009 Mini-Audits of Agency Fund documentation for all complex area schools: 06/30/2009
Nanakuli-Waianae	**Earlyne Harada**	The Business Manager will review the segregation of duties policies with the appropriate staff at each school, and help to put into place internal controls as required. The Business Manager will then do a monthly check of compensating controls and provide a monthly report of the findings to the principal.	Reviews will begin as of March 1, 2009

Improving Compensating Controls for Inadequate Segregation of Duties over Agency Funds

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Caste-Kahuku	**Cindi Ahuna**	☐ Revised Non-Appropriated Local School Fund Administrator's Checklist to be more user friendly (see attached) o Included recommended frequency & person responsible o Added months in the left columns	December 2008
		☐ Held training for principals on the following: o Completing each section o Filling out the Administrator's Checklist o Importance of completing the Checklist	December 2008
		☐ For schools that have requested assistance we will complete the following sections as designees: o Daily Cash Deposit o Disbursement Documentation o Journal Vouchers	March 2009 – April 2009
		☐ Created Local School Account binders for each school. Each binder includes a section for the Administrator's Checklist. We will be monitoring the completion of the Checklist.	February 2009
		Reviewed and Trained SASAs individually at each school.	February 2009 – March 2009
Kailua-Kalaheo	**Sydney Kline**	☐ Revised Non-Appropriated Local School Fund Administrator's Checklist to be more user friendly (see attached) o Included recommended frequency & person responsible o Added months in the left columns	December 2008
		☐ Held training for principals on the following: o Completing each section o Filling out the Administrator's Checklist o Importance of completing the Checklist	December 2008
		☐ For schools that have requested assistance we will complete the following sections	March 2009 –

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
		as designees: o Daily Cash Deposit o Disbursement Documentation o Journal Vouchers ☐ Created Local School Account binders for each school. Each binder includes a section for the Administrator's Checklist. We will be monitoring the completion of the Checklist. Reviewed and Trained SASAs individually at each school.	April 2009 February 2009 February 2009 – March 2009
Hilo-Laupahoehoe-Waiakea	**Adri Wilson**	To maintain consistency amongst all Complex Area schools, all school offices will adopt the compensating controls as discussed below: 1. Conducting periodic unannounced cash counts of the school or office petty cash fund ▪ Periodic cash counts will be conducted throughout the year by the following: o CABM (semi-annual) o ASA (semi-annual) o School administrator (quarterly) 2. Verifying that the monthly reconciliations between the bank statement and the school's register are being performed. The reviewer should sign both the documents if the reconciliation is completed ▪ School administrator will continue to verify the balances are reconciled on a monthly basis. ▪ CABM & ASA will communicate quarterly closing dates so ensure schools are properly informed of deadlines ▪ CABM will verify reconciliations are accurate during quarterly review ▪ CABM will verify new reconciliation formats are being used at all schools and reconciliations are done timely 3. Inspecting checks outstanding for more than six months ('stale' checks), during the review of the monthly bank reconciliation. These checks should be cancelled.	March 2009

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
		▪ CABM will verify that 'stale' checks are cancelled in a timely manner during quarterly review of bank reconciliations. 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 ▪ During quarterly review, CABM will perform sample testing of cash receipts to verify that dates on the Form 239 are the same as the bank deposit date. 5. The principal or administrator should prepare a report of the review 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. ▪ School administrators will continue to use the Administrator's Checklist to document the controls verified throughout the year. ▪ CABM will issue quarterly reports based on results of the reviews to document the areas reviewed, the date of the reviews, and discrepancies found. ▪ School will maintain copies of these reports for audit purposes.	
Kau-Keaau-Pahoa	**Karie Klein**	Ensure use of and completion of the standardized Administrator's Checklist by each school. This checklist encompasses the compensating controls. The quarterly mini-audit conducted by the CABM would include confirmation that the checklist shows signoff by the administrator.	Ongoing
Honokaa-Kealakehe-Kohala-Konawaena	**Scott Jeffrey**	In the absence of a Complex Area Business Manager (who is to start effective March 16, 2009), the CAS has tasked the ASAs to support and train their school complex' Principals, SASAs and Account Clerks as needed. ASAs will also cross-train in their area of expertise and assist other complex schools as requested. Beginning March 19, 2009, it is anticipated that the CABM and ASAs will begin on-site quarterly visits to complex schools. All reports to be submitted to the CAS for review and final approval.	June 2009
Baldwin-Kekaulike-Maui	**Kevin Drake**	The status of each school's compensating control program is being reviewed for effectiveness. The reviews, any process changes and any retraining of staff will be completed by the end of the 4th quarter.	June 2009

Improving Compensating Controls for Inadequate Segregation of Duties over Agency Funds

Attachment B

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Lahainaluna-Lanai-Molokai	**Nancy Hall**	Local School Fund (LSF) training by an Information Systems Training Section DP UST was held on Molokai so that all SASAs, or those employees responsible for bank reconciliation, are fully trained in all aspects of LSF accounting. All schools identified as needing further assistance have received one-on-one training by the CABM.	August, 2008
		SASAs in Hana, Lahaina, and Lanai have all received one-on-one training by the CABM.	Sept, 2008
		The results from the Annual Checklist for Compliance of Local School Fund Procedures FYE 6/30/08 was reviewed by the CABM with the CAS. The CABM then met with every SASA at every school in the Complex Area to review the results. Any deficiencies were discussed and corrective action plans were put in place at the schools.	Nov, 2008
		Every school in the Complex Area has been visited by the CABM and the Administrator's Checklist has been reviewed with every SASA. Spot audits have been performed at every school using the Administrator's Checklist so the following have all been reviewed and verified: • Cash counts of Petty Cash, if applicable • Verification of monthly bank reconciliations • Review cash collections for daily deposit • Review supporting documents for disbursements • Review outstanding checks to make sure none are more than 6 months old • Review JV documentation and Principal's signature Prior to year end, the Administrator's Checklist will be reviewed again at every school to ensure that the Principal or designee continue to review all of the above items. This will ensure segregation of duties as someone other than the SASA will be performing the tests.	March, 2009
Kauai-Waimea	**Gail Nakaahiki**	Kauai Complex Area has been conducting various training during this fiscal year including Local School Accounting. Training is a collaborative effort between ASAs, UST, and CABM. A workshop was held on October 3, 2008 by ASAs and CABM	October 3, 2008

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Kauai-Waimea (Continued)	**Gail Nakaahiki**	regarding the June 30, 2007 audit findings for the three Kauai high schools. We required our middle and high schools SASAs and Account Clerks attend. As part of the training, schools brought their FMS User Policy & Process Flow Guide and looked up policies and procedures cited in the audit.	
		On February 11 & 12, 2009, a mandatory hands-on workshop was held for all schools for the new mandated bank reconciliation Excel spreadsheet. The workshop was held at the Kauai Information Technology Center (ITC) and was conducted by the CABM with ASAs and UST assisting. Schools were required to bring their January 2009 bank statement and bank reconciliation from July – December 2008. Schools were required to send their SASA and other clerical personnel (Clerk Typist or Account Clerk). Two personnel per school were required to attend. If the primary clerical staff was absent, then the bank reconciliation could still be done by the other person trained. On the afternoon of March 11, 2009, we held a make-up class for the two SASAs that were unable to attend due to vacation/staff shortage along with school users that want/need additional training/assistance on the Excel bank reconciliation. Schools are required to start submitting to the CABM their monthly bank reconciliation for February 2009 to June 2009, due March 16 through July 15, 2009. ASAs will follow up with schools to get in by deadlines to the CABM.	February 11-July 15, 2009
		On the morning of March 11, 2009, we conducted a Local School Workshop for current users at the Kauai ITC. ASAs and CABM made a presentation on audit findings, including the Administrator's Checklist. The Private Secretary will go over Kauai's donation procedure. Schools will be required to bring their FMS User Policy & Process Flow Guide to look up policies and procedures cited in the audit. In addition to audit findings, we reviewed other concerns from schools e.g., sample excursion packets. As a follow up, ASAs will visit schools and see if addition assistance is needed.	March 11-June 30, 2009
		As a follow up to the LSA workshop, the CABM is planning to work with ASAs for fiscal year 2009-10, to visit a school monthly as a team and conduct mini audits, combining the Review Program shared at the last CABM meeting in January; Kauai's CABM/ASA checklist; and other tips shared by the OFS School Support Section at a recent audit of a Kauai school.	July 1, 2009-June 30, 2010

_2008-04_ **_Agency Fund Bank Reconciliations_** *(Pages 67 to 68)*

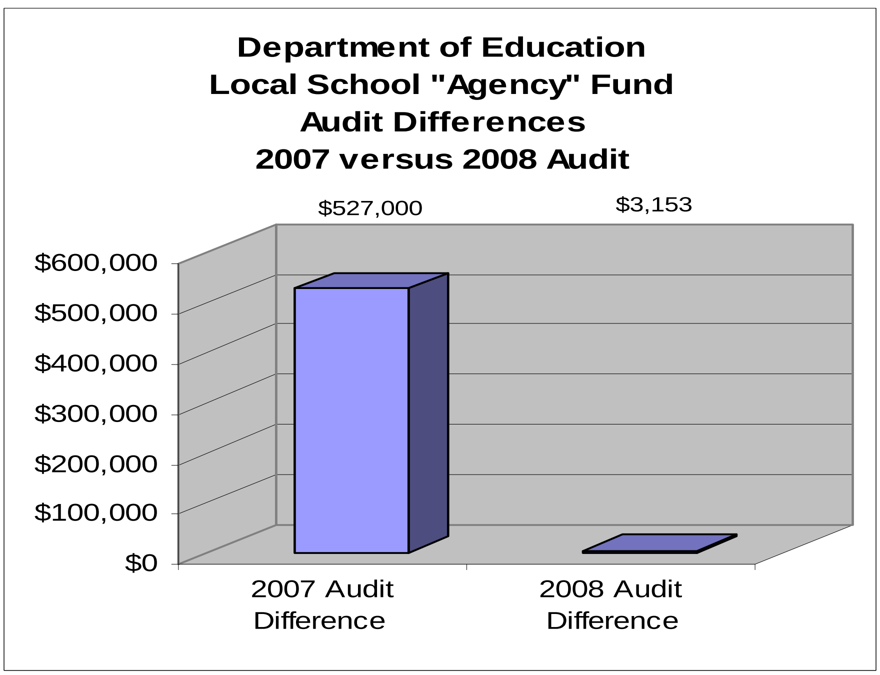
Corrective Action Plan

Standardized bank reconciliation procedures and templates
On January 23, 2009, the Superintendent directed all schools to comply with standardized bank reconciliation procedures and templates for all local school "agency" funds.

On January 7, 2009, all Complex Area Business Managers were trained on these standardized bank reconciliation procedures and templates, as well as on the corrective action plan with timelines.

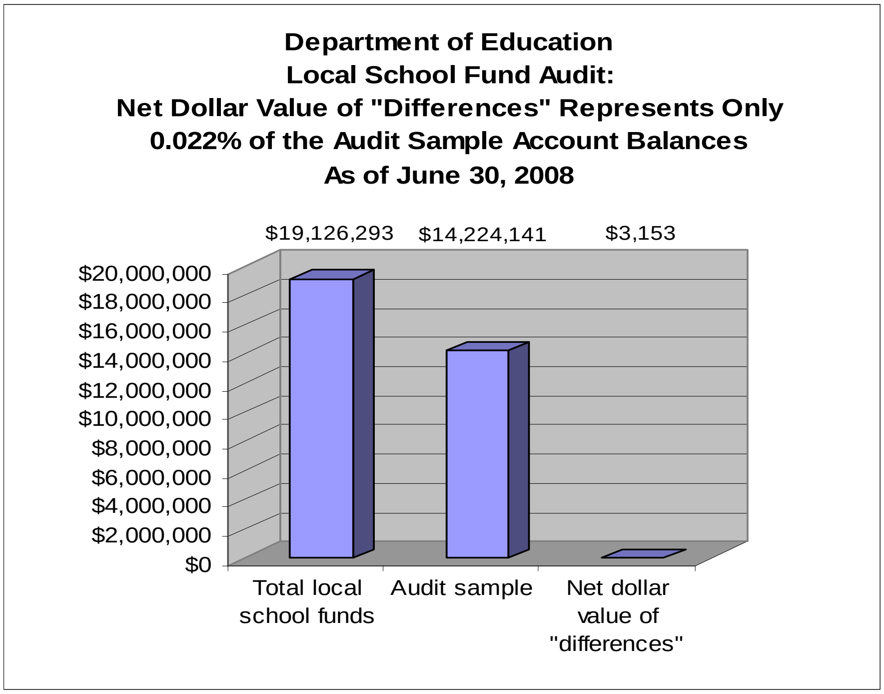
We anticipate that the implementation of these standardized bank reconciliation procedures and templates will serve to minimize or eliminate this audit finding.

Contextual information
In the prior year 2007 audit finding, the Department's "agency" funds were overstated by approximately $527,000, and an audit adjustment was made. In the current year, a net difference of $3,153 was determined to be small enough and therefore did not warrant an audit adjustment, as follows:



For the 2008 audit, the Accounting Section closely scrutinized the local school "agency" fund balances across all 257 schools, and ensured that the "agency" fund financial statement fund balance was properly accounted for. Therefore, no audit adjustments were necessary in the current 2008 audit. This represented a significant improvement over the prior year.

The 2008 audit finding indicates "forty (40) schools where either the cash on hand or investment balances on the reconciliations did not agree to the Principal's Financial Report as of June 30, 2008." These differences of 40 schools totaled to a net of $3,153. This represents only 0.022 percent of the audit sample account balances of $14 million, as follows:



In addition, as depicted above, the audit sample also represents 74 percent, or almost three-fourths (3/4) of the total local school "agency" fund balances as of June 30, 2008. Accordingly, although the wording of the finding implies differently, the Department has made <u>substantial progress</u> in improving the reconciliation process at the 257 schools.

The additional factor affecting these "differences" is that each school's local school fund balances must be extracted at fiscal year-end, and must be reported in the Department's Financial Management System (FMS) for summarization and reporting to the State Department of Accounting and General Services (DAGS) as part of the State's Consolidated Annual Financial Report (CAFR). If school data is not "closed" at fiscal year end, the data must be reviewed in detail by the Accounting Section and manually adjusted, school-by-school. For the 2008 audit, the Accounting Section made school-by-school manual adjustments, and thereby minimized these "differences," compared to the 2007 audit. As mentioned earlier, although prior year 2007 audit adjustments of $527,000 were needed, no audit adjustments were necessary in the current 2008 audit. This represented a significant improvement over the prior year.

Please refer to ***Attachment C*** *for details of each Complex Area Business Manager as contact persons, for the specifics of additional corrective action plans for each of the 15 complex areas across the state, with anticipated completion dates.*

Contact Persons: Please refer to ***Attachment C.***

Anticipated Completion Dates: Please refer to ***Attachment C.***

Agency Fund Bank Reconciliations

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Farrington-Kaiser-Kalani	**May K. Price**	All school personnel responsible for completing bank reconciliations are required to complete bank reconciliations on the standardized bank reconciliation template. Training will be provided to each school personnel responsible for completing bank reconciliations. To date, all schools have received training except for one. The one exception has received all training documents and scheduled for individual training. The bank reconciliations will be reviewed by the Complex Area Business Manager (CABM) for the months of February, March, April, May and June, 2009. One-on-one training will continue to be provided on an as needed basis.	6/2009
Kaimuki-McKinley-Roosevelt	**Elden Nakamura**	According to FMS User Policy 9.6 Bank Reconciliation, Schools shall reconcile the bank statement report with the school's Check Register report on a monthly basis. A standardized bank reconciliation template has been developed. The use of the standardized bank reconciliation template and process is mandatory for all schools. Memo from Complex Area Superintendents, dated 1/29/2009, Subject: Implementation of Standardized Reconciliation Procedures Mandatory Training Mandatory training was provided by Complex Area Business Managers (CABM) on implementation of the standardized bank reconciliation template on February 23rd, 2009 and February 25th, 2009 at the McKinley ITC. Schools sent SASA and staff assigned to complete bank reconciliations to the training. Beginning March 16, 2009, bank reconciliations will be submitted to the Complex Area Business Manager for review. The CABM will review the following: 1. Bank reconciliations are done monthly. 2. The bank reconciliation amount matches the check register. 3. Stale dated checks (checks over 6 months old) are written off with a journal voucher. 4. Review the bank statement for any unusual entries. 5. Review the check register for any unusual adjustments. 6. Verify that the principal or designee signs/approves the bank reconciliation and bank statement.	2/25/2009 3/16/2009 4/16/2009 5/15/2009 6/15/2009 7/15/2009

Agency Fund Bank Reconciliations **Attachment C**

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Aiea-Moanalua-Radford	**Adrienne Freitas**	Business Manager has trained schools in using the standardized bank reconciliation template. Training was also provided (on an as needed basis) on other topics such as how to book common journal vouchers, basic Excel skills and how to use the Bank Of Hawaii token access to print out a bank statement. Business Manager will continue to monitor schools for timely quarterly closing of the local school account.	07/01/2009 and beyond: continuous
Leilehua-Mililani-Waialua	**Judy Skeen Gray**	Review monthly bank statements and bank reconciliations. Ensure all schools are using the current reconciliation template. Notify school of errors and/or necessary changes. Train as needed.	06/30/2009
Campbell-Kapolei	**Michael N. Tanaka**	A new bank reconciliation excel form was developed, which all schools are using for the February report. Each school is submitting their reconciliation using this form, which is being reviewed by the CABM. Additionally, the CABM has worked with a number of the schools encouraging the use of online statements to improve the timeliness of bank information for credits, insufficient funds (NSF) items and the like. Performed training for schools as needed.	6/30/2009
Pearl City-Waipahu	**Lawrence Suan**	1. Generate/forward instructions and conduct training at respective complex area schools on the use of the standardized bank reconciliation template for agency funds. This template, when processed correctly, will address the audit findings noted during past reviews of agency fund bank reconciliations. Complex area schools will submit their February 2009 bank reconciliations and supporting documentation to the CABM for review by March 16, 2009. The CABM will review submissions and conduct additional training to complex area schools that have findings and/or identifiable processing errors. 2. Complex area schools will submit to the CABM their March 2009 agency fund bank reconciliations and supporting documentation for review by April 16, 2009. The CABM will provide additional training to schools that have findings upon review of these submissions.	1. 03/16/2009 2. 04/16/09

Agency Fund Bank Reconciliations

Attachment C

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Nanakuli-Waianae	**Earlyne Harada**	A monthly review of bank reconciliations will now be performed by the Business Manager, as part of a monthly check of local school fund procedures and practices adherence. The schools will be required to submit their bank reconciliations for review to the Business Manager. This was not a requirement in prior years. The Business Manager will note any findings on a report to the principal.	Monthly Reviews will start as of March 1, 2009
Castle-Kahuku	**Cindi Ahuna**	☐ Reviewed all bank reconciliations at June 30, 2008 and subsequent bank reconciliations. Visited and corrected bank reconciliation with material adjustments on reconciliation. o Assist school with researching transactions. o Assist school with journal voucher o Monitor and review subsequent bank reconciliations.	July 2008 – Present
		☐ Bank reconciliation template training. o One on one training at each school. o Created Local School Binders which included bank reconciliation instructions.	January 2009 – March 2009
		☐ Provided the following training to assist schools with the timely and accurate completion of bank reconciliations. o Bank "token" training: Allows schools daily online access to the local school account bank statement. Adjustments to be made can be identified earlier. o Journal Voucher (JV) training: Provided examples of the different types of JVs to assist schools in recording JVs timely and accurately.	February 2009 – March 2009
Kailua-Kalaheo	**Sydney Kline**	☐ Reviewed all bank reconciliations at June 30, 2008 and subsequent bank reconciliations. Visited and corrected bank reconciliation with material adjustments on reconciliation. o Assist school with researching transactions. o Assist school with journal voucher o Monitor and review subsequent bank reconciliations.	July 2008 – Present

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
		☐ Bank reconciliation template training. o One on one training at each school. o Created Local School Binders which included bank reconciliation instructions. ☐ Provided the following training to assist schools with the timely and accurate completion of bank reconciliations. o Bank "token" training: Allows schools daily online access to the local school account bank statement. Adjustments to be made can be identified earlier. o Journal Voucher (JV) training: Provided examples of the different types of JVs to assist schools in recording JVs timely and accurately.	January 2009 – March 2009 February 2009 – March 2009
Hilo-Laupahoehoe-Waiakea	**Adri Wilson**	To ensure timely and accurate bank reconciliations are performed at schools, the following controls will be adopted at all Complex Area schools: ▪ School administrators will continue to verify the balances are reconciled on a monthly basis. ▪ CABM & Administrative Services Assistant (ASA) will communicate quarterly closing dates so ensure schools are properly informed of deadlines ▪ CABM will verify reconciliations are accurate during quarterly review ▪ CABM will verify new reconciliation formats are being used at all schools and reconciliations are done timely ▪ CABM will verify that 'stale' checks are cancelled in a timely manner during quarterly review of bank reconciliations.	March 2009
Kau-Keaau-Pahoa	**Karie Klein**	To make sure the schools comply with the 2009-01-23 letter from Superintendent--tool to address recurring findings. This includes the mandatory use of the standardized bank reconciliation process and template. CABM will review the monthly and quarterly reconciliations prepared by the schools.	Ongoing

Agency Fund Bank Reconciliations **Attachment C**

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Honokaa-Kealakehe-Kohala-Konawaena	**Scott Jeffrey**	In the absence of a Complex Area Business Manager (who is to start effective March 16, 2009), the CAS has tasked the ASAs to support and train their school complex' Principals, School Administrative Services Assistants (SASAs) and Account Clerks as needed. Currently, the ASAs have been assisting schools with completing corrective action plans for internal audits. ASAs will also cross-train in their area of expertise and assist other complex schools as requested. Beginning March 19, 2009, it is anticipated that the CABM and ASAs will begin on-site quarterly visits to complex schools. All reports to be submitted to the CAS for review and final approval.	June 2009
Baldwin-Kekaulike-Maui	**Kevin Drake**	Each school's office staff has been trained on the DOE standardized bank reconciliation process and template. Monitoring is ongoing and bank reconciliations have been reviewed each month. It is expected that all schools will have balanced bank reconciliations on a timely basis by the end of the 4th quarter.	June 2009
Lahainaluna-Lanai-Molokai	**Nancy Hall**	The CABM has met with the SASA at every school in the Complex Area and reviewed the June 30, 2008 bank reconciliation. I have worked with any schools that did not have timely or accurate bank reconciliations and all issues have been resolved. A standardized bank reconciliation template has been developed for Local School Fund (LSF) bank reconciliations, as part of a statewide Corrective Action Plan. The CABM has trained every school on the use of the new standardized bank reconciliation template. Bank reconciliations will be sent to the CABM every month for verification of timeliness and accuracy. Outstanding checks over 6 months old and reconciling items will be reviewed and resolved. Spot-audits of LSF have been performed by the CABM at every school in the Complex Area. Additional one-on-one training has been conducted as needed.	Dec, 2008 January, 2009 Monthly March, 2009

Agency Fund Bank Reconciliations

Corrective Action Plan

Complex Area	Contact Person	Corrective Action Plan	Anticipated Completion Date
Kauai-Waimea	**Gail Nakaahiki**	On February 11 & 12, 2009, a mandatory hands-on workshop was held for all schools for the newly-mandated bank reconciliation excel spreadsheet. The workshop was held at the Kauai Information Technology Center (ITC) and was conducted by the CABM with ASAs and UST assisting. Schools were required to bring their January 2009 bank statement and bank reconciliation from July – December 2008. Schools were required to send their SASA and other clerical personnel (Clerk Typist or Account Clerk). Two personnel were required to attend from each school. If the primary clerical staff was absent, then the bank reconciliation could still be done by the other person trained. On the afternoon of March 11, 2009, we held a make-up class for the two SASAs that were unable to attend due to vacation/staff shortage along with school users that want/need additional training/assistance on the Excel bank reconciliation. Schools are required to start submitting to the CABM their monthly bank reconciliation for February 2009 to June 2009, due March 16 through July 15, 2009). ASAs will follow up with schools to get in by deadlines to the CABM.	February 11-July 15, 2009

2008-05 Risk Financing *(Pages 69 to 70)*

Corrective Action Plan

On January 6, 2009, the Workers' Compensation (WC) Unit revised its Reserve Methodology Procedure and Reserve Methodology to implement the outside loss reserve specialist's recommendations to increase the likelihood of setting accurate claim reserves and follow best practices.

The revised written procedures and methodology include the following recommendations from the outside loss reserve specialist:

1. Require a reason for no manual adjustment where the factors for consideration produce an increase to the factored value related to the body part and injury at or above 35%.

2. Require using the Renaissance/Case tracking program (REN) to identify cases with no payments for longer than 3 months and claims with no reserves. A special report was created to extract specific claim information from the REN. This report showing claims with no payments over 3 months and a report showing no reserves (missing reserves) will be provided to case managers monthly for their review and attention. The case managers are given a deadline to provide verification of their action taken (e.g. case closure, adding initial reserves, reason for case being active, reason for no reserves, etc.).

3. Require examiners to complete a semi-annual balancing of claims. Claim balancing involves reviewing the current disposition plan against payments made and payments likely to be due through anticipated closure, to assess reserve adequacy. The WC Unit supervisor will ensure that a list of open WC claims is provided to each case manager and that they follow the procedure.

4. Update procedures to require supervisory review of 10 claims per examiner per quarter to assess reserve accuracy. The WC Unit Supervisor includes this review in his monthly quality control reviews.

5. The WC Unit will continue to work with the Office of Fiscal Services (OFS), Operations Section and Payroll to expedite payroll reconciliation of WC disability with leave benefits. Per a prior agreement as a result of prior audit findings, Payroll provides the WC Unit with DOE Disability Worksheets (Form O9s) after every pay date for entering by the WC Unit staff into the REN. This is done for accurate record keeping and to reconcile the Payroll data with the WC authorized wage loss data. After reconciliation, the WC Unit forwards to Payroll a spreadsheet showing REN wage loss payments for a particular pay period, a worksheet showing any discrepancies with the Payroll data, and a monthly spread sheet showing all unpaid wage loss claims for Payroll's payment and reconciliation.

Contact Persons: *Keith Nakanishi, Personnel Specialist II*
Workers' Compensation Unit
Personnel Assistance Branch
Office of Human Resources

Edwin Koyama, Accounting Director
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: *COMPLETED, January 6, 2009*

2008-06 Procurement *(Page71)*

Corrective Action Plan

The Department of Education, Office of Fiscal Services, Procurement and Contracts Branch (PCB) provides workshops and training on procurement and contracts issues throughout the year. The workshops and training are provided to a target audience of school/program administrators, school administrative services assistants (SASAs), account clerks, administrative services assistants (ASAs), and complex area business managers (CABMs). The training is provided as stand-alone workshops as sponsored by PCB or as requested by program managers and offices.

The training covers the various procurement methods, including price/vendor lists, small purchase and exempt procurements for goods and services ($0-$24,999), exempt, sole source, IFB, RFP, professional services, emergency procurement and MOA/MOU procurements ($25,000 and above). A procurement and contracting database is maintained with flowcharts, checklists, forms, and instructions/guidelines and is available to all DOE employees as necessary for review and reference. DOE employees are also able to contact PCB if there are further questions that may arise.

PCB will continue to provide training via workshops and through an "opening of school/office" memo to remind all administrators and support staff of procurement and contracts requirements. In addition, PCB will review their procurement procedures and processes to ensure that the proper internal controls exist. The Office of Fiscal Services will work with the CABMs to perform reviews of school level procurement transactions to ensure on-going compliance. Program managers will also notify their program participants of compliance to the procurement code, whether for federal or general fund procurement transactions.

Contact Person: Andrell Beppu Aoki, Director
Procurement and Contracts Branch
Office of Fiscal Services

Anticipated Completion Date: September 30, 2009

FEDERAL AWARD FINDINGS

2008-07 ***<u>Allowable Costs and Cost Principles – Payroll Certifications</u>*** *(Pages 72 to 73)*

<u>Corrective Action Plan</u>

The Department of Education's Federal Compliance and Project Management Office has developed a Standard of Practice (SoPO404), department-wide, that requires all federally paid employees to complete a payroll certification as per the requirement outlined in attachment B, paragraph 8h(3) of the Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments.

The Department will monitor to ensure program managers of federally funded programs:

1. *Include as part of their regular program monitoring and evaluation activities verification of fund recipient adherence to the payroll certification requirement SoP0404, and*

2. *Assurance that fund recipient training includes information regarding this requirement.*

3. *Attend a mandatory training on the requirements of OMB Circular A-87(8)(h). All Program Managers of federal funds will be required to submit to the Federal Compliance and Project Management Office an annual monitoring plan to ensure compliance with OMB Circular A-87(8)(h) no later than May 29, 2009.*

Contact Person: *Robert Campbell, Ph.D., Director*
Federal Compliance and Project Management Office
Office of the Superintendent

Anticipated Completion Date: *October, 2009*

2008-08 ***Cash Management*** *(Pages 74 to 76)*

Corrective Action Plan

The financial audit report by Grant Thornton LLP for the prior fiscal year ended June 30, 2007 was not completed and issued until August 14, 2008, which was after the end of the current audited fiscal year ended June 30, 2008. Therefore, this finding in the 2007 audit is repeated in the 2008 audit report.

The Accounting Section has in place specific cash withdrawal procedures and worksheets. Through continuous training, review, and monitoring, we will be assured of accurate compliance regarding the cash management requirements.

Beginning July 1, 2008, the Accounting Section implemented withdrawing federal funds based on actual expenditures only. Our previous cash withdrawal methodology involved estimated projections of our semi-monthly payroll requirements based on a payroll data received from the Department of Accounting and General Services (DAGS), which the Department posts in its Financial Management System (FMS) only on a once-a-month basis.

We have developed and have established a new reporting process to incorporate the use of the semi-monthly DAGS payroll data to provide the accountants with actual payroll expense information. With this updated information, our cash draw-downs will include improved calculations and will serve to reduce the differences between actual expenditures versus estimates.

We do not agree with some of the auditor's recommendations:

- ***Develop and implement a written policy related to cash draw downs to maintain consistency among programs.***

The federal cash withdrawal process is an operational function that does not require a policy statement. The Accounting Section already has written procedures that are in place. Due to the newly hired staff, these procedures were followed in varying degrees. The Accounting Section has undergone significant turnover of staff within the last two years. The current staff is now being trained, and the Section will develop better techniques or reporting tools to minimize excess cash balances to meet federal compliance issues.

- ***Maintain a schedule when cash draws are to be made. For example, one program could draw every other Monday, another program every other Wednesday, and so forth.***

This is not a suitable solution for the Accounting Section and will present an operational problem. The Accounting Section is responsible for the accounting for over 50 federal grants. If cash draws are staggered, the Accounting Section staff will be working on cash draws virtually all day, every day of the week, and will not be able *to attend to other duties. The Accounting Section has, and will continue to, draw for all federal fund programs based on the operational needs of each federal grant.*

- ***Implement a policy where estimated payroll amounts greater than $50,000 (or other amount as appropriate) are reconciled to actual as soon as information is available.***

Beginning July 1, 2008, the Accounting Section has implemented withdrawing federal funds based on actual expenditures only. Our previous cash withdrawal methodology involved estimated projections of our semi-monthly payroll requirements based on a payroll data received from the Department of Accounting and General Services (DAGS), which the Department records in its Financial Management System (FMS) only on a once-a-month basis.

We have developed and have established a new reporting process to incorporate the use of the semi-monthly DAGS payroll data to provide the accountants with actual payroll expense information. With this updated information, our cash draw-downs have improved the calculations and have served to minimize the differences between actual expenditures versus estimates. The Accounting Section manages over 50 active federal grants that may require weekly cash withdrawals. The cash status of each federal grant is evaluated and reviewed at the time the Accounting Section will make the decision to draw funds.

As stated earlier, the federal cash withdrawal process is an operation function that does not require a policy statement. In accordance with federal regulations, the Department is not allowed to keep excess cash balances of federal funds without expenditure.

Other comments on findings/recommendations:

Special Education "overdraw":

The overdraw and excess cash balance of $1,600,000 was due to an accountant's error in double-counting a June 5, 2008 amount, on the draw-down worksheet. This oversight was by an employee who is no longer in the Accounting Section. The replacement accountant has corrected this procedure.

Amounts on worksheets "unsupported" or "did not agree to documentation provided":

The audit sample of transactions were from the audit period prior to the massive accounting staff turnover in April 2008, and prior to the changes in accounting procedures implemented on July 1, 2008. Accordingly, findings in this 2008 audit are similar to that of the prior 2007 audit. Since the 2007-08 year, corrective measures have been taken.

Worksheets "did not contain proper evidence of reviews":

One of the previous accounting supervisors, who has since left the Accounting Section, did not always sign off to evidence reviews of draw-down worksheets. Since March 2008, after the massive turnover of accounting staff, the practice is that drawdown worksheets are reviewed and signed off by the respective supervisors. We recognize the importance of supervisory review of federal cash withdrawals, and have implemented corrective measures so that our withdrawal procedures comply with federal requirements.

Communication with the U.S. Department of Education, as cognizant agency:

The Hawaii DOE submitted its corrective action plan to the U.S. Department of Education Post Audit Group, with the Hawaii DOE's new Letter of Credit Withdrawal Procedure for review.

The Hawaii DOE corrective action plan was accepted by the U.S. Department of Education Post Audit Group on January 28, 2009.

Contact Person: *Roy Tomasu, Fiscal Specialist III*
Accounting Section
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: *Revised Procedures: July 1, 2008*
Improved Audit Results: June 30, 2009

2008-09 <u>Oversight of Charter Schools</u> *(Pages 77 to 78)*

<u>Corrective Action Plan</u>

The Department will work with the Charter School Administrative Office to develop formal procedures for the inclusion of Public Charter Schools in the federal funded program monitoring plans. The procedures shall be presented to the Charter School Review Panel no later than July 31, 2009.

Contact Person: *Robert Campbell, Ph.D., Director*
Federal Compliance and Project Management Office
Office of the Superintendent

Maunalei Love, Executive Director
Charter School Administrative Office

Anticipated Completion Date: *June 30, 2009*

2008-10 Eligibility *(Page 79)*

Corrective Action Plan

School Food Services Branch (SFSB) plans to do more workshops to inform school level personnel of the overall application processing and the importance of entering and updating status for students.

On-site reviews are done annually at each school. At that time, SFSB matches the benefit issuance of students on "Student Management System" (computerized application data program) to the schools' "Point of Sale" (computerized counting and claiming program). Schools found to have errors must complete corrective action to bring rosters up to date.

This year the SMS is commingled statewide. By next school year, July 2009, all applications will be numerically filed in one location. Since October 2008, the SMS has been programmed to back-up files daily, which provides SFSB the capability of calling up past information at any point in time.

SFSB has added temporary Clerk Typist II positions to assist in the processing of applications. Five of these positions will remain beyond the peak application period to provide support during the verification period and enable SFSB to continuously update information throughout the school year. The information in the computerized program can then be our main source of information.

Contact Person: *Glenna Owens, Director*
School Food Services Branch
Office of School Facilities & Support Services

Anticipated Completion Date: *July 1, 2009*

2008-11 Matching, Level of Effort, and Earmarking *(Page 80)*

Corrective Action Plan

The Community Education Section (CES) (aka Adult Education) will implement systems to monitor matching, level of effort and earmarking calculations.

1. Matching Requirements. CES will confer with the Accounting Section to identify the Program IDs that will be counted toward the matching calculation. The Accounting Section will create a spreadsheet that the program manager will use to review expenditures on a quarterly basis. The Program IDs will be identified and the spreadsheet will be created by March 31, 2009.

2. Level of Effort Requirements. CES will review program and fiscal reports to monitor level of effort expenditures. All providers are currently required to submit quarterly program and financial reports, and an annual desk monitoring report to document how funding is expended to meet intended outcomes. In addition, annually, CES conducts on-site visitations at 50% of providers. The CES staff are currently monitoring programs, and analyzing expenditures to check allowable, appropriate and adequate use of funds. The first report will be available by April 15, 2009; all reports will be available by May 2009.

3. Earmarking Calculations. For each yearly grant award, the program manager will calculate the appropriate percentage of funds for administration, leadership, correctional/institutionalized education, and grants/contracts. These appropriated amounts will be allocated into unique program identification accounts (Program IDs) from which the program manager will monitor adequate and appropriate use. The program manager will ensure that the requirements are met within the period of its availability (27 months).

By implementing these systems, CES is confident that matching, level of effort and earmarking requirements will be monitored and documented throughout the year.

Contact Person: *Deborah Miyao, Educational Specialist*
Community Education Section
School and Community Leadership Branch
Office of Curriculum, Instruction and Student Support

Anticipated Completion Date: *September, 2009*

2008-12 <u>Equipment and Real Property Management</u> *(Page 81)*

<u>Corrective Action Plan</u>

Corrective measures have already been taken to address the concerns listed in the audit report. Equipment purchased was to support a school-level program. As a result, equipment was delivered directly to the school. The equipment was not immediately put on the inventory for the State since the equipment resided at the school level. At the time, personnel were not clear as to how the equipment should be recorded in inventory since the State had purchased the equipment but the equipment was to be housed at the school level. These procedures have since been clarified and the paperwork to transfer inventory from the State to the school have been completed.

In order to ensure that all equipment is properly logged and procedures are followed, inventory training sessions and work sessions were held on July 23, 2008, August 13, 2008, August 31, 2008 and September 17, 2008. Work sessions were held to double check that all equipment was, in fact, inventoried and training sessions were held to clarify proper procedures. The staff was also informed of the importance of keeping inventory lists up-to-date.

Contact Person: *Sherilyn Lau, Educational Specialist, Carl D. Perkins Act*
Arts, Sciences and Technology Section
Instructional Services Branch
Office of Curriculum, Instruction and Student Support

Anticipated Completion Date: *COMPLETED, September 17, 2008*

2008-13 <u>Special Tests and Provisions – Required Level of Expenditures</u> *(Page 82)*

<u>Corrective Action Plan</u>

The Information Resources Management Branch (IRM) will work with other organizations within DOE to pull ADA (Average Daily Attendance) data for both SPED Federally Connected and SPED non-Federally Connected students. This will be done by comparing and drawing data from the following three currently existing databases: a) the Federal Survey Database to identify federally connected students; b) the eCSSS database to identify SPED students; and c) the eSIS database to obtain average daily attendance data. We will also be working with charter schools to obtain ADA information for their SPED students.

Contact persons: *Miles Dodo, Budget Specialist*
Budget Execution Section
Budget Branch
Office of Fiscal Services

Karl Yoshida, IRM Director
Information Resources Management Branch
Office of Information Technology Services

Anticipated Completion Date: *September 30, 2009*

2008-14 *Allowable Costs – Native Hawaiian Education-Unallowable Costs of Entertainment*
(Page 83)

Corrective Action Plan

The Department has established a Grant Administrator and Monitor position within the Federal Compliance and Project Management Office. The duties of this position includes developing tools and training for Department of Education (DOE) state, complex, and school-level staff regarding grant administration activities. Allowable costs will be included in the training. This position will be notified when discretionary grants are awarded to schools or complex areas.

Contact Person: *Robert Campbell, Ph.D., Director*
Federal Compliance and Project Management Office
Office of the Superintendent

Anticipated Completion Date: *August 31, 2009*

Molokai continues to have one of the highest unemployment rates (e.g., greater than 12%) and large proportions of families with young children receiving government assistance, requests are annually made to the school to provide the children with direct experience in seeing and participating in activities of the "real world" outside of Molokai. Research has found that broadening the experiential base of children has significant impact on learning factors such as motivation, aspiration, association, and relevance. The experience allowed by the Native Hawaiian Education grant has broadened our student's perspective of the opportunities and career choices that are available to them.

External evaluation of overall KEA project cited positive results: Kaunakakai Experience Associations (KEA) Project Evaluation 2005-08, Dr. Mildred Higashi, November 2008:

"The culminating activity took 6^{th} graders to New York and Washington, D.C. In preparation for the trip, students studied the history, culture, customs and sites of these cities. They made their own study book and travel guide. ..." "Pre-post tests on New York and Washington, D.C. showed much learning ..." (p. 29)

In the future, the program manager will work closer with the Federal Compliance and Project Management Office to ensure that all future expenditures are allowable, and if necessary, obtain the proper pre-approvals from the USDOE.

Contact Person: *Janice Espiritu, Program Manager*
Native Hawaiian Education Program
Kaunakakai School

Anticipated Completion Date: *March 31, 2009*

2008-15 Procurement, Suspension, and Debarment *(Pages 84 to 85)*

Corrective Action Plan

The Department of Education, Office of Fiscal Services, Procurement and Contracts Branch (PCB) acknowledges room for improvement in our procurement processes. We note that there were only 10 instances out of 175 purchase orders tested at the school level, which represents a minimal 5.7% of the total tested.

For several years now, PCB has provided workshops and training on procurement and contracts issues throughout the year. The workshops and training are provided to a target audience of school/program administrators, school administrative services assistants (SASAs), account clerks, administrative services assistants (ASAs), and complex area business managers (CABMs). The training by PCB has been provided as stand-alone workshops or as requested by complex area superintendents, program managers, and state offices.

The training covers the various procurement methods, including price lists, vendor lists, small purchase and exempt procurement for goods and services ($0 - $24,999), exempt, sole source, IFB, RFP, professional services, emergency procurement, and MOA/MOU procurements ($25,000 and above). A procurement and contracting database is maintained with flowcharts, checklists, forms, and instructions/guidelines and is available to all DOE employees as necessary for review and reference. DOE employees are also able to contact the PCB if there are further questions that may arise.

PCB will continue to provide training via workshops and through an "opening of school/office" memo to remind all administrators and support staff of procurement and contracts requirements. After implementation of a reorganization of PCB, PCB will institute its own internal documentation review process for projects/contracts for $25,000 and more. The Office of Fiscal Services will work with the CABMs to perform reviews of school level procurement transactions to ensure on-going compliance. A working team of CABMs are working with PCB to develop an audit program for the schools and offices to ensure that monitoring is part of the review of the schools procurement transactions. The federal program managers will also notify their program participants of compliance to the procurement code, whether for federal or general fund procurement transactions. Finally, school level administrators and support staff must be more diligent in complying with applicable procurement requirements, as outlined in training and notifications to the federal program participants.

Contact Person: Andrell Beppu Aoki, Director
Procurement and Contracts Branch
Office of Fiscal Services

Anticipated Completion Date: March 31, 2010

2008-16 ***Period of Availability*** *(Page 86)*

Corrective Action Plan

The Department uses the First-In First-out (FIFO) accounting methodology for both of the federal grants cited. The Department's Financial Management System (FMS) DAFR4210 report displays the grant number and grant fiscal years for the respective grants in question.

For the Native Hawaiian Education Grant (84.362) being cited for a cash balance of $59,525 for grant year 2004 and grant year 2006, the grant year 2007 had eligible expenditures within the obligation period that had not been applied to the earlier grant year balances.

For the Improving Teacher Quality State Grants (84.367) being cited for a cash balance of $48,521 of which $42,886 is for grant year 2004, the grant year 2005 had sufficient expenditures within the obligation period that had not been applied to grant year 2004.

For the Improving Teacher Quality State Grant of $5,635 from grant year 2006, the grant year 2007 had eligible expenditures within the obligation period that had not been applied to grant year 2006.

The finding is based on the fact that FIFO journal entries were not made by the Accounting Section in a timely manner for the two federal grants cited.

The Accounting Section will instruct the new accountants to record FIFO journal entries to clear grant balances within the ninety-day adjustment period after the grant obligation period end date.

Questioned costs $289:

The 2002 costs in question were processed in error to the federal Special Education grant in 2007-08 due to a recent effort to resolve old outstanding invoices owed to a travel vendor. The Department will make the correction for this item by transferring the cost to its general operating fund, where the cost should have been originally charged.

Contact Person: *Roy Tomasu, Fiscal Specialist III*
Accounting Section
Administrative Services Branch
Office of Fiscal Services

Anticipated Completion Date: *Revised Procedures: July 1, 2008*
Improved Audit Results: June 30, 2009

2008-17 ***Special Tests and Provisions – Highly Qualified Teachers and Paraprofessionals***

(Page 87)

Corrective Action Plan

Approved by the USDOE on June 26, 2007, the Highly Qualified Teacher State Plan and Equity Plan have been implemented by the HIDOE to ensure that all core academic classes in Hawaii's schools are taught by teachers who are highly qualified. The plans stipulate the actions required to: 1) hire the most qualified teachers available to teach core content areas in all schools, 2) accurately report to the USDOE when classes are taught by teachers who are not highly qualified, 3) inform parents if their children are taught by teachers who are not highly qualified, and 4) have professional development plans in place to assist teachers without proper qualifications to obtain them as quickly as possible.

In February 2009, the DOE Title II Program was monitored by the USDOE, and the USDOE noted that "... in general, the (USDOE) team was pleased with the progress that you (DOE) are making to ensure that Federal funds are being used effectively to ensure that all teachers of core academic classes will be highly qualified." The DOE has made tremendous strides in reclassifying status of teachers based on revised Title II criteria, identifying and creating a database on highly qualified status of teachers, assisting non-highly qualified teachers to become highly qualified teachers, and developing opportunities for non-highly qualified teachers to gain content knowledge and earn the federal designation of highly qualified.

Letters dated July 23, 2007; March 21, 2006; and October 21, 2005 from the USDOE to DOE to all Chief State School Officers note that while states were making progress in addressing the qualifications of teachers, most states were unlikely to reach the No Child Left Behind goal of 100% of core academic subject classes taught by highly qualified teachers by the end of the 2005-06 school year. The letters also noted that all states which did not reach the 100% goal would not be penalized if they were implementing the law and making a good-faith effort to reach the highly qualified teacher goal as quickly as possible. The DOE has submitted required Title II data annually to the USDOE and is in compliance with the data submission. As of 2009, only one state, North Dakota, has met the goal of 100% core content classes taught by highly qualified teachers.

Contact Persons: *For the Highly Qualified Teacher State Plan and Equity Plan:*

Robert Campbell, Ph.D., Director
Federal Compliance and Project Management Office
Office of the Superintendent

Amy Shimamoto, Director
Personnel Development Branch
Office of Human Resources

Contact Persons: *For Title I Schools:*

Sharon Nakagawa, Educational Specialist
Special Programs Management Section
School and Community Leadership Branch
Office of Curriculum and Instructional Services

Anticipated Completion Date: *Ongoing requirement by USDOE*

2008-18 <u>Indirect Costs</u> *(Page 88)*

<u>Corrective Action Plan</u>

As mentioned earlier in the corrective action plan to Finding 2008-01, and in Attachment A to the corrective action plan, the Accounting Section was impacted by massive employee turnover during the fiscal year under audit. Despite the turnover, the temporary replacement staff and newly-hired replacement staff were able to prepare the Indirect Cost Proposal and submit it to the U.S. Department of Education in a short period of time. This 53-page proposal was completed accurately and in compliance with the federal regulations, except that the two pages mentioned by the auditors were not completed.

On September 8, 2008, the U.S. Department of Education Indirect Cost representative visited the Hawaii Department of Education Accounting Section in person, and conducted a review of the indirect cost proposal documentation. The representative was pleased with our records, and was impressed with the technical competence of the temporary and newly-hired replacement accounting staff. During or after the visit, there was no mention of the two documents omitted. In subsequent communications, the U.S. Department of Education Indirect Cost representative indicated that the items were procedural details that were not as important as the actual 53-page proposal itself.

In order to address the certification requirement, the Department has filed the Certificate of Indirect Costs document on March 10, 2009. For the attestation requirement, to properly process expenditure data to compute the adjusted indirect costs accurately, an accounting "mid-year close" must be run (which takes place annually in March); accordingly, an extension of time was requested from and granted by the U.S. Department of Education. The Letter of Attestation will be submitted after the final indirect cost assessment adjustments are completed, by April 9, 2009.

For future indirect cost proposals, all required documentation will be submitted. The "oversight" for the attestation was not in Internal Audit; the Accounting Section had not communicated the attestation requirement request to Internal Audit. This attestation requirement was a one-time exception due to the indirect cost adjustment referred to above. The Accounting Section will ensure that proper documents are filed as applicable.

Contact Person: Roy Tomasu, Fiscal Specialist III
Accounting Section
Administrative Services Branch
Office of Fiscal Services

Completion Date: Revised Procedures: April 2009

PART VI

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Prior Fiscal Year Ended June 30, 2007

SECTION II - FINANCIAL STATEMENT FINDINGS

2007-01 ***Error Corrections***
(Pages 65 to 67 of the Prior Year June 30, 2007 Report)

Status *-- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Findings No. 2008-01.*

2007-02 ***Accounting for Compensated Absences***
(Pages 67 to 68 of the Prior Year June 30, 2007 Report)
(Pages 55 to 56 of the June 30, 2006 Report)

Status *-- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2008-02.*

2007-03 ***Improve Compensating Controls For Inadequate Segregation of Duties over Agency Funds***
(Pages 68 to 69 of the Prior Year June 30, 2007 Report)
(Pages 57 to 58 of the June 30, 2006 Report)

Status *-- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2008-03.*

2007-04 ***Agency Fund Bank Reconciliations***
(Pages 69 to 70 of the Prior Year June 30, 2007 Report)

Status *-- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2008-04.*

2007-05 ***Risk Financing***
(Page 70 of the Prior Year June 30, 2007 Report)
(Pages 59 to 60 of the Prior Year June 30, 2006 Report)

Status *-- Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2008-05.*

2007-06 ***Internal Controls – Cash Management***

(Pages 71 to 73 of the Prior Year June 30, 2007 Report)
(Page 69 of the June 30, 2006 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-08.*

2007-07 ***Internal Controls – Matching, Level of Effort, and Earmarking***

(Pages 73 to 74 of the Prior Year June 30, 2007 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-11.*

2007-08 ***Internal Controls – Allowable Costs and Cost Principles*** ***(Payroll Certifications)***

(Pages 74 to 75 of the Prior Year June 30, 2007 Report)
(Pages 61 to 62 of June 30, 2006 Report)

Status -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-07.*

2007-09 ***Period of Availability***

(Pages 75 to 76 of the Prior Year June 30, 2007 Report)

Status -- *Corrective action has been taken with respect to Career and Technical Education (formerly Vocational Education). However, this finding was noted in Special Education Grant, Native Hawaiian Education Grant, and Improving Teacher Quality State Grants in the current year. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-16.*

2007-10 ***Earmarking***

(Page 76 of the Prior Year June 30, 2007 Report)

Status -- *Corrective action has been taken with respect to Special Education. However, this was noted in Adult Education in the current year. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-11.*

2007-11 ***<u>Allowable Costs and Cost Principles</u>*** *(Charging correct Federal Program)*
(Page 77 of the Prior Year June 30, 2007 Report)

<u>Status</u> -- *Corrective action has been taken to the extent that this finding no longer appears in the Federal Award Findings and Questioned Costs.*

2007-12 ***<u>Special Tests and Provisions – Highly Qualified Teachers and Paraprofessionals</u>***
(Page 78 of the Prior Year June 30, 2007 Report)

<u>Status</u> -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-17.*

2007-13 ***<u>Procurement, Suspension, and Debarment</u>***
(Pages 78 to 80 of the Prior Year June 30, 2007 Report)

<u>Status</u> -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-15.*

2007-14 ***<u>Indirect Cost Rate</u>***
(Page 80 of the Prior Year June 30, 2007 Report)

<u>Status</u> -- *Partially Accomplished. Corrective action and monitoring is in progress. Please refer to the current year response in the Federal Award Findings and Questioned Costs Finding No. 2008-18.*