

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917



LESLIE H. KONDO
State Auditor

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DEPT. COMM. NO. 356

April 19, 2017

HAND DELIVER

The Honorable Ronald D. Kouchi
Senate President
415 S. Beretania Street
State Capitol, Room 409
Honolulu, Hawaii 96813

Re: Audit of the Department of Education

Dear President Kouchi:

The financial and single audit report of the Department of Education for the fiscal year ending June 30, 2016 was issued on March 24, 2017. The Office of the Auditor retained N&K CPAs, Inc. to perform the financial and single audit. For your information, we are enclosing a copy of the two-page Auditor's Summary, the financial and single audit report, and the management letter.

You may view the Auditor's Summary and report electronically on our website at:
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOE_Summary_2016.pdf and
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOE2016.pdf.

If you have any questions about the report, please contact me.

Very truly yours,

Leslie H. Kondo
State Auditor

LHK:RTS:ifs

Enclosures

Auditor's Summary

Financial Audit of the Department of Education

Financial Statements, Fiscal Year Ended June 30, 2016



PHOTO: OFFICE OF THE AUDITOR

THE PRIMARY PURPOSE of the audit was to form an opinion on the fairness of the presentation of the financial statements for the Department of Education (DOE), as of and for the fiscal year ended June 30, 2016, and to comply with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), which established audit requirements for state and local governmental units that receive federal awards. The audit was conducted by N&K CPAs, Inc.

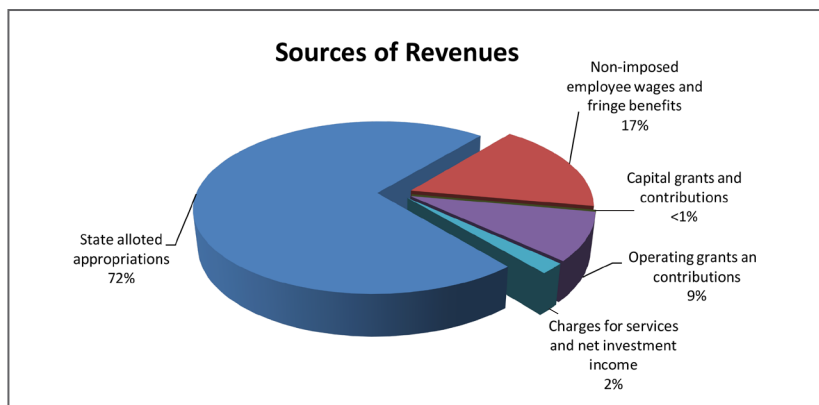
About the Department

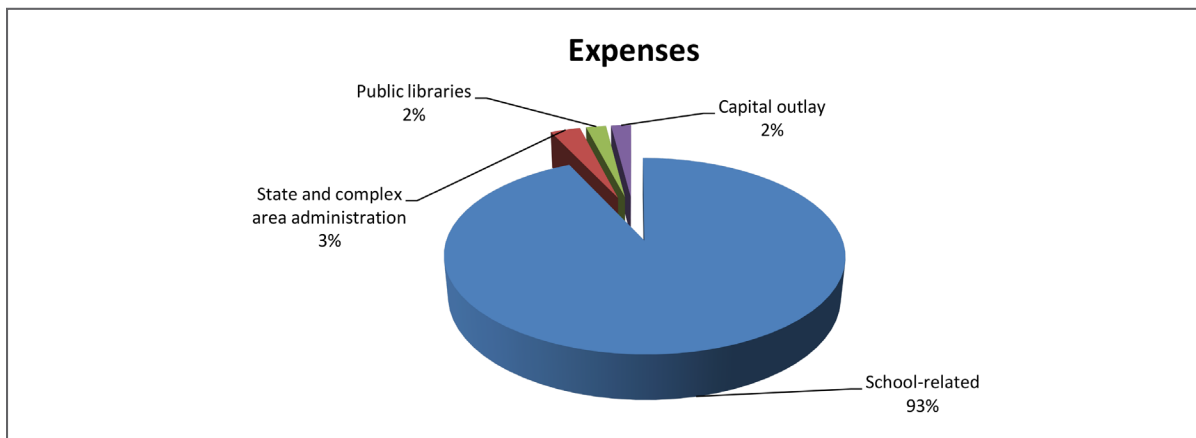
DOE administers the statewide system of public schools and public libraries. DOE is also responsible for administering state laws regarding regulation of private school operations through a program of inspection and licensing and the professional certification of all teachers for every academic and non-college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

Financial Highlights

FOR THE FISCAL YEAR ended June 30, 2016, DOE reported total revenues of \$3.10 billion and total expenditures and net transfer of \$2.68 billion, resulting in an increase in net position of \$418 million.

Sources of revenues included \$2.22 billion in state general fund appropriations, \$539 million in non-imposed employee wages and fringe benefits, \$265 million in operating grants and contributions, \$8 million in capital grants and contributions, and \$63 million in charges for services and net investment income.





Expenses consisted of \$2.50 billion for school-related costs, \$68 million for state and school complex area administration, \$47 million for public libraries, and \$66 million for capital outlay.

As of June 30, 2016, DOE's total assets exceeded total liabilities by \$2.23 billion. Of this amount, approximately \$670 million is unrestricted and may be used to meet ongoing expenses and obligations. Total assets of \$2.66 billion were comprised of cash of \$1.06 billion, receivables of \$41 million, and net capital assets of \$1.56 billion. Liabilities totaled \$424 million.

Auditors' Opinions

DOE RECEIVED AN UNMODIFIED OPINION that the financial statements were presented fairly, in all material respects, in accordance with generally accepted accounting principles. DOE received an unmodified opinion on its compliance with major federal programs in accordance with the *Uniform Guidance*.

Findings

THERE WERE NO REPORTED DEFICIENCIES in internal controls over financial reporting that were considered to be material weaknesses and required to be reported under *Government Auditing Standards*. However, the auditors identified two deficiencies in internal controls over financial reporting that are considered significant deficiencies:

- Complete and timely information was not provided for proper accounting of completed construction projects.
- The Schedule of Expenditure of Federal Awards did not initially report the amount of awards to subrecipients for the 21st Century Community Learning Centers program.

THERE WERE NO FINDINGS that were considered material weaknesses in internal control over compliance in accordance with the *Uniform Guidance*.

For the complete report and financial statements visit our website at:
http://files.hawaii.gov/auditor/Reports/2016_Audit/DOE2016.pdf

ORIGINAL

DEPT. COMM. NO. 356

**DEPARTMENT OF EDUCATION
STATE OF HAWAI'I**

Management Letter

Fiscal Year Ended June 30, 2016



N&K CPAs, Inc.

ACCOUNTANTS|CONSULTANTS

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**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

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To the Auditor
State of Hawaii, Office of the Auditor

Board of Education and Superintendent
State of Hawaii, Department of Education

In planning and performing our audit of the financial statements of the Department of Education, State of Hawaii (DOE) as of and for the fiscal year ended June 30, 2016, 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, we considered DOE's internal control over financial reporting (internal control) as a basis for designing our auditing procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of DOE's internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. This letter does not affect our report dated March 24, 2017 on the financial statements of the DOE.

We have already discussed many of these comments and suggestions with various DOE personnel, and we will be pleased to discuss them in further detail at your convenience, to perform additional study of these matters, or to assist you in implementing the recommendations.

This communication is intended solely for the information and use of management, the Hawaii State Office of the Auditor, the Board of Education, and others within the DOE, and is not intended to be, and should not be, used by anyone other than these specified parties.

N + K CPAs, INC.

Honolulu, Hawaii
March 24, 2017

Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS
Fiscal Year Ended June 30, 2016

16-01 Comply With Established Policies and Procedures Over Purchase Card Transactions

During our testing of 40 Purchase Card transactions, we noted 1 instance where the purchasing worksheet was approved after the invoice date.

The DOE requires all Purchase Card holders to complete an online course and pass the final post-assessment with 100% correct answers. Module 3 of the *DOE P-Card for Cardholders* training presentation states in part, "Before making a purchase, complete the FMS-P1 Purchasing Worksheet or the Lotus Notes Purchasing Worksheet for each purchase and have the Cardholder approve the worksheet...."

Recommendation

The DOE should comply with all its established policies and procedures over purchase card transactions.

16-02 Reevaluate Purchase Policies and Procedures

In 5 out of 40 Purchase Card transactions tested, blanket purchase orders were used for purchases not to exceed \$2,500 for one-month-long periods. The blanket purchase orders were issued by the Facilities and Maintenance Branch as a carryover practice by the personnel who transferred to DOE from the State Department of Accounting and General Services.

It is DOE's practice that blanket purchase orders should not exceed \$500.

Recommendation

The DOE should reevaluate its purchase policies and procedures, including the blanket purchase order threshold, to determine whether they are practical while ensuring adequate purchasing controls.

16-03 Resolve Unreconciled Differences Between FMS and FAMIS Cash Balances

The DOE maintains its accounting records using the computerized *Financial Management System* (FMS). As a department of the State of Hawaii, it also maintains accounts for its transactions at a higher level in the State's computerized *Financial Accounting and Management Information System* (FAMIS).

**Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS (Continued)
Fiscal Year Ended June 30, 2016**

16-03 Resolve Unreconciled Differences Between FMS and FAMIS Cash Balances (Continued)

As a control procedure to ensure accuracy of the accounting records between the two systems, the DOE reconciles the cash balance between the two systems. During our review of the reconciliations for several appropriation accounts as of June 30, 2016, we noted recurring unreconciled cash differences that originated from years ago for five appropriation accounts. The unreconciled differences ranged from approximately \$20,000 to approximately \$1.5 million. Reconciliation for some appropriation accounts showed a higher adjusted cash balance in FMS and other appropriation accounts showed a higher adjusted cash balance in FAMIS.

For these accounts with unreconciled differences, FMS reflected a net lower adjusted report cash balance of approximately \$1,525,000.

It is important that the cash balance reported in FAMIS is accurate for the State to make informed decisions and prevent overspending or underutilization of cash balances. In addition, as the official accounting records for the State of Hawaii, FAMIS has precedence and the DOE is limited to the cash balance reported in FAMIS. The DOE may be subjecting itself to unnecessary cash limitation should unreconciled differences that are unresolved result in a lower reported cash balance in FAMIS.

Recommendation

The DOE should resolve the unreconciled differences between FMS and FAMIS cash balances.

16-04 Improve Monitoring System for Vacation and Sick Leave Records

The various schools and offices record compensated absence balances, credits earned and leave taken on the *Employee Leave Record* (Form 7), and summarized the transactions and balances either electronically or manually in records separate from KRONOS. All leave taken recorded in both KRONOS and summary leave Form 7 should be supported by the approved *Application for Leave of Absence*, Forms G-1 or DOE OHR 300-001, which documents the request and approval of absences.

During our testing of accrued vacation and sick leave records for 40 employees, we noted the following conditions:

- For four employees, sick leave recorded on the Form 7 and KRONOS was not always supported by the *Application for Leave of Absence*.
- For one employee, the *Application for Leave of Absence* was not signed for approval by the supervisor in four instances.

Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS (Continued)
Fiscal Year Ended June 30, 2016

16-04 Improve Monitoring System for Vacation and Sick Leave Records (Continued)

Recommendation

The DOE should improve its monitoring system to ensure that the schools and offices prepare leave documents completely and in a timely manner. The DOE should perform random quality control reviews of leave records to ensure the vacation and sick leave records are accurately reported.

16-05 Comply with Established Policies and Procedures Over Student Activity Funds

The *State of Hawaii Department of Education Standard Practice (SP) Document* numbers SP 1500 through 1521 provides guidance on the handling of non-appropriated student activity funds.

The DOE summarizes the non-appropriated student activity fund cash balances as it is recorded on its books as of June 30 for financial reporting purposes.

We reviewed bank reconciliations for 121 schools as of June 30, 2016, and we noted the following conditions:

- Forty-eight schools reviewed the bank reconciliations after the tenth business day after the close of the month.
- Six schools did not date the principal's review of the bank reconciliation on the bank reconciliation report.
- Ten schools had returned checks over six months that remained as reconciling items that should be resolved.
- Two schools listed stale dated checks over six months old as reconciling items that should be investigated and possibly re-issued or voided.

In accordance with our contract with the State of Hawaii, Office of the Auditor, contract no. 64728 dated May 19, 2016, we performed site visits of ten individual schools. We noted the following weaknesses in the administration of the student activity funds during our review of the records for the ten schools:

Cash Receipts

- In 2 out of 50 cash receipts tested, bank deposits were not made in a timely manner. The known lag ranged from 7 to 8 business days.
- Two schools had several numerical copy of receipts missing from the Form 239 receipt books.

Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS (Continued)
Fiscal Year Ended June 30, 2016

16-05 Comply with Established Policies and Procedures Over Student Activity Funds (Continued)

- One school could not locate the numerical copy of two receipt books.

Cash Disbursements

- Five schools completed the related purchase orders after the vendor invoice date.
- In 15 out of 50 cash disbursements tested, the *Approval for Payment* stamp was not affixed on the vendor invoice or did not have the appropriate approval signature on the stamp.
- One school did not use purchase orders.

Administrator's Checklist

- Three schools did not perform all of the procedures for compensating internal controls on the *Administrator's Checklist*.
- One school did not complete the *Administrator's Checklist* during the fiscal year.
- Five schools did not date and/or initial when the tasks on the checklist were performed.
- Three schools continued to use the Non-Appropriated Local School Fund version of the *Administrator's Checklist* instead of Form SAF-IC-1.

Other

- Eight schools did not print the annual *Category Umbrella Overview Report* (Report #5).
- Five schools did not have the approval signature on the monthly *Category Umbrella Overview Report* (Report #5).
- Three schools either did not have the approval signature on the *Range of Date Transaction - Detailed Summary* (Report #11B) as part of the monthly bank reconciliation.
- Three schools did not sign and/or date the approval of the monthly bank statements for the selected test month.
- Four schools did not ensure fundraising subaccount balances were zero as of June 30, 2016.

Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS (Continued)
Fiscal Year Ended June 30, 2016

16-05 Comply with Established Policies and Procedures Over Student Activity Funds (Continued)

- Three schools had accounts with deficit balance as of June 30, 2016.
- Four schools recorded correcting entries as transfers and used the Form SAF-R2, *Authorization to Transfer Funds*, instead of Form SAF-R4, *Request for Journal Entry or Modification* to record journal entries.
- One school did not have supporting documents on file for five of the five journal entries/transfers selected for testing at that school.

Recommendation

To increase compliance with established policies and procedures over the student activity funds, continued mandatory training and technical assistance should be given to all personnel.

16-06 Submit *Employer's Report of Industrial Injury* Timely

During our test of workers' compensation claims, we noted 17 out of 40 claims for which Form WC-1, *Employer's Report of Industrial Injury*, was submitted to the DOE's Workers' Compensation office after the date the DOE was required to report the injury to the State Director of Labor and Industrial Relations. Delinquent forms were submitted to the Workers' Compensation office between 8 and 19 working days after the injury was reported to the employer, which generally was a school or office where the employee worked.

Section 386-95 of the Hawaii Revised Statutes states in part, "...Within seven working days after the employer has knowledge of such injury causing absence from work for one day or more or requiring medical treatment beyond ordinary first aid, the employer shall make a report thereon to the director. The report shall set forth the name, sex, wages, and occupation of the injured employee and shall state the date and hour of the accident, if the injury is produced thereby, the nature and cause of the injury, and such other information as the director may require...."

Recommendation

The schools and offices where the injured employees work should ensure timely submission of the Form WC-1, *Employer's Report of Industrial Injury*.

Department of Education
State Of Hawaii
COMMENTS AND RECOMMENDATIONS (Continued)
Fiscal Year Ended June 30, 2016

16-07 Perform Timely Quality Control Reviews and Monitoring Procedures for Workers' Compensation Reserves

During our review of the workers' compensation reserves recorded in the Renaissance system for 40 claims, we noted 1 instance which no additions to the base reserve for the initial reserve were made for items documented in the "Factors of Consideration" section of the reserves worksheet.

We noted 76 claims in the Renaissance system with closed status had negative net reserve balances that should have been adjusted to zero net reserves as of June 30, 2016. We also noted an additional 44 claims in the Renaissance system with open status had net negative reserve balances as of June 30, 2016. The total additional reserves for these open claims that should have been recorded as of June 30, 2016 based on reserve worksheets in the case files during our fieldwork amounted to approximately \$1.8 million. Although the net negative reserves were adjusted by a third party in determining the workers' compensation liability as of June 30, 2016, there should not be any net negative reserves in the Renaissance system.

In addition, the Renaissance system was unable to accept adjustments to the reserve amount for 28 claims. As a result, the amount of reserves in the Renaissance system that was reported to the actuary to estimate the amount workers compensation liability as of June 30, 2016 was understated by approximately \$760,000.

The above errors could have been detected and corrected by performing timely quality control reviews and monitoring of reserve balances.

We were also informed that the current reserves methodology and established amounts used to determine the reserves have not been assessed for adequacy in many years.

Incorrect recorded reserves could result in material misstatement of the workers' compensation liability.

Recommendation

To ensure reasonable measurement of the workers compensation liability, the DOE should perform timely quality control reviews and monitoring of the workers compensation reserves and adjust the reserves accordingly.

In addition, the DOE should assess its current reserves methodology and established amounts used to determine the reserves to ensure the reserves represent a reasonable estimation of workers' compensation costs that could be incurred for claims. This may include a study of how the reserve estimates compare to the final claim. Reserve increases and decreases over time can be studied for indication whether initial reserves are reasonable.

**Department of Education
State Of Hawaii
STATUS
Fiscal Year Ended June 30, 2016**

This section contains the current status of the prior comments. The recommendations are referenced to the previous management advisory report for the fiscal year ended June 30, 2015, dated March 24, 2016.

Recommendations	Status
15-01 Comply With Established Policies and Procedures Over Purchase Card Transactions	
The DOE should comply with all its established policies and procedures over purchase card transactions.	Not accomplished. Refer to Finding 16-01.
15-02 Resolve Unreconciled Differences Between FMS and FAMIS Cash Balances	
The DOE should resolve the unreconciled differences between FMS and FAMIS cash balances.	Not accomplished. Refer to Finding 16-03.
15-03 Improve Monitoring System for Vacation and Sick Leave Records	
The DOE should also improve its monitoring system to ensure that the schools and offices prepare leave documents completely and accurately, and record leave taken in a timely manner. The DOE should perform random quality control reviews of leave records to ensure the vacation and sick leave records are accurately reported.	Not accomplished. Refer to Finding 16-04.
15-04 Comply with Established Policies and Procedures Over Student Activity Funds	
To increase compliance with established policies and procedures over student activity funds, mandatory training and technical assistance should be given to all personnel.	Not accomplished. Refer to Finding 16-05.
15-05 Submit <i>Employer's Report of Industrial Injury</i> Timely	
The schools and offices where the injured employees work should ensure timely submission of the Form WC-1, <i>Employer's Report of Industrial Injury</i> .	Not accomplished. Refer to Finding 16-06.

**Department of Education
State Of Hawaii
STATUS
Fiscal Year Ended June 30, 2016**

Recommendations	Status
<p>15-06 Perform Timely Quality Control Reviews and Monitoring Procedures for Workers' Compensation Reserves</p> <p>To ensure reasonable measurement of the workers compensation liability, the DOE should perform timely quality control reviews and monitoring of the workers compensation reserves and adjust the reserves accordingly.</p> <p>In addition, the DOE should assess its current reserves methodology and established amounts used to determine the reserves to ensure the reserves represent a reasonable estimation of workers' compensation costs that could be incurred for claims. This may include a study of how the reserve estimates compare to the final claim. Reserve increases and decreases over time can be studied for indication whether initial reserves are reasonable.</p>	<p>Not accomplished. Refer to Finding 16-07.</p>
<p>15-07 Establish Procedures to Ensure Eligible New and Significantly Expanded Charter Schools Receive Appropriate Funding</p> <p>The DOE should issue guidance annually to charter schools and the State Public Charter School Commission to ensure that they are aware of the requirements of ESEA section 10306 and its implementing regulations, such as the 120-day notice requirement and the definition of "significant expansion of enrollment."</p>	<p>Accomplished.</p>

DAVID Y. IGE
GOVERNOR



KATHRYN S. MATAYOSHI
SUPERINTENDENT

STATE OF HAWAII
DEPARTMENT OF EDUCATION
P.O. BOX 2360
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

March 24, 2017

N&K CPAs, Inc.
American Savings Bank Tower, Suite 1700
1001 Bishop St
Honolulu, HI 96813

Ladies and Gentlemen:

We have received your Management Letter which was issued in conjunction with the annual audit of the financial statements of the Department of Education (Department) as of the fiscal year ended June 30, 2016. The summary of your comments and suggestions gives us the opportunity to further strengthen identified weaknesses in the policies and procedures that may exist within the Department.

Attached is the Department's Management Letter Response. If you have any questions, please contact Ms. Denise Yoshida, Internal Audit Director, at 586-3325 or e-mail at denise_yoshida@notes.k12.hi.us.

Very truly yours,

A handwritten signature in black ink, appearing to read "K. Matayoshi", written over a horizontal line.

Kathryn S. Matayoshi
Superintendent

KSM:dy
Attachment

c: Board of Education
Internal Audit Office

AN AFFIRMATIVE ACTION AND EQUAL OPPORTUNITY EMPLOYER

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-01 Comply With Established Policies and Procedures Over Purchase Card Transactions

Recommendation

The DOE should comply with all its established policies and procedures over purchase card transactions.

View of Responsible Officials

Management agrees with the audit findings and recommendation.

Corrective Action Plan

The Accounting Services Branch, Operations Section will obtain from N&K CPAs, Inc. the list of purchasing cardholders that are not completing the Purchasing Worksheet (form FMS-P1) in compliance with established policies and procedures, and will share this list with Leadership for corrective action by the non-complying cardholders.

*Contact Person: Tom Ishimaru, Accounting Director
 Accounting Services Branch
 Office of Fiscal Services*

Anticipated Completion Dates: June 30, 2017

16-02 Reevaluate Purchase Policies and Procedures

Recommendation

The DOE should evaluate its purchase policies and procedures, including the blanket purchase order threshold, to determine whether they are practical while ensuring adequate purchasing controls.

View of Responsible Officials

Management agrees with the audit findings and recommendation.

Corrective Action Plan

The Accounting Services Branch, Operations Section, along with the Procurement and Contracts Branch, will reevaluate the purchasing policies and procedures for practicality and control purposes, as it applies to the Facilities and Maintenance Branch's use of a blanket purchase order.

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-02 Reevaluate Purchase Policies and Procedures (Continued)

Contact Person: Tom Ishimaru, Accounting Director
Accounting Services Branch
Office of Fiscal Services

Anticipated Completion Dates: June 30, 2017

16-03 Resolve Unreconciled Differences Between FMS and FAMIS Cash Balances

Recommendation

The DOE should resolve the unreconciled differences between FMS and FAMIS cash balances.

View of Responsible Officials

Management agrees with the finding and recommendation.

Corrective Action Plan

The DOE maintains its accounting records on the DOE's computerized Financial Management System (FMS). As a department of the State of Hawaii (State), the DOE also maintains accounting records on the State's computerized Financial Accounting and Management Information System (FAMIS).

As a control procedure to ensure accuracy of the accounting records between the two systems, the DOE Accounting Section reconciles the cash balance between the two accounting systems on a quarterly basis. There are certain reconciling differences which have not been corrected from a number of years back as more investigation needs to be done. These reconciling differences have generally remained as a fixed, recurring amount on the quarterly reconciliations.

The DOE Accounting Section will perform further investigation of the long-standing uncorrected reconciling differences and will make necessary corrections.

Contact Person: Trisha Kaneshiro, Fiscal Specialist
Accounting Section
Accounting Services Branch
Office of Fiscal Services

Anticipated Completion Dates: June 30, 2017

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-04 Improve Monitoring System for Vacation and Sick Leave Records

Recommendation

The DOE should improve its monitoring system to ensure that the schools and offices prepare leave documents completely and accurately, and record leave taken in a timely manner. The DOE should perform random quality control reviews of leave records to ensure the vacation and sick leave records are accurately reported.

View of Responsible Officials

Management agrees with the audit findings and recommendation.

Corrective Action Plan

The Accounting Services Branch, Operations Section, Leave Management Unit (LMU) has developed a Leave Monitoring program. The program has monitoring tools, such as the Leave Review Checklist, that will be used by the Complex Area Business Managers (CABM) when they do random on-site visits to review the status of Leave records at schools. The CABMs will share review results with the school timekeeper and administrator so they can take corrective action if needed.

The LMU has implemented a schedule to train all fifteen (15) Complex Area Business Managers on the Leave Monitoring program over the next six (6) months.

*Contact Person: Tom Ishimaru, Accounting Director
 Accounting Services Branch
 Office of Fiscal Services*

Anticipated Completion Date: September 30, 2017

16-05 Comply with Established Policies and Procedures Over School Activity Funds

Recommendation

To increase compliance with established policies and procedures over the student activity funds, continued mandatory training and technical assistance should be given to all personnel.

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-05 Comply with Established Policies and Procedures Over School Activity Funds
(Continued)

View of Responsible Officials

Management agrees with the audit findings and recommendation to increase compliance with established SAF policies and procedures, with continued mandatory training and technical assistance. However, the DOE finds it a continuous and arduous challenge to ensure that all 256 schools process all SAF transactions error free.

Corrective Action Plan

The DOE will continue the current practice of requiring new SAF users to review the four (4) SASA Academy Student Activity Fund modules, which explains the purpose and use of the SAF system. The user must pass a test for each module as well as attend an introductory and advanced SAF training sessions that are presented by User Support Technicians (UST) before they are allowed access to the SAF system. Current users can get refresher training from the UST or Complex Area Business Managers (CABM) and will be trained on program changes and upgrades, and be given updated system documentation.

To help ensure that users comply with policies and procedures, they will be encouraged to refer to the SASA Academy SAF learning modules as well as to the SAF Standards of Practices (SP), which provides policies and procedures guidance, and contains active links to forms, documents, and reference material related to SAF activities.

As the first point of contact for SAF users, the CABMs will be reminded to assist users with any system or policy/procedural questions or concerns, as well as do timely reviews of the status of SAF account balances, bank reconciliations, cash receipts and disbursement entries, and confirm that the administrator's checklist is reviewed and signed timely.

*Contact Person: Tom Ishimaru, Accounting Director
 Accounting Services Branch
 Office of Fiscal Services*

Anticipated Completion Date: May 30, 2017

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-06 Submit Employer's Report of Industrial Injury Timely

Recommendation

The schools and offices where the injured employees work should ensure timely submission of the Form WC-1, Employer's Report of Industrial Injury.

View of Responsible Officials

Management agrees with the finding and continues to provide support to the schools and offices. However, this finding and recommendation should continue to be directed to the specific schools or offices where the delinquent submissions were found. Details regarding the guidance and support provided by the Office of Human Resources (OHR) are submitted below.

Corrective Action Plan

The schools and offices where the injured employees work should ensure timely submission of the Form WC-1, Employer's Report of Industrial Injury (WC-1). The specific schools and/or offices responsible for the 17 untimely submissions of the WC-1 should be responsible for addressing the findings and recommendations.

The requirement to submit the WC-1 to the Department of Labor and Industrial Relations (DLIR) via the Department of Education (DOE) Workers' Compensation (WC) Unit within seven (7) working days has been communicated to schools and offices repeatedly and reinforced as follow:

- 1) School Code Procedure #5504 and #5504.1 (for schools, districts, and state offices applying for WC benefits);*
- 2) Training provided by the WC Unit to schools and offices, upon request;*
- 3) DOE, OHR Intranet Portal, WC site, WC forms, and WC instructional packet and forms;*
- 4) The memorandum, dated May 27, 2014, from Superintendent Kathryn S. Matayoshi entitled, "Request for Corrective Action Plan for Schools/Offices with Audit Findings from the Annual Financial & Single Audit Report FYE 06/30/13";*
- 5) The memorandum, dated May 6, 2015, from Superintendent Kathryn S. Matayoshi entitled, "Request for Corrective Action Plan for Schools/Offices with Audit Findings from the Annual Financial & Single Audit Report FYE 06/30/14";*
- 6) The memorandum, dated April 25, 2016, from Superintendent Kathryn S. Matayoshi entitled, "Request for Corrective Action Plan for Schools/Offices with*

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-06 Submit Employer's Report of Industrial Injury Timely (Continued)

Audit Findings from the Annual Financial & Single Audit Report FYE 06/30/15";

- 7) The memorandum, dated January 23, 2015, from OHR Assistant Superintendent Barbara A. Krieg entitled, "Instructions for Completing and Filing Form WC-1, Employer's Report of Industrial Injury";*
- 8) The School Administrative Services Assistant (SASA) Academy, Workers' Compensation course #PD180369 was updated and mandatory for all SASAs, effective September 29, 2015. This was communicated in the September 29, 2015 memorandum to all principals and SASAs from Superintendent Kathryn S. Matayoshi, entitled, "Mandatory Workers' Compensation Course"; and*
- 9) Quarterly reports of non-compliance are distributed by OHR Assistant Superintendent Barbara Krieg to all Complex Area Superintendents (CAS) to ensure timely compliance. The latest report was distributed on February 24, 2017 for the second quarter of school year (SY) 2016-2017.*

The Office of Human Resources, Personnel Assistance Branch, Workers' Compensation Unit will:

- 1) Continue to forward quarterly reports of non-compliance to CASs through the OHR Assistant Superintendent with a reminder that penalties assessed to the DOE will be remitted to the schools/offices for payment.*
- 2) Continue to issue and maintain notices, reminders and guidance.*
- 3) Continue to provide training, upon request, to any schools or offices desiring the same.*

*Contact Person: Aizen Mineshima, Personnel Program Manager
Workers' Compensation Unit, Personnel Assistance Branch
Office of Human Resource*

Anticipated Completion Date: Completed and will continue.

16-07 Perform Timely Quality Control Reviews and Monitoring Procedures for Workers' Compensation Reserves

Recommendation

To ensure reasonable measurement of the workers compensation liability, the DOE should perform timely quality control reviews and monitoring of the workers compensation reserves and adjust the reserves accordingly.

Department of Education
State of Hawaii
MANAGEMENT LETTER RESPONSE
June 30, 2016

16-07 Perform Timely Quality Control Reviews and Monitoring Procedures for Workers' Compensation Reserves (Continued)

In addition, the DOE should assess its current reserves methodology and established amounts used to determine the reserves to ensure the reserves represent a reasonable estimation of workers' compensation costs that could be incurred for claims. This may include a study of how the reserve estimates compare to the final claim. Reserve increases and decreases over time can be studied for indication whether initial reserves are reasonable.

View of Responsible Officials

Management agrees with the findings; and will continue performing timely quality reviews and monitoring of WC reserves and adjusting the reserves accordingly.

Corrective Action Plan

The Office of Human Resources, Personnel Assistance Branch, Workers' Compensation (WC) Unit will:

- 1) Continue to review, assess and refine the reserve methodology, procedures and worksheet that was created to work with the upgraded NavRisk database system in December 2016. The new procedures define each reserve category and explain reserve rationale for each type of payment. Standards of reserving based on WC law were used as the basis for reserve rationale.*
- 2) Continue to train staff to improve the process of evaluation and justification of reserves.*
- 3) Continue to review and monitor reserve data and procedures to ensure reasonable measurement of WC liability and monitoring of accurate reserves.*
- 4) Continue reassigning work from the WC Unit Supervisor to staff, to help provide additional support, stricter oversight and monitoring of WC claims, and help ensure timely reviews and alerts to the unit supervisor for correction of claims data and its corresponding reserve allocations. However, we note here the chronic staffing shortfall and repeated (unsuccessful) attempts to obtain additional authorized positions for the WC functions.*

*Contact Person: Aizen Mineshima, Personnel Program Manager
Workers' Compensation Unit, Personnel Assistance Branch
Office of Human Resource*

Anticipated Completion Date: March 31, 2018

ORIGINAL

DEPT. COMM. NO. 356

**FINANCIAL AUDIT OF THE
DEPARTMENT OF EDUCATION
STATE OF HAWAII**

Fiscal Year Ended June 30, 2016

**Submitted by
The Auditor
State of Hawaii**



March 24, 2017

Mr. Leslie Kondo, State Auditor
Office of the Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education

Dear Mr. Kondo and the Board of Education:

This is our report on the financial audit of the Department of Education of the State of Hawaii (DOE) as of and for the fiscal year ended June 30, 2016. Our audit was conducted in accordance with the terms of our contract with the Office of the Auditor, State of Hawaii and with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

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 basic financial statements as of and for the fiscal year ended June 30, 2016, and to comply with the requirements of the Uniform Guidance, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for opinions on the fairness of the DOE's basic financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2016.
2. To consider the DOE's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the DOE's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D and 103F, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the DOE's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.

5. To provide an opinion on the DOE's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.

SCOPE OF THE AUDIT

Our audit was conducted 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 Uniform Guidance. The scope of our audit included an examination of the transactions and accounting records of the DOE for the fiscal year ended June 30, 2016.

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, 2016, and our opinions on the basic financial statements and supplementary information.
- Part II - Our report on internal control over financial reporting and on compliance and other matters.
- Part III - Our report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - Departmental response as provided by the Department of Education, State of Hawaii.
- Part VI - The summary schedule of prior audit findings.

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

Sincerely,

N + K CPAs, INC.

**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

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**DEPARTMENT OF EDUCATION
STATE OF HAWAII**

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PART I
FINANCIAL SECTION

INDEPENDENT AUDITOR'S REPORT

To the Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education of the State of Hawaii (Department), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain public charter schools which represent 1% of the total assets and 1% of total fund balances as of June 30, 2016, and 3% of total revenues for the fiscal year ended June 30, 2016, of the Department's governmental funds. Those statements were audited by other auditors, whose reports have been furnished to us, and our opinions, insofar as it relates to the amounts included for the Department, is based on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of

the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2016, and the respective changes in financial position, and, where applicable, the respective budgetary comparison for the General Fund and Federal Fund for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A, the financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2016, and the changes in its financial position for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 8 - 14 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the

information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2017, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

N + K CPAs, INC.

Honolulu, Hawaii
March 24, 2017

**Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year Ended June 30, 2016**

As management of the Department of Education of the State of Hawaii (the Department) we offer readers this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2016. We encourage readers to consider the information presented here in conjunction with the accompanying basic financial statements and notes to enhance their understanding of the Department's financial performance.

The basic financial statements represent the combination of Department of Education (DOE), the Hawaii State Public Library System (HSPLS), and the Public Charter Schools (PCS) where the DOE prepares entries, based on information provided by the HSPLS and PCS, to combine financial data for the three units, in aggregate known as the Department. The fiscal and oversight authority for the DOE, HSPLS and PCS are managed independently. The DOE has determined that the PCS balances are significant, but not material, and relies on certain financial information which have been audited by other auditors and coordinated by the PCS.

FINANCIAL HIGHLIGHTS

Key government-wide financial highlights for fiscal year ended June 30, 2016 (FY 2016) compared to the prior fiscal year ended June 30, 2015 (FY 2015) are as follows:

- Total FY 2016 revenues were \$3.098 billion, an increase of 12% or \$341 million from \$2.757 billion in FY 2015.
- Total FY 2016 expenses were \$2.679 billion, an increase of 5% or \$128 million from \$2.550 billion in FY 2015.
- Of the total FY 2016 expenses of \$2.679 billion, 93% or \$2.498 billion was spent for school-related activities. Of the total FY 2015 expenses of \$2.550 billion, 94% or \$2.393 billion was spent for school-related activities.
- Total assets exceeded liabilities as of June 30, 2016 by \$2.233 billion (net position), compared to \$1.815 billion as of June 30, 2015, an increase of 23%.
- Capital assets, net of accumulated depreciation, comprised 70% and 81% of total net position as of June 30, 2016 and 2015, respectively.

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The Department's basic financial statements which are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

- *Government-wide financial statements* - These statements provide a broad overview of the Department's finances, in a manner similar to a private sector business.

The statement of net position presents information on all of the Department's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The statement of activities presents information showing how the Department's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

- *Fund financial statements* - A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department has two types of funds: governmental funds and fiduciary funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, the governmental funds financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's near-term financial position. The Department presents four major funds in the fund financial statements: (1) General Fund, (2) Federal Fund, (3) Capital Projects Fund, and (4) Other Fund.

The Department has an annual appropriated budget for its general and federal funds. A budgetary comparison schedule has been provided for these funds to demonstrate compliance with the budget.

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (Continued)

Fiduciary funds are used to account for resources held for the benefit of parties outside the Department. The Department reports on agency funds (or student activity funds as the term is used in the 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. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's programs.

- *Notes to Basic Financial Statements* - The notes to basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

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

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016

Exhibit A-1
Government-wide Statements of Net Position
Fiscal years 2016 and 2015
(Amounts in millions)

	Governmental activities		2016 - 2015	
	2016	2015	Increase (decrease)	Percentage change
Assets:				
Current	\$ 1,096.4	\$ 771.1	\$ 325.3	42 %
Noncurrent (capital assets, net of depreciation)	<u>1,561.2</u>	<u>1,463.1</u>	<u>98.1</u>	7 %
Total assets	\$ <u>2,657.6</u>	\$ <u>2,234.2</u>	\$ <u>423.4</u>	19 %
Liabilities:				
Current	\$ 300.6	\$ 308.1	\$ (7.5)	(2) %
Noncurrent	<u>123.7</u>	<u>111.2</u>	<u>12.5</u>	11 %
Total liabilities	<u>424.3</u>	<u>419.3</u>	<u>5.0</u>	1 %
Net position:				
Investment in capital assets	1,561.2	1,463.1	98.1	7 %
Restricted	2.2	5.8	(3.6)	(62) %
Unrestricted	<u>669.9</u>	<u>346.0</u>	<u>323.9</u>	94 %
Total net position	<u>2,233.3</u>	<u>1,814.9</u>	<u>418.4</u>	23 %
Total liabilities and net position	\$ <u>2,657.6</u>	\$ <u>2,234.2</u>	\$ <u>423.4</u>	19 %

Overall Financial Position - The Department's overall net position has increased as of June 30, 2016 compared to the prior fiscal year-end. The Department's largest portion of net position is investment in capital assets (e.g., land, buildings, equipment), which are unavailable for future spending. The Department's unrestricted portion of net position is available for future use to provide program services. Total government-wide net position increased by \$418 million, or 23%, primarily due to an increase in unrestricted net position.

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016

Exhibit A-2
Government-wide Changes of Net Position
Fiscal years 2016 and 2015
(Amounts in millions)

	Governmental activities		2016 - 2015	
	2016	2015	Increase (decrease)	Percentage change
Revenues:				
Program revenues:				
Charges for services	\$ 62.3	\$ 53.8	\$ 8.5	16 %
Operating grants and contributions	265.5	260.2	5.3	2 %
Capital grants and contributions	7.7	10.5	(2.8)	(27) %
General revenues:				
State allotted appropriations, net of lapses	2,223.3	1,942.5	280.8	14 %
Non-imposed employee wages and fringe benefits	538.6	489.6	49.0	10 %
Unrestricted investment earnings	0.4	0.2	0.2	100 %
Total	\$ 3,097.8	\$ 2,756.8	\$ 341.0	12 %
Transfers, net	\$ (0.9)	(0.9)	0.0	0 %
Expenses:				
School-related	\$ 2,498.0	2,392.8	105.2	4 %
State and complex area administration	67.7	62.6	5.1	8 %
Public libraries	46.8	37.1	9.7	26 %
Capital outlay	66.0	57.6	8.4	15 %
Total	2,678.5	2,550.1	128.4	5 %
Change in net position	\$ 418.4	\$ 205.8	\$ 212.6	103 %

Overall Results of Operations - The Department's results of operations for FY 2016 have resulted in an increase in net position of \$418 million. This is somewhat higher than the increase in net position of \$206 million for the prior FY 2015. Total FY 2016 expenses were \$2.678 billion, an increase of 5% or \$128 million from \$2.550 billion in FY 2015.

Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016

GOVERNMENTAL FUND FINANCIAL ANALYSIS

Within the governmental fund financial statements, the overall net change in fund balance for FY 2016 was \$333.3 million, and the total overall fund balance for the governmental funds as of June 30, 2016 was \$ 831.1 million.

General Fund Budget Results - The Department was appropriated general funds of \$1.643 billion in FY 2016. Increases of "Final" compared to "Original" budgeted amounts as reported on the Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis) - General Fund are primarily due to legislative appropriations due to collective bargaining compensation changes.

For the General Fund, the Department is allowed to carry over up to 5% of any appropriation at the end of the fiscal year. 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 DOE's single-school calendar, schools start their school year in July statewide, within weeks of the beginning of the fiscal year. For the fiscal year ended June 30, 2016, general funds carried over totaled \$45.4 million, representing 3% of general fund appropriations.

Federal Fund Budget Results - The Department expended \$29.5 million less federal funds than was appropriated during FY 2016; this merely reflects the timing of expenditures versus federal cash that may have been received during the fiscal year.

AGENCY FUNDS

Agency funds, or "student activity funds," are held for students in a custodial capacity and do not require deposit into the State Treasury. The fund contains 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 funds due to the students and others was \$25.9 million in FY 2016 representing a 3% increase from the prior fiscal year balance of \$25.3 million.

CAPITAL ASSETS

The Department's capital improvement program strives to provide and maintain 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.

**Department of Education
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2016**

The Department's capital assets as of June 30, 2016 amounted to \$1.561 billion (net of accumulated depreciation of \$1.668 billion), an increase of \$98.1 million, compared to capital assets as of June 30, 2015 which amounted to \$1.463 billion (net of accumulated depreciation of \$1.554 billion). Depreciation expense for FY 2016 amounted to \$126.9 million.

The Department is committed under contracts awarded and orders placed for construction, repairs and maintenance, and related expenses. These commitments amounted to approximately \$533.3 million.

Additional information on the Department's capital assets and construction contract commitments can be found in Note E and Note L to the basic financial statements.

REQUESTS FOR INFORMATION

Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of the Fiscal Services, Department of Education, P.O. Box 2360, Honolulu, Hawaii 96804. General information about the Department can be found at the Department's website, www.hawaiipublicschools.org.

Department of Education
State of Hawaii
STATEMENT OF NET POSITION
June 30, 2016

	<u>Governmental Activities</u>
ASSETS	
Current assets	
Cash	\$ 1,055,520,677
Receivables	
Due from federal government	27,887,763
Due from other agencies	2,233,516
Accounts receivable	<u>10,810,591</u>
Total current assets	1,096,452,547
Capital assets, net of accumulated depreciation	<u>1,561,170,829</u>
Total assets	\$ <u><u>2,657,623,376</u></u>
LIABILITIES AND NET POSITION	
Current liabilities	
Vouchers and contracts payable	\$ 123,319,541
Accrued wages and employee benefits	137,020,887
Accrued compensated absences	21,601,923
Workers' compensation claims reserve	13,623,736
Due to State of Hawaii general fund	<u>5,000,000</u>
Total current liabilities	300,566,087
Accrued compensated absences, less current portion	46,463,262
Workers' compensation claims reserve, less current portion	<u>77,201,173</u>
Total liabilities	<u>424,230,522</u>
Net position	
Net investment in capital assets	1,561,170,829
Restricted	2,263,687
Unrestricted	<u>669,958,338</u>
Total net position	<u>2,233,392,854</u>
Total liabilities and net position	\$ <u><u>2,657,623,376</u></u>

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2016

	Program revenues			Net revenue (expenses) and change in net assets Governmental activities
	Expenses	Charges for services	Operating grants and contributions	
Governmental activities:				
School-related	\$ 2,497,993,229	\$ 60,419,832	\$ 262,316,539	\$ (2,175,256,858)
State and complex area administration	67,724,294	--	1,808,365	(65,915,929)
Public libraries	46,777,251	1,891,246	1,368,734	(43,517,271)
Capital outlay	66,006,577	--	--	(58,311,282)
Total governmental activities	\$ 2,678,501,351	\$ 62,311,078	\$ 265,493,638	(2,343,001,340)
General revenues:				
State allotted appropriations, net of lapses				2,223,274,344
Nonimposed employee wages and fringe benefits				538,637,867
Unrestricted investment earnings				388,796
Total general revenues				2,762,301,007
Other financing sources (uses):				
Transfers in				1,738,931
Transfers out				(2,620,431)
Net transfers				(881,500)
Change in net position				418,418,167
Net position at June 30, 2015				1,814,974,687
Net position at June 30, 2016				\$ 2,233,392,854

See accompanying notes to the basic financial statements.

**Department of Education
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2016**

	<u>General</u>	<u>Federal</u>	<u>Capital Projects</u>	<u>Other</u>	<u>Total</u>
ASSETS					
Cash and cash equivalents	\$ 159,643,965	\$ 135,883,835	\$ 677,010,320	\$ 82,982,557	\$ 1,055,520,677
Receivables					
Due from federal government	--	27,887,763	--	--	27,887,763
Due from other agencies	--	--	--	2,233,516	2,233,516
Accounts receivable	--	--	--	<u>10,810,591</u>	<u>10,810,591</u>
Total assets	\$ <u>159,643,965</u>	\$ <u>163,771,598</u>	\$ <u>677,010,320</u>	\$ <u>96,026,664</u>	\$ <u>1,096,452,547</u>
LIABILITIES AND FUND BALANCES (DEFICITS)					
LIABILITIES					
Vouchers and contracts payable	\$ 48,048,561	\$ 17,390,179	\$ 52,588,856	\$ 5,291,945	\$ 123,319,541
Accrued wages and employee benefits payable	127,707,849	5,224,844	335,165	3,753,029	137,020,887
Due to State general fund	<u>5,000,000</u>	--	--	--	<u>5,000,000</u>
Total liabilities	<u>180,756,410</u>	<u>22,615,023</u>	<u>52,924,021</u>	<u>9,044,974</u>	<u>265,340,428</u>
FUND BALANCES (DEFICITS)					
Restricted	--	2,263,687	--	--	2,263,687
Committed	--	--	--	86,981,690	86,981,690
Assigned	72,703,181	138,892,888	624,086,299	--	835,682,368
Unassigned	<u>(93,815,626)</u>	--	--	--	<u>(93,815,626)</u>
Total fund balances (deficits)	<u>(21,112,445)</u>	<u>141,156,575</u>	<u>624,086,299</u>	<u>86,981,690</u>	<u>831,112,119</u>
Total liabilities and fund balances (deficits)	\$ <u>159,643,965</u>	\$ <u>163,771,598</u>	\$ <u>677,010,320</u>	\$ <u>96,026,664</u>	\$ <u>1,096,452,547</u>

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET POSITION**
June 30, 2016

Total fund balances - governmental funds		\$ 831,112,119
Amounts reported for governmental activities in the statement of net position are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.		
Capital Assets		
Governmental capital assets	\$ 3,229,237,107	
Less accumulated depreciation	<u>(1,668,066,278)</u>	1,561,170,829
Accrued compensated absences are not due in the current period and therefore are not reported in the governmental funds.		(68,065,185)
Workers' compensation claims reserve is not due in the current period and, therefore, is not reported in the funds.		<u>(90,824,909)</u>
Net position of governmental activities		\$ <u>2,233,392,854</u>

See accompanying notes to the basic financial statements.

**Department of Education
State of Hawaii
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Fiscal Year Ended June 30, 2016**

	General	Federal	Capital Projects	Other	Total
REVENUES					
State allotments, net	\$ 1,678,009,753	\$ --	\$ 318,576,304	\$ 4,567,670	\$ 2,001,153,727
Nonimposed employee wages and fringe benefits	538,637,867	--	--	--	538,637,867
Intergovernmental revenues	--	261,911,363	--	1,134,132	263,045,495
Other revenues	--	--	222,120,617	72,843,312	294,963,929
	<u>2,216,647,620</u>	<u>261,911,363</u>	<u>540,696,921</u>	<u>78,545,114</u>	<u>3,097,801,018</u>
EXPENDITURES					
School-related	2,088,942,747	227,498,223	--	68,305,398	2,384,746,368
State and complex area administration	63,236,843	2,599,700	--	133,953	65,970,496
Public libraries	43,124,904	1,149,760	--	2,021,249	46,295,913
Capital outlay	825,788	7,695,235	253,375,128	4,621,395	266,517,546
	<u>2,196,130,282</u>	<u>238,942,918</u>	<u>253,375,128</u>	<u>75,081,995</u>	<u>2,763,530,323</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>20,517,338</u>	<u>22,968,445</u>	<u>287,321,793</u>	<u>3,463,119</u>	<u>334,270,695</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	--	1,619,851	1,619,851
Transfers out	--	(1,619,851)	(1,000,580)	--	(2,620,431)
Total other financing sources (uses)	--	(1,619,851)	(1,000,580)	1,619,851	(1,000,580)
NET CHANGE IN FUND BALANCES	20,517,338	21,348,594	286,321,213	5,082,970	333,270,115
FUND BALANCES (DEFICITS) AT JULY 1, 2015	<u>(41,629,783)</u>	<u>119,807,981</u>	<u>337,765,086</u>	<u>81,898,720</u>	<u>497,842,004</u>
FUND BALANCES (DEFICITS) AT JUNE 30, 2016	\$ <u>(21,112,445)</u>	\$ <u>141,156,575</u>	\$ <u>624,086,299</u>	\$ <u>86,981,690</u>	\$ <u>831,112,119</u>

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2016

Net change in fund balances - total government funds	\$ 333,270,115
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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
 as depreciation expense.

Expenditures for capital assets	\$ 229,854,934	
Loss on disposal of capital assets	(4,898,733)	
Less current fiscal year depreciation	<u>(126,930,378)</u>	98,025,823

Change in 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	(1,603,813)
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Change in workers' compensation liability reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as expenditures in governmental funds	<u>(11,273,958)</u>
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Change in net position of governmental activities	\$ <u>418,418,167</u>
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See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
STATEMENT OF REVENUES AND EXPENDITURES -
BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS) - GENERAL FUND
Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual on	Variance
	Original	Final	Budgetary	Favorable
			Basis	(Unfavorable)
REVENUES				
State allotments	\$ 1,642,608,565	\$ 1,679,523,275	\$ 1,679,492,561	\$ (30,714)
EXPENDITURES				
School-related	1,563,064,441	1,605,528,771	1,560,724,963	44,803,808
State and complex				
area administration	46,984,179	41,562,251	40,915,231	647,020
Public libraries	32,559,945	32,432,253	32,432,121	132
	<u>1,642,608,565</u>	<u>1,679,523,275</u>	<u>1,634,072,315</u>	<u>45,450,960</u>
Excess of revenues over				
expenditures	\$ --	\$ --	\$ 45,420,246	\$ 45,420,246

See accompanying notes to the basic financial statements.

Department of Education
 State of Hawaii
STATEMENT OF REVENUES AND EXPENDITURES -
BUDGET AND ACTUAL (NON-GAAP BUDGETARY BASIS) - FEDERAL FUND
Fiscal Year Ended June 30, 2016

	Budgeted Amounts		Actual on	Variance
	Original	Final	Budgetary	Favorable
			Basis	(Unfavorable)
REVENUES				
Federal grants	\$ 492,799,059	\$ 429,792,772	\$ 245,418,947	\$ (184,373,825)
	<u>492,799,059</u>	<u>429,792,772</u>	<u>245,418,947</u>	<u>(184,373,825)</u>
EXPENDITURES				
School-related	490,307,047	421,321,710	212,826,276	208,495,434
State and complex				
area administration	1,126,768	7,721,062	2,708,526	5,012,536
Public libraries	<u>1,365,244</u>	<u>750,000</u>	<u>391,891</u>	<u>358,109</u>
	<u>492,799,059</u>	<u>429,792,772</u>	<u>215,926,693</u>	<u>213,866,079</u>
Excess of revenues over				
expenditures	\$ <u> --</u>	\$ <u> --</u>	\$ <u>29,492,254</u>	\$ <u>29,492,254</u>

See accompanying notes to the basic financial statements.

Department of Education
State of Hawaii
STATEMENT OF FIDUCIARY NET POSITION - AGENCY FUNDS
June 30, 2016

	<u>Agency Funds</u>
ASSETS	
Cash and cash deposits in financial institutions	\$ <u>25,942,270</u>
Total assets	<u>25,942,270</u>
LIABILITIES	
Due to student groups and others	<u>25,942,270</u>
Total liabilities	<u>25,942,270</u>
NET POSITION	\$ <u><u> --</u></u>

See accompanying notes to the basic financial statements.

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE A - FINANCIAL REPORTING ENTITY

- (1) **Introduction** - The Department of Education of the State of Hawaii (the Department) administers the statewide system of public schools and public libraries. Additionally, the Department 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 noncollege type of school. Federal grants received to support public school and public library programs are administered by the Department on a statewide basis.

These financial statements represent the combination of the Department of Education (DOE), the Hawaii State Public Library System (HSPLS), and the Public Charter Schools (PCS) where the DOE prepares entries, based on information provided by the HSPLS and PCS, to combine financial data for the three units, in aggregate known as the Department. The fiscal and oversight authority for the DOE, HSPLS and PCS are managed independently. The DOE has determined that the PCS balances are significant, but not material, and relies on certain financial information which have been audited by other auditors and coordinated by the PCS.

The Department is a part of the executive branch of the State of Hawaii (the State). The financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2016, and the changes in its financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America (GAAP). The State Comptroller maintains the central accounts for all state funds and publishes the State's Comprehensive Annual Financial Report, which includes the Department's financial activities.

- (2) **Reporting Entity** - The Department has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Department are such that exclusion would cause the Department's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. The Department has determined, based on the GASB criteria, that it has no component units.

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Department have been prepared in accordance with GAAP 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 Department as a whole.

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments are reported as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net position is restricted when constraints placed on it are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net position. When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

Separate financial statements are provided for governmental funds and fiduciary funds. The fiduciary funds, however, are excluded from the government-wide financial statements because the Department cannot use those assets to finance its operations. Major individual governmental funds are reported as separate columns in the fund financial statements. Nonmajor funds are summarized into a single column.

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

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.

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 Department 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

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

expenditure due to the State's present appropriation system. These revenues have been accrued in accordance with GAAP since they have been earned and are expected to be collected within 60 days of the end of the period. Other revenues are considered to be measurable and available only when cash is received by the Department.

Expenditures generally are recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include employees' vested vacation and workers' compensation claims, which are recorded as expenditures when utilized or paid. The amount of accumulated vacation and for workers' compensation claims reserve at June 30, 2016 has been reported only in the government-wide financial statements.

Encumbrances are recorded obligations in the form of purchase or contracts. The State records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at fiscal year-end do not constitute expenditures or liabilities.

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. Agency funds do not have a measurement focus and report only assets and liabilities.

(3) Fund Accounting

The financial transactions of the Department 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 nonmajor funds are combined in one column. Major funds are funds that have total assets, liabilities, revenues, or expenditures of the fund that are at least 10% of the same element for all funds of its fund type or at least 5% of the same element for all governmental funds combined.

Governmental Funds

General Fund - The general fund is the main operating fund of the Department. 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.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Fund - The federal fund is used to account for federally funded programs for the Department's major activities. This fund is made up entirely by special revenue funds, which account for the proceeds of specific revenue sources that are for specified purposes. In this case, the expenditures are for activities authorized by the federal agency grantor.

Capital Projects Fund - The capital projects fund includes all amounts related to the Department's capital improvement program. It is used to account for financial resources used for the acquisition or construction of major capital facilities.

Other Funds - The other funds is used to account for all financial activities not required to be accounted for in another fund. It includes special revenue and trust funds, which account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes.

Fund Balance

In the fund financial statements, Governmental Funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

The Department classifies fund balances based primarily on the extent to which a government is bound to follow constraints on how resources can be spent in accordance with GASB Statement No. 54 (GASB 54), *Fund Balance Reporting and Governmental Fund Type Definitions*. Classifications include:

Restricted - Balances that are restricted for specific purposes by external parties such as creditors, grantors, or other governments.

Committed - Balances that can only be used for specific purposes pursuant to constraints imposed by formal action of the State Legislature.

Assigned - Balances that are constrained by management to be used for specific purposes, but are neither restricted nor committed.

Unassigned - Residual balances that are not contained in the other classifications.

When both restricted and unrestricted resources are available for use, generally it is the Department's policy to use restricted resources first, then unrestricted resources as they are needed. When committed, assigned and unassigned resources are available for use, generally it is the Department's policy that committed amounts be reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of these unrestricted fund balance classifications could be used.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fiduciary Funds

Agency Fund - The agency funds are used to account for assets held by the Department 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 and Cash Equivalents** - 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 monies paid into the State Treasury. 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 weighted average cash balances of each account.

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.

Major outlays for capital assets and improvements are capitalized as projects are constructed. 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.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

Depreciation expense is recorded in the government-wide financial statements. The Department utilizes the straight-line method over the assets' estimated useful life. No depreciation is recorded for land. The Department 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) **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 position.
- (7) **Program Revenues** - Program revenues are derived directly from the programs of the Department or from parties outside of the Department 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 nonexchange 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.

- (8) **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.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (9) **Risk Management** - The Department 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.
- (10) **Use of Estimates** - The preparation of the basic financial statements in accordance with GAAP 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 5% 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, 2016, general funds carried over amounted to approximately \$45,400,000 representing approximately 3% of appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in accordance with GAAP. The Department'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 grants accruals and deferrals. These differences represent a departure from GAAP.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2016:

	<u>General</u>	<u>Federal</u>
Excess of revenues over expenditures - actual on a budgetary basis	\$ 45,420,246	\$ 29,492,254
Reserved for encumbrances at fiscal year-end	82,979,127	15,742,358
Expenditures for liquidation of prior fiscal year encumbrances	(115,977,826)	(25,579,002)
Net accrued revenues and expenditures	<u>8,095,791</u>	<u>3,312,835</u>
Excess of revenues over expenditures - GAAP basis	\$ <u>20,517,338</u>	\$ <u>22,968,445</u>

NOTE D - CASH AND CASH EQUIVALENTS

The Director is responsible for the safekeeping of all monies paid into the State Treasury. The Director may invest any monies of the State, which, in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of or guaranteed by the U.S. government, obligations of the State, federally insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions.

Information relating to the bank balance, insurance, and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

Cash and cash equivalents at June 30, 2016 consisted of amounts held in State Treasury of approximately \$1,013,827,000.

- (1) **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.
- (2) **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.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE D - CASH AND CASH EQUIVALENTS (Continued)

- (3) ***Custodial Credit 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.
- (4) ***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.
- (5) ***Cash in Bank*** - The DOE maintains cash in banks which is held separately from cash in the State Treasury. As of June 30, 2016, the carrying amount of total bank deposits was approximately \$6,942,000 and the corresponding bank balances were approximately \$19,622,000. The PCS also held cash outside of the State Treasury totaling approximately \$34,752,000 at June 30, 2016.

All deposits are collateralized in accordance with State statutes. The balances are insured by the Federal Deposit Insurance Corporation (FDIC) and collateralized with securities held by the Department's agent. 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.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE E - CAPITAL ASSETS

For the fiscal year ended June 30, 2016, capital assets activity for the DOE was as follows:

	Balance July 1, 2015	Additions	Deductions	Balance June 30, 2016
Government activities:				
Capital asset, not being depreciated:				
Land	\$ 88,238,609	\$ --	\$ --	\$ 88,238,609
Construction in progress	<u>205,649,780</u>	<u>205,409,702</u>	<u>(214,074,917)</u>	<u>196,984,565</u>
Total capital assets not being depreciated	<u>293,888,389</u>	<u>205,409,702</u>	<u>(214,074,917)</u>	<u>285,223,174</u>
Capital assets, being depreciated:				
Land improvements	236,983,751	25,245,029	--	262,228,780
Buildings and improvements	2,166,459,331	147,481,907	--	2,313,941,238
Furniture and equipment	239,228,294	58,600,563	(6,678,740)	291,150,117
Vehicles	10,845,980	327,055	(68,959)	11,104,076
Public library materials	<u>70,146,900</u>	<u>4,589,559</u>	<u>(9,146,737)</u>	<u>65,589,722</u>
Total capital assets being depreciated	<u>2,723,664,256</u>	<u>236,244,113</u>	<u>(15,894,436)</u>	<u>2,944,013,933</u>
Less accumulated depreciation for:				
Land improvements	(134,284,603)	(13,372,675)	--	(147,657,278)
Buildings and improvements	(1,230,242,808)	(64,164,975)	--	(1,294,407,783)
Furniture and equipment	(120,591,456)	(44,013,646)	4,056,673	(160,548,429)
Vehicles	(9,666,134)	(547,950)	68,329	(10,145,755)
Public library materials	<u>(59,622,638)</u>	<u>(4,831,132)</u>	<u>9,146,737</u>	<u>(55,307,033)</u>
Total accumulated depreciation	<u>(1,554,407,639)</u>	<u>(126,930,378)</u>	<u>13,271,739</u>	<u>(1,668,066,278)</u>
Government activities, net	\$ <u>1,463,145,006</u>	\$ <u>314,723,437</u>	\$ <u>(216,697,614)</u>	\$ <u>1,561,170,829</u>

Depreciation expense was charged to functions as follows:

	Governmental Activities
School-related	\$ 117,004,844
State and complex area administration	1,709,950
Public libraries	<u>8,215,584</u>
Total additions to accumulated depreciation	\$ <u>126,930,378</u>

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE F - LONG-TERM LIABILITIES

The change in long-term liabilities during the fiscal year ended June 30, 2016, was as follows:

	Accrued compensated absences	Workers' compensation claims
Balance at July 1, 2015	\$ 66,461,372	\$ 79,550,951
Additions	27,875,990	23,955,461
Reductions	<u>(26,272,177)</u>	<u>(12,681,503)</u>
Balance at June 30, 2016	68,065,185	90,824,909
Less current portion	<u>(21,601,923)</u>	<u>(13,623,736)</u>
	\$ <u>46,463,262</u>	\$ <u>77,201,173</u>

The compensated absences and workers' compensation liabilities have been paid primarily by the general fund in the past. The carrying amount of liabilities for unpaid workers' compensation claims of approximately \$93.6 million is reported at present value using a discount rate of 2.0 %.

NOTE G - FOOD DISTRIBUTION PROGRAM

U.S. Department of Agriculture (USDA), Food and Nutrition Service (FNS), has delegated to the Hawaii Child Nutrition Programs office (HCNP) the administrative responsibility of the Food Distribution Program. HCNP is the State Agency that distributes USDA Foods to schools (public, private, and charter), institutions and organizations that participate in the National School Lunch Program (NSLP) and Summer Food Service Program (SFSP). Hawaii's entitlement is determined in part by the number of lunches reimbursed under the NSLP and SFSP of the previous school year. FNS estimates the cost to purchase the USDA Foods. The estimated prices can be found by referring to: <http://www.fns.usda.gov/fdd/pcims/Nov15CommodityFiles.htm>. The amount charged to the entitlement is based upon the net dollar values of the purchased USDA Foods. Bonus commodities are USDA Foods that are additional to Hawaii's entitlement. A portion of the entitlement is allocated for the purchase of fresh produce.

The Department received approximately \$ 5,402,376 of commodities for the fiscal year ended June 30, 2016. No bonus commodities were received for the fiscal year ended June 30, 2016.

NOTE H - NONIMPOSED EMPLOYEE WAGES AND FRINGE BENEFITS

Payroll fringe benefit costs and certain payroll costs related to backpay of the Department's employees that are funded by state appropriations are assumed by the State and are not charged to the Department's operating funds. These costs, totaling approximately \$538,638,000 for the fiscal year ended June 30, 2016, have been reported as revenues and expenditures in the general fund of the Department.

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE I - LEASE COMMITMENTS

The Department leases equipment from third-party lessors under various operating leases expiring through 2023. Future minimum lease rentals under noncancelable operating leases with terms of one year or more at June 30, 2016 were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2017	\$ 4,210,000
2018	3,230,000
2019	2,172,000
2020	1,256,000
2021	422,000
2022 - 2023	<u>121,000</u>
	\$ <u>11,411,000</u>

Total rent expense related to the above leases for the fiscal year ended June 30, 2016 amounted to approximately \$4,256,000.

NOTE J - RETIREMENT BENEFITS

(1) *Employees' Retirement System (ERS)*

Plan Description - Generally, all full-time employees of the State and counties are required to be members of the ERS, a cost-sharing multiple-employer defined benefit pension plan that administers the State's pension benefits program. Benefits, eligibility, and contribution requirements are governed by HRS Chapter 88 and can be amended through legislation. The ERS issues publicly available annual financial reports that can be obtained at ERS' website: <http://www.ers.ehawaii.gov>.

Benefits Provided - The ERS Pension Trust is comprised of three pension classes for membership purposes and considered to be a single plan for accounting purposes since all assets of the ERS may legally be used to pay the benefits of any of the ERS members or beneficiaries. The ERS provides retirement, disability and death benefits with three membership classes known as the noncontributory, contributory and hybrid retirement classes. The three classes provide a monthly retirement allowance equal to the benefit multiplier (generally 1.25% or 2%) multiplied by the average final compensation multiplied by years of credited service. Average final compensation for members hired prior to July 1, 2012 is an average of the highest salaries during any three years of credited service, excluding any salary paid in lieu of vacation for members hired January 1, 1971 or later and the average of the highest salaries during any five years of credited service including any salary paid in lieu of vacation for members hired prior to January 1, 1971. For members hired after June 30, 2012, average final compensation is an average of the highest salaries during any five years of credited service excluding any salary paid in lieu of vacation.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE J - RETIREMENT BENEFITS (Continued)

Each retiree's original retirement allowance is increased on each July 1 beginning the calendar year after retirement. Retirees first hired as members prior to July 1, 2012 receive a 2.5% increase each year of their original retirement allowance without a ceiling. Retirees first hired as members after June 30, 2012 receive a 1.5% increase each year of their original retirement allowance without a ceiling. The annual increase is not compounded.

The following summarizes the provisions relevant to the largest employee groups of the respective membership class. Retirement benefits for certain groups, such as police officers, firefighters, some investigators, sewer workers, judges, and elected officials, vary from general employees.

Noncontributory Class

Retirement Benefits - General employees' retirement benefits are determined as 1.25% of average final compensation multiplied by the years of credited service. Employees with ten years of credited service are eligible to retire at age 62. Employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 12.5% of average final compensation.

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a monthly benefit of 30% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. Additional benefits are payable to surviving dependent children up to age 18. If there is no spouse/reciprocal beneficiary or dependent children, no benefit is payable.

Ordinary death benefits are available to employees who were active at time of death with at least ten years of credited service. The surviving spouse/reciprocal beneficiary (until remarriage/reentry into a new reciprocal beneficiary relationship) and dependent children (up to age 18) receive a benefit equal to a percentage of the member's accrued maximum allowance unreduced for age or, if the member was eligible for retirement at the time of death, the surviving spouse/reciprocal beneficiary receives 100% joint and survivor lifetime pension and the dependent children receive a percentage of the member's accrued maximum allowance unreduced for age.

**Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016**

NOTE J - RETIREMENT BENEFITS (Continued)

Contributory Plan for Members Hired Prior to July 1, 2012

Retirement Benefits - General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 55.

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.5% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and fire fighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a one-time payment of the member's contributions and accrued interest plus a lifetime pension of 50% of their average final compensation. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined as 1.75% of average final compensation multiplied by the years of credited service but are payable immediately, without an actuarial reduction, and at a minimum of 30% of average final compensation.

Death Benefits - For service-connected deaths, the surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Ordinary death benefits are available to employees who were active at time of death with at least one year of service. Ordinary death benefits consist of a lump-sum payment of the member's contributions and accrued interest plus a percentage of the salary earned in the 12 months preceding death, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributory Plan for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 60.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE J - RETIREMENT BENEFITS (Continued)

Police officers and firefighters' retirement benefits are determined using the benefit multiplier of 2.25% for qualified service, up to a maximum of 80% of average final compensation. Police officers and firefighters with ten years of credited service are eligible to retire at age 60. Police officers and firefighters with five years of credited service are eligible to retire at age 55. Police officers and fire fighters with 25 years of credited service are eligible to retire at any age, provided the last five years is service credited in these occupations.

Disability and Death Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 50% of their average final compensation plus refund of contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are 3% of average final compensation for each year of service for judges and elected officers and 1.75% of average final compensation for each year of service for police officers and firefighters and are payable immediately, without an actuarial reduction, at a minimum of 30% of average final compensation.

Death benefits for contributory members hired after June 30, 2012 are generally the same as those for contributory members hired June 30, 2012 and prior.

Hybrid Plan for Members Hired Prior to July 1, 2012

Retirement Benefits - General employees' retirement benefits are determined as 2% of average final compensation multiplied by the years of credited service. General employees with five years of credited service are eligible to retire at age 62. General employees with 30 years of credited service are eligible to retire at age 55.

Disability Benefits - Members are eligible for service-related disability benefits regardless of length of service and receive a lifetime pension of 35% of their average final compensation plus refund of their contributions and accrued interest. Ten years of credited service is required for ordinary disability. Ordinary disability benefits are determined in the same manner as retirement benefits but are payable immediately, without an actuarial reduction, and at a minimum of 25% of average final compensation.

Death Benefits - For service-connected deaths, the designated surviving spouse/reciprocal beneficiary receives a lump sum payment of the member's contributions and accrued interest plus a monthly benefit of 50% of the average final compensation until remarriage or re-entry into a new reciprocal beneficiary relationship. If there is no surviving spouse/reciprocal beneficiary, surviving dependent children (up to age 18) or dependent parents are eligible for the monthly benefit. If there is no spouse/reciprocal beneficiary or dependent children/parents, the ordinary death benefit is payable to the designated beneficiary.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE J - RETIREMENT BENEFITS (Continued)

Ordinary death benefits are available to employees who were active at time of death with at least five years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest plus a percentage multiplied by 150%, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Hybrid Plan for Members Hired After June 30, 2012

Retirement Benefits - General employees' retirement benefits are determined as 1.75% of average final compensation multiplied by the years of credited service. General employees with ten years of credited service are eligible to retire at age 65. Employees with 30 years of credited service are eligible to retire at age 60. Sewer workers, water safety officers, and emergency medical technicians may retire with 25 years of credited service at age 55.

Disability and Death Benefits - Provisions for disability and death benefits generally remain the same except for ordinary death benefits. Ordinary death benefits are available to employees who were active at time of death with at least ten years of service. Ordinary death benefits consist of a lump sum payment of the member's contributions and accrued interest, or 50% Joint and Survivor lifetime pension if the member was not eligible for retirement at the time of death but was credited with at least ten years of service and designated one beneficiary, or 100% Joint and Survivor lifetime pension if the member was eligible for retirement at the time of death and designated one beneficiary.

Contributions - Contributions are governed by HRS Chapter 88 and may be amended through legislation. The employer rate is set by statute based on the recommendations of the ERS actuary resulting from an experience study conducted every five years. Since July 1, 2005, the employer contribution rate is a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liabilities. The contribution rates for fiscal year 2016 were 25.00% for police officers and firefighters and 17.00% for all other employees. Contributions to the pension plan from the Department were approximately \$232,418,000 for the fiscal year ended June 30, 2016.

The employer is required to make all contributions for noncontributory members. Contributory members hired prior to July 1, 2012 are required to contribute 7.8% of their salary, except for police officers and firefighters who are required to contribute 12.2% of their salary. Contributory members hired after June 30, 2012 are required to contribute 9.8% of their salary, except for police officers and firefighters who are required to contribute 14.2% of their salary. Hybrid members hired prior to July 1, 2012 are required to contribute 6.0% of their salary. Hybrid members hired after June 30, 2012 are required to contribute 8.0% of their salary.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE J - RETIREMENT BENEFITS (Continued)

State Policy - Measurement of assets and actuarial valuations are made for the ERS as a whole and are not separately computed for individual participating employers such as the Department. It is the State's policy on the accounting and reporting for pension benefits to allocate a portion of the net pension liability, pension expense, and related deferred inflows and outflows of resources to only component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR). The State's CAFR includes the note disclosures and required supplementary information on the State's pension plan.

(2) ***Post-Employment Healthcare 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. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are based on date of hire.

State Policy - The actuarial valuation of the EUTF does not provide 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 stand-alone departmental financial statements or in the State's CAFR. The basis for the allocation is the proportionate share of the State's total covered employee headcount by each component unit or proprietary fund for retiree health benefits.

Contributions - Contributions are financed on a pay-as-you-go basis and the Department's contributions for the years ended June 30, 2016, 2015, and 2014 were approximately \$128,075,000, \$130,946,000, and \$128,183,000.

Required Supplementary Information and Disclosures - The State's CAFR includes the required disclosures and supplementary information on the State's OPEB plan.

(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 an unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but has the duty of due care that would be required of an ordinary prudent investor.

Department of Education
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2016

NOTE K - RISK MANAGEMENT

The State 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 retains the first \$1,000,000 per occurrence of property losses, the first \$4,000,000 with respect to general liability claims, and the first \$500,000 of losses due to crime. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence of property losses is \$200,000,000 except for terrorism, which is \$50,000,000 per occurrence. The annual aggregate limit for general liability losses is \$5,000,000 per occurrence and for crime losses, the limit per occurrence is \$10,000,000 with no aggregate limit. The State also has an insurance policy to cover medical malpractice risk in the amount of \$35,000,000 per occurrence and \$39,000,000 in the aggregate.

The State is generally self-insured for workers' compensation and automobile claims. The Department administers its workers' compensation losses. A liability for workers' compensation is established if information indicates that a loss has been incurred as of June 30, 2016, and the amount of the loss can be reasonably estimated. The liability also includes an estimate for amounts incurred but not reported and loss adjustment expenses. The amount of the estimated loss is recorded in the accompanying statement of net position, as those losses will be liquidated with future expendable resources.

NOTE L - COMMITMENTS AND CONTINGENCIES

- (1) **Encumbrances** - The Department is committed under contracts awarded and orders placed for construction, repairs and maintenance, expenses, supplies, etc. These commitments as of June 30, 2016 were as follows:

Fund	Amount
General Fund	\$ 92,300,469
Federal Fund	19,334,419
Capital Projects Fund	533,312,933
Other Funds	<u>5,006,887</u>
	\$ <u>649,954,708</u>

- (2) **Litigation** - The Department has been named as defendant in a number of lawsuits and claims arising in the normal course of operations. To the extent that the outcome of such litigation has been determined to result in probable financial loss to the Department, such loss has been accrued in the basic financial statements. Of the remaining claims, a number of claims may possibly result in adverse judgments against the Department. However, such claim amounts cannot be reasonably estimated at this time. Although the Department and its counsel are unable to express opinions as to the outcome of on-going litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the Department because any judgments against the Department are judgments against the State and would be funded by the legislative appropriation of the State General Fund.

SUPPLEMENTARY INFORMATION

**Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Agriculture				
Child Nutrition Cluster				
School Breakfast Program	10.553		\$ 11,871,928	\$ 724,929
National School Lunch Program	10.555			
Cash assistance			48,165,740	2,444,395
Cash assistance (commodities)			5,402,376	--
Subtotal - National School Lunch Program			53,568,116	2,444,395
Summer Food Service Program for Children	10.559			
Cash assistance			518,161	516,161
State administrative expense			45,901	--
Subtotal - Summer Food Service Program for Children			564,062	516,161
Total - Child Nutrition Cluster			66,004,106	3,685,485
Child and Adult Care Food Program	10.558		7,641,035	7,539,374
State Administrative Expense for Child Nutrition	10.560		1,260,262	--
Team Nutrition Grant	10.574		11,669	--
Child Nutrition Discretionary Grants Limited Availability	10.579		88,656	85,957
Fresh Fruit and Vegetable Program	10.582		462,584	158,632
Total - U.S. Department of Agriculture			75,468,312	11,469,448
U.S. Department of Commerce				
Office for Coastal Management	11.473		49,804	--
Total - U.S. Department of Commerce			49,804	--
U.S. Department of Defense				
Competitive Grants: Promoting K-12 Student Achievement at Military-Connected Schools	12.556			
AVID Radford Complex			439,258	--
Expanding Virtual Learning Opportunities			81,560	--
Implement Blended Learning			1,490	--
Math Learners			433,689	--
Comprehensive Stem			420,855	--
Readying Radford Complex			51,159	--
Total - DoDEA Grant Program			1,428,011	--
Invitational Grants for Military-Connected Schools	12.557		264,311	--
DoD Impact Aid	12.558		1,960,019	--
Community Investment	12.600		7,695,235	--
Passed-through U.S. Pacific Command				
Joint Venture Education Forum	12.N00038		20,581	--
Total - U.S. Department of Defense			\$ 11,368,157	\$ --

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Education				
Adult Education - Basic Grants to States	84.002		\$ 2,033,265	\$ --
Title I - Grants to Local Educational Agencies	84.010		51,347,487	--
Migrant Education - State Grant Program	84.011		925,609	--
Title I - Program for Neglected and Delinquent Children	84.013		690,728	--
Special Education Cluster				
Grants to States	84.027		41,076,143	--
Preschool Grants	84.173		862,467	--
Total - Special Education Cluster			41,938,610	--
Impact Aid	84.041		22,574,561	--
Migrant Education Coordination Program	84.144		117,402	--
School Safety National Activities	84.184		314,692	--
Education and Homeless Children and Youth	84.196		209,603	--
Twenty-First Century Community Learning Centers	84.287		3,726,522	1,802,885
Advanced Placement Program	84.330		114,228	--
English Language Acquisition State Grants	84.365		3,182,579	--
Mathematics and Science Partnerships	84.366		528,605	--
Supporting Effective Instruction State Grant	84.367		11,765,297	--
Grants for State Assessments and Related Activities	84.369		4,532,097	--
Statewide Longitudinal Data Systems	84.372		81,200	--
School Improvement Grants	84.377		3,401,043	--
Common Core of Data Survey Project	84.ED-08-CO-0029		5,147	--
NAEP State Coordinator	84.ED-08-CO-0029		205,346	--
Passed-through Office of the State of Director for Vocational Education				
Career and Technical Education - Basic Grants to States	84.048	V048A13-V048A15	2,393,137	--
Passed-through State Department of Human Services				
Rehabilitation Services - Vocational Rehabilitation				
Grants to States	84.126	H126A150015-160015	78,222	--
DVR Work Readiness Training	84.126	DHS-16-VR-3028	132,506	--
Total - Passed-through State Department of Human Services			210,728	--
Passed-through Alu Like, Inc.				
Native Hawaiian Career and Technical Education	84.259	VE-CAS1314-01	\$ 282,116	\$ --

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2016**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number ¹	Pass-through Entity Identifying Number	Total Federal Expenditures	Passed Through to Subrecipients
U.S. Department of Education (Continued)				
Passed-through University of Hawaii				
Gaining Early Awareness and Readiness	84.334	P334S110026	\$ 698,997	\$ --
Gaining Early Awareness and Readiness	84.334A	P334A110247	169,814	--
Native Hawaiian Education	84.362A	S362A11,S362A12,S362A14	776,237	--
College Access Challenge Grant Program	84.378A	P378A130027-40027	187,229	--
Total - Passed-through University of Hawaii			1,832,277	--
Total - U.S. Department of Education			<u>152,412,279</u>	<u>1,802,885</u>
U.S. Department of Health and Human Services				
Substance Abuse and Mental Health Services_Projects of Regional and National Significance	93.243		182,300	--
Passed-through State Department of Human Services				
Child Care and Development Block Grant	93.575	DHS-15-CCPO	236,262	--
Temporary Assistance for Needy Families	93.558	DHS-14-ETPO-1029	2,628,578	--
Total - Passed-through State Department of Human Services			2,864,840	--
Head Start	93.600		16,736	--
Cooperative Agreements to Promote Adolescent Health through School-Based HIV/STD Prevention and School-Based Surveillance	93.079		58,015	--
Total - U.S. Department of Health and Human Services			<u>3,121,891</u>	<u>--</u>
U.S. Department of Homeland Security				
Passed-through State Department of Homeland Security				
Homeland Security Grant Program	97.067	EMW-2014-SS-00003-S01	12,327	--
Total - U.S. Department of Homeland Security			<u>12,327</u>	<u>--</u>
U.S. Department of Interior				
Economic, Social and Political Development of the Territories	15.875		1,276,000	--
Total - U.S. Department of Interior			<u>1,276,000</u>	<u>--</u>
U.S. Department of Justice				
Passed-through State Department of Human Services				
Juvenile Justice and Delinquency Prevention_Allocation to States	16.540	DHS-14-OYS-411 DHS-15-OYS-547	69,020	--
Total - U.S. Department of Justice			<u>69,020</u>	<u>--</u>
Institute of Museum and Library Services				
Grants to States	45.310		1,162,110	--
Total - Institute of Museum and Library Services			<u>1,162,110</u>	<u>--</u>
Total Expenditures of Federal Awards			<u>\$ 244,939,900</u>	<u>\$ 13,272,333</u>

¹ Other identifying number used if no CFDA number available.

The accompanying notes are an integral part of this schedule.

**Department of Education
State of Hawaii
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016**

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditure of federal awards (Schedule) includes the federal award activity of the Department of Education (DOE), the Hawaii State Public Library System (HSPLS), and Public Charter Schools (PCS) where the DOE prepares the Schedule, based on information provided by the HSPLS and PCS, to combine federal financial data for the three departments, in aggregate known as the Department.

The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Department, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Department.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the cash basis of accounting. Such expenditures are recognized following as applicable, either the cost principles in the Office of Management and Budget Circular A-87 *Cost Principles for State, Local and Indian Tribe Governments*, or the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

NOTE 3 - INDIRECT COST RATE

The Department has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

PART II

**REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS**

**REPORT 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**

INDEPENDENT AUDITOR'S REPORT

To the Auditor
State of Hawaii
Board of Education
State of Hawaii, Department of Education

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Education of the State of Hawaii (Department), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated March 24, 2017. Our report includes a reference to other auditors who audited the financial statements of certain public charter schools, as described in our report on the Department's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

A deficiency in internal control 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Department's

financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2016-001 and 2016-002 that we consider to be a significant deficiencies.

Compliance and Other Matters

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

Department's Response to Findings

The Department's response to the findings identified in our audit is described in Part V, Corrective Action Plan. The Department's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

N + K CPAs, INC.

Honolulu, Hawaii
March 24, 2017

PART III

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE**

**REPORT ON COMPLIANCE FOR
EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

INDEPENDENT AUDITOR'S REPORT

To the Auditor
Office of the Auditor
Board of Education
State of Hawaii, Department of Education

Report on Compliance for Each Major Federal Program

We have audited the Department of Education of the State of Hawaii's (Department) compliance with the types of compliance requirements described in the Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the fiscal year ended June 30, 2016. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Department's major federal programs based on our audit of the types of compliance requirements referred to above. 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 the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Department's compliance.

Opinion on Each Major Federal Programs

In our opinion, the Department complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of the Department is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Department's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

N&K CPAs, Inc.

ACCOUNTANTS | CONSULTANTS

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

N + K CPAs, INC.

Honolulu, Hawaii
March 24, 2017

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, 2016

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued on whether
the financial statements audited were
prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

Material weakness(es) identified?

☐ yes

☒ no

Significant deficiency(ies) identified?

☒ yes

☐ none reported

Noncompliance material to the financial statements
noted?

☐ yes

☒ no

Federal Awards

Internal control over major federal programs:

Material weakness(es) identified?

☐ yes

☒ no

Significant deficiency(ies) identified?

☐ yes

☒ none reported

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

Unmodified

Any audit findings disclosed that are required to be
reported in accordance with 2 CFR 200.516(a)?

☐ yes

☒ no

Identification of major programs:

CFDA Number

Name of Federal Program or Cluster

	Child Nutrition Cluster:
10.553	School Breakfast Program
10.555	National School Lunch Program
10.559	Summer Food Service Program for Children
10.558	Child and Adult Care Food Program
84.041	Impact Aid
84.369	Grants for State Assessments and Related Activities

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

\$3,000,000

Auditee qualified as a low-risk auditee?

☐ yes

☒ no

**Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016**

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref. No. Internal Control Findings

2016-001 Tracking and Accounting for Capital Assets

Criteria:

Generally accepted accounting principles in the United States of America requires the reclassification of construction projects as completed capital assets when completed and the recognition of depreciation when the asset is placed in service. Capital assets that are purchased or constructed should be reported at cost.

Condition:

The DOE's Office of School Facilities and Support Services (OSFSS) is responsible for planning and directing the expenditure of capital improvement, repair and maintenance funds, and other operating funds released for such projects.

The State Department of Accounting and General Services' Public Works Division (Public Works) provides information regarding construction projects it manages for the Public Libraries to the Public Libraries.

The Office of Fiscal Services, Accounting Services Branch (Accounting) relies on information provided by the OSFSS and the Public Libraries to prepare the CIP and fixed assets schedules for the Department's government-wide financial reporting. Complete, accurate, and timely information provided by the OSFSS and Public Libraries is crucial for proper reporting of capital asset information, both construction projects in progress (CIP) and completed fixed assets, in the Department's financial statements.

During our audit of capital assets, we noted the following conditions:

1. The Public Libraries reported a building at a cost of approximately \$12 million although its construction was not completed. In addition, the cost for three other construction projects classified as completed fixed assets were understated by an approximate total of \$173,000.
2. The schedules summarizing projects managed by OSFSS reflected the following:
 - a. Four projects were actually completed or partially placed in service but were not transferred to fixed assets. The cost basis and related accumulated depreciation for these assets as of June 30, 2016 totaled approximately \$35 million and \$683,000, respectively.
 - b. Eighty-nine construction jobs completed in prior years totaling approximately \$55 million were transferred from construction-in-progress to completed capital assets in the current year. Accumulated depreciation related to prior years of approximately \$5 million was recognized during the fiscal year ended June 30, 2016.

**Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016**

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No. Internal Control Findings (Continued)

2016-001 Tracking and Accounting for Capital Assets (Continued)

- c. We tested a non-statistical sample of project expenditures for the classification between repairs and maintenance and construction-in-progress. We noted misclassifications between the two categories. Based on our sample, we projected a net understatement of approximately \$19 million in construction-in-progress costs as of June 30, 2016.
3. Four equipment additions for the public schools were overstated in total by approximately \$1 million due to keypunch and other clerical errors.

Cause:

The above discrepancies were due to the following:

1. We were informed that the errors made by the Public Libraries were due to uncertainty of the project completion information received from Public Works and that a new personnel in Public Libraries did not correctly use the information from Public Works.
2. OSFSS did not provide Accounting with complete and timely information regarding the status of DOE-managed construction projects.
3. The errors in the amount for equipment additions were not detected in the review process.

Effect:

The Public Libraries overstated capital asset cost and related accumulated depreciation for as of June 30, 2016 by approximately \$12 million and \$197,000, respectively. The DOE, excluding Public Libraries, understated capital assets and accumulated depreciation as of June 30, 2016, by approximately \$4 million and \$760,000, respectively.

The DOE adjusted its financial statements to correct the above known errors.

Identification as a Repeat Finding, if applicable:

See finding 2015-002 included in the Summary Schedule of Prior Audit Findings.

Recommendation:

The Public Libraries should improve its tracking and accounting for completed construction by having knowledgeable personnel review applicable reports and documents. The OSFSS should be continuously tracking the status of all construction projects throughout the year for proper recordkeeping purposes, and provide accurate and timely information to Accounting for financial reporting purposes. In general, capital asset reports and schedules should be reviewed more carefully to ensure accuracy.

Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No. Internal Control Findings (Continued)

2016-001 Tracking and Accounting for Capital Assets (Continued)

Views of Responsible Official(s) and Planned Corrective Action:

Management agrees with the finding and recommendation. See Corrective Action Plan on page 62.

2016-002 Preparation of the Schedule of Expenditures of Federal Awards

Criteria:

2 CFR 200.510(b) states in part, "Schedule of Expenditures of Federal awards. The auditee must also prepare a schedule of expenditures of federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with §200.502 Basis for determining Federal awards expended.... At a minimum, the schedule must: ... Include the total amount provided to subrecipients from each Federal program...."

Condition:

The Schedule of Expenditures of Federal Awards for the fiscal year ended June 30, 2016 prepared by the DOE did not include the amount of awards provided to subrecipients for the 21st Century Community Learning Centers program (CFDA No. 84.287) totaling approximately \$1.8 million. Awards provided to subrecipients during the fiscal year ended June 30, 2016 as reported was approximately \$13.3 million.

Cause:

The DOE did not have a system in place to notify the Accounting Section which prepares the Schedule of Expenditure of Federal Awards the existence of subrecipients for the 21st Century Community Learning Center program.

Effect:

The Schedule of Expenditures of Federal Awards as of June 30, 2016 was incompletely prepared. The amount of awards provided to subrecipients was understated by approximately \$1.8 million. The schedule was revised to report the missing subrecipient award provision upon our notification of the deficiency.

Department of Education
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No. Internal Control Findings (Continued)

2016-002 Preparation of the Schedule of Expenditures of Federal Awards (Continued)

Recommendation:

The DOE should improve its preparation of the Schedule of Expenditures of Federal Awards by establishing procedures to ensure all information required for schedule preparation such as subrecipient related information is given to the Accounting Section.

Views of Responsible Official(s) and Planned Corrective Action:

Management agrees with the finding and recommendation. See Corrective Action Plan on page 64.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None

PART V

DEPARTMENTAL RESPONSE

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

DAVID Y. IGE
GOVERNOR



KATHRYN S. MATAYOSHI
SUPERINTENDENT

STATE OF HAWAII
DEPARTMENT OF EDUCATION
P.O. BOX 2360
HONOLULU, HAWAII 96804

OFFICE OF THE SUPERINTENDENT

March 24, 2017

N&K CPAs, Inc.
American Savings Bank Tower, Suite 1700
1001 Bishop St
Honolulu, HI 96813

Ladies and Gentlemen:

The Single Audit of the State of Hawaii Department of Education (HIDOE) for the fiscal year ended June 30, 2016 was completed before the March 31, 2017 Federal deadline. We are pleased that the HIDOE received an unmodified opinion on its financial statements.

We have reviewed your audit findings and recommendations and corrective action plans have been prepared. In accordance with 2 CFR 200.508, the following pages contain the **Corrective Action Plan** for the year ended June 30, 2016 and the **Summary Schedule of Prior Audit Findings** for the year ended June 30, 2015.

Very truly yours,

A handwritten signature in black ink, appearing to read "K. Matayoshi", is written over the typed name and title.

Kathryn S. Matayoshi
Superintendent

KSM:dy
Attachments

c: Internal Audit Office

AN AFFIRMATIVE ACTION AND EQUAL OPPORTUNITY EMPLOYER

STATE OF HAWAII DEPARTMENT OF EDUCATION
CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2016

FINANCIAL STATEMENT FINDING

2016-001 Tracking and Accounting for Capital Assets (Page 56)

2016-001 Condition #1

View of Responsible Officials

Management agrees with the finding and recommendation.

Corrective Action Plan

The Public Libraries has now assigned the Account Clerk III to be responsible for all accounting and reporting of all HSPLS capital asset costs and related accumulated depreciation with the documents provided by the Department of Accounting and General Services (DAGS). The Administrative Services Officer will review these reports of all construction projects for compliance and completion before submission to DAGS. The errors noted in these findings have been corrected and updated in our current Fixed Assets reports.

*Contact Person: Keith T. Fujio, Special Assistant to the State Librarian
Administrative Services Branch
Hawaii State Public Library System*

Anticipated Completion Date: Completed as of January 1, 2017

STATE OF HAWAII DEPARTMENT OF EDUCATION
CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2016

2016-001 Tracking and Accounting for Capital Assets (Continued)

2016-001 Condition #2

View of Responsible Officials

The Branch agrees with the findings.

Corrective Action Plan

The process that Facilities Development Branch (FDB) has in place now allows Branch personnel to access project acceptance notices which will signify the completion of a project. Greater continuity within the Branch personnel will allow continual improvement to the process.

*Contact Person: Duane Kashiwai, Public Works Administrator
Facilities Development Branch
Office of School Facilities and Support Services*

Anticipated Completion Date: April 1, 2017

2016-001 Condition #3

View of Responsible Officials

Management agrees with the finding and recommendation.

Corrective Action Plan

The DOE Accounting Section will review fixed asset equipment additions on the Financial Management System (FMS) at a minimum once a year to identify keypunch and other clerical errors resulting in overstatement of inventory for financial reporting purposes.

*Contact Person: Trisha Kaneshiro, Fiscal Specialist
Accounting Section
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: June 30, 2017

STATE OF HAWAII DEPARTMENT OF EDUCATION
CORRECTIVE ACTION PLAN
Fiscal Year Ended June 30, 2016

FINANCIAL STATEMENT FINDING

2016-002 Preparation of the Schedule of Expenditures of Federal Awards (Page 58)

View of Responsible Officials

Management agrees with the finding and recommendation.

Corrective Action Plan

The DOE Accounting Section will create an expenditure object code within the Financial Management System (FMS) to separately classify and record payments to subrecipients for subawards, as defined by 2 CFR 200.93 and 2 CFR 200.92, respectively.

The DOE Accounting Section will issue written guidance to Federal program managers that will include the following:

- 1. A reminder of the Federal requirement for the DOE to prepare a Schedule of Expenditures of Federal Awards (SEFA) which must include the total amount provided to subrecipients from each Federal program (see 2 CFR 200.510).*
- 2. A request to DOE program managers responsible for Federal awards to send copies of all executed subawards to the DOE Accounting Section.*
- 3. A request to DOE program managers responsible for Federal awards to utilize the newly created FMS expenditure object code to separately classify and record payments to subrecipients for subawards.*

*Contact Person: Trisha Kaneshiro, Fiscal Specialist
Accounting Section
Accounting Services Branch
Office of Fiscal Services*

Anticipated Completion Date: June 30, 2017

PART VI

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

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

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Prior Fiscal Year Ended June 30, 2015

SECTION II – FINANCIAL STATEMENT FINDINGS

2015-001 Improve Financial Statement Preparation for Agency Fund
(Page 60 of the Prior Year June 30, 2015 Report)

Status -- *Corrective action has been taken to the extent that this finding no longer appears in the Schedule of Findings and Questioned Costs.*

2015-002 Improve Procedures Over Tracking and Accounting for Completed Construction
(Page 60 to 61 of the Prior Year June 30, 2015 Report)

Status -- *Partially Accomplished. Last year the Branch put in place a process to identify projects that were already completed. During this process, it was found that many projects were actually completed without being moved into the fixed asset category. Due to recent turnover within the Branch, there has been a lag in the investigation of completed projects. Corrective action and monitoring is in progress. Please refer to the current year response in the Financial Statement Finding No. 2016-001.*

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

2015-003 Improve Record Maintenance for Documentation of Students Excluded from the Four-Year Adjusted Cohort Graduation Rate
(Page 62 of the Prior Year June 30, 2015 Report)

Status -- *Partially Accomplished. The Office of Information Technology Services (OITS) notified all school registrars of procedural guidelines for student enrollment and withdrawal on July 6, 2016, via a DOE Memo titled "Start of the Year Procedures for All Public Schools SY 2016-17." In addition, the Office of Strategy, Innovation, and Performance instructed all school registrars to verify the status of student exit and enrollment on September 1, 2016, via a DOE Memo titled "Verification of Student Exits for Dropout Statistics." OITS will distribute an updated Enrollment and Withdrawal Process and Procedures Manual (EWPPM) in order to complete the corrective action plan. The EWPPM is currently being reviewed by the State of Hawaii Department of the Attorney General for approval. The EWPPM will be distributed and implemented when it is approved.*