

**FINANCIAL AUDIT OF THE  
DEPARTMENT OF PUBLIC SAFETY  
STATE OF HAWAII**

**Fiscal Year Ended June 30, 2003**



March 29, 2004

Mr. John F. Peyton  
Director  
Department of Public Safety  
State of Hawaii

Dear Mr. Peyton:

This is our report on the financial audit of the Department of Public Safety of the State of Hawaii (PSD) as of and for the fiscal year ended June 30, 2003. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

#### **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the PSD's basic financial statements as of and for the fiscal year ended June 30, 2003, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the PSD's basic financial statements.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the PSD is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government.
3. To determine whether the PSD has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.
4. To determine whether the PSD has complied with the laws and regulations that may have a material effect on the basic financial statements and on its major federal financial assistance programs.

## SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the PSD for the fiscal year ended June 30, 2003.

## ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the PSD as of and for the fiscal year ended June 30, 2003, and our opinion on the basic financial statements.
- Part II - Our report on compliance and on internal control over financial reporting.
- Part III - Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - The summary schedule of prior audit findings.
- Part VI - Response of the affected agency.

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

Sincerely,



Ron T. Shiigi  
Principal

**DEPARTMENT OF PUBLIC SAFETY  
STATE OF HAWAII**

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**DEPARTMENT OF PUBLIC SAFETY  
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**PART I**  
**FINANCIAL SECTION**



NISHIHAMA & KISHIDA, CPA'S, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN SAVINGS BANK TOWER  
1001 BISHOP STREET, SUITE 1700  
HONOLULU, HAWAII 96813-3696  
TELEPHONE (808) 524-2255  
FAX (808) 523-2090

## INDEPENDENT AUDITORS' REPORT

To the Director  
Department of Public Safety  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department of Public Safety of the State of Hawaii (PSD), as of and for the fiscal year ended June 30, 2003, which collectively comprise the PSD's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the PSD's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements of the PSD are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the PSD. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003, and the changes in its financial position and its cash flows, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the

PSD, as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 16, 2004, on our consideration of the PSD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the PSD's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
January 16, 2004

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

The Management's Discussion and Analysis (MD&A) offers readers of the PSD's basic financial statements a narrative overview and analysis of the PSD's financial activities for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with the basic financial statements and notes to the basic financial statements.

**FINANCIAL HIGHLIGHTS**

- Total assets of the PSD exceeded its total liabilities at June 30, 2003 by approximately \$90 million. Net assets invested in capital assets accounted for nearly all of this amount.
- During the fiscal year ended June 30, 2003, the PSD incurred approximately \$197 million of expenses of which approximately \$181 million was funded by general fund revenues.
- Approximately \$162 million of governmental funds were expended for incarceration and related inmate programs.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This MD&A serves as an introduction to the PSD's basic financial statements. The basic financial statements 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**

The government-wide financial statements report information about the PSD as a whole using the economic resources measurement focus and accrual basis of accounting, which is similar to those used by private-sector companies. It provides both long-term and short-term information about the PSD's overall financial status. The statement of net assets includes all of the PSD's assets and liabilities. All of the current fiscal year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two statements report the PSD's net assets and how they have changed. Over time, increases or decreases in the PSD's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

Both statements distinguish between the governmental and business-type activities of the PSD as follows:

**Governmental activities** - reflect the PSD's basic services including confinement (incarceration of law offenders), law enforcement, parole, crime victim compensation, and general support (administration). Allotments from the State of Hawaii (State) and federal grants finance most of these activities.

**Business-type activities** - reflect the business-type operations of the Correctional Industries, which charges fees for goods and services that covers its operating costs including depreciation.

**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 PSD uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the PSD are divided into three categories: governmental funds, proprietary funds, and fiduciary funds. Governmental funds are used to account for most, if not all, of a government entity's tax-supported activities. Proprietary funds are used to account for a government entity's business-type activities, where all or part of the costs of activities are supported by fees and charges that are paid directly by those who benefit from the activities. Fiduciary funds are used to account for resources that are held by a government entity as a trustee or agent for parties outside of the government entity. The resources of fiduciary funds cannot be used to support the government entity's own programs.

The fund financial statements of the PSD include the following types of funds:

**Governmental funds** - Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources and balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

By comparing the governmental fund and government-wide financial statements, readers may better understand the long-term impact of the entity's near-term financing decisions. In order to facilitate a comparison between the governmental fund and government-wide financial statements, a reconciliation between the two is provided following the governmental fund financial statements.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**Proprietary funds** - Proprietary funds are used to account for the same functions reported as business-type activities in the government-wide financial statements but the fund financial statements report in more detail and with additional information such as cash flows. As in the government-wide financial statements, the accrual basis of accounting is applied to the proprietary funds. There are two types of proprietary funds.

Enterprise funds are used to report activity for which a fee is charged to external users for goods or services. The PSD uses an enterprise fund to account for its Correctional Industries' operations.

Internal service funds, the second type of proprietary fund, are used to report activity that provides goods or services to other funds, departments, agencies, or other governments on a cost-reimbursement basis in which the reporting government entity is the predominant participant in the activity. The PSD currently does not have any funds classified as internal service funds.

**Fiduciary funds** - Fiduciary funds are used to account for assets held in a trustee or agency capacity. The PSD, as a fiduciary, temporarily holds monies for prison inmates and process servers, monies for law enforcement related equipment purchases for the State, cities, and counties of Hawaii under a federal program, and repayments by employees for salaries overpaid by the State. These activities are excluded from the PSD's government-wide financial statements because the PSD cannot use these assets to finance its operations.

**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The following table presents a condensed government-wide statement of net assets of the PSD as of June 30, 2003 and 2002.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**Condensed Statement of Net Assets**

	Governmental Activities		Business-Type Activities		Total	
	2003	2002	2003	2002	2003	2002
Current and other assets	\$ 20,280,219	\$ 19,702,903	\$ 739,797	\$ 975,151	\$ 21,020,016	\$ 20,678,054
Capital assets	<u>97,143,191</u>	<u>102,592,312</u>	<u>2,195,501</u>	<u>2,425,748</u>	<u>99,338,692</u>	<u>105,018,060</u>
Total assets	<u>\$ 117,423,410</u>	<u>\$ 122,295,215</u>	<u>\$ 2,935,298</u>	<u>\$ 3,400,899</u>	<u>\$ 120,358,708</u>	<u>\$ 125,696,114</u>
Long-term debt outstanding	\$ 19,513,236	\$ 8,383,896	\$ 657,932	\$ 283,452	\$ 20,171,168	\$ 8,667,348
Other liabilities	<u>9,964,880</u>	<u>16,222,649</u>	<u>161,992</u>	<u>689,207</u>	<u>10,126,872</u>	<u>16,911,856</u>
Total liabilities	<u>\$ 29,478,116</u>	<u>\$ 24,606,545</u>	<u>\$ 819,924</u>	<u>\$ 972,659</u>	<u>\$ 30,298,040</u>	<u>\$ 25,579,204</u>
Net assets						
Invested in capital assets, net of related debt	\$ 97,143,191	\$ 102,592,312	\$ 2,070,001	\$ 2,164,940	\$ 99,213,192	\$ 104,757,252
Restricted	1,761,583	2,036,642	–	–	1,761,583	2,036,642
Unrestricted (deficit)	<u>(10,959,480)</u>	<u>(6,940,284)</u>	<u>45,373</u>	<u>263,300</u>	<u>(10,914,107)</u>	<u>(6,676,984)</u>
Total net assets	<u>\$ 87,945,294</u>	<u>\$ 97,688,670</u>	<u>\$ 2,115,374</u>	<u>\$ 2,428,240</u>	<u>\$ 90,060,668</u>	<u>\$ 100,116,910</u>

The PSD's combined net assets decreased by 10% from \$100 million as of June 30, 2002 to \$90 million as of June 30, 2003. The decrease in net assets is attributed to:

1. Increase in net depreciable assets.
2. Increase in accrued wages and employee benefits payable.
3. Increase in accrued vacation adjustment.
4. Increase in health care voucher payable.

Governmental net assets accounted for 98% of total net assets that reflected primarily buildings and improvements for correctional facilities.

The deficit in unrestricted net assets for governmental activities was approximately \$11 million and \$7 million as of June 30, 2003 and 2002, respectively. This deficit in unrestricted net assets results primarily from program liabilities incurred as of June 30, 2003, for which state allotted appropriations were not yet available. The largest liability was incurred for compensated absences totaling \$15 million and \$13 million as of June 30, 2003 and 2002, respectively, which are not funded by state allotted appropriations until the earned leave is used by the employee or – in the case of accrued vacation leave – is paid in lump sum upon termination. Therefore, there are no assets currently available to the PSD to pay for the compensated absences liability as of June 30, 2003.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**Condensed Changes in Net Assets**

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
<b>REVENUES</b>						
Program revenues	\$ 6,754,373	\$ 5,345,924	\$ 4,210,187	\$ 4,656,833	\$ 10,964,560	\$ 10,002,757
General revenues	<u>180,715,798</u>	<u>166,115,525</u>	<u>3,597</u>	<u>16,089</u>	<u>180,719,395</u>	<u>166,131,614</u>
Total revenues	<u>187,470,171</u>	<u>171,461,449</u>	<u>4,213,784</u>	<u>4,672,922</u>	<u>191,683,955</u>	<u>176,134,371</u>
<b>EXPENSES</b>						
Confinement	161,787,740	146,591,578	-	-	161,787,740	146,591,578
Law enforcement	17,024,599	14,177,076	-	-	17,024,599	14,177,076
Parole	2,651,642	2,463,584	-	-	2,651,642	2,463,584
Crime victim compensation	1,736,187	1,464,243	-	-	1,736,187	1,464,243
General support	9,220,485	8,554,061	-	-	9,220,485	8,554,061
Correctional industries	<u>-</u>	<u>-</u>	<u>4,526,650</u>	<u>5,219,370</u>	<u>4,526,650</u>	<u>5,219,370</u>
Total expenses	<u>192,420,653</u>	<u>173,250,542</u>	<u>4,526,650</u>	<u>5,219,370</u>	<u>196,947,303</u>	<u>178,469,912</u>
Deficiency before transfers and lapsed appropriations	(4,950,482)	(1,789,093)	(312,866)	(546,448)	(5,263,348)	(2,335,541)
Transfers out	(555,290)	(58,651)	-	-	(555,290)	(58,651)
Lapsed appropriations	<u>(4,237,604)</u>	<u>(2,725,297)</u>	<u>-</u>	<u>-</u>	<u>(4,237,604)</u>	<u>(2,725,297)</u>
Change in net assets	\$ <u>(9,743,376)</u>	\$ <u>(4,573,041)</u>	\$ <u>(312,866)</u>	\$ <u>(546,448)</u>	\$ <u>(10,056,242)</u>	\$ <u>(5,119,489)</u>

Total net assets decreased by approximately \$10 million during the fiscal year ended June 30, 2003 as shown above.

Total revenues for PSD increased by \$16 million. The revenue increase is attributed primarily to increases in funding to send more inmates to out-of-state facilities, to cover collective bargaining costs, and to cover fringe benefit costs.

Expenses for the fiscal years ended June 30, 2003 and 2002, totaled approximately \$197 million and \$178 million, respectively. The \$19 million increase stems from increases in fringe benefit costs, out-of-state inmate expenses, collective bargaining costs, and inmate health care costs.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**Governmental Activities**

Governmental activities accounted for over 95% of total expenses in each fiscal year, with program expenses for the confinement of inmates accounting for approximately 85% of total expenses for governmental activities. Approximately \$29 million and \$27 million was expended for the housing and care of inmates in out-of-state correctional facilities for the fiscal years ended June 30, 2003 and 2002, respectively. Expenses increased because the number of inmates housed in out-of-state facilities increased.

**Business-type Activities**

Pressed by a poor economy and state agency (customer) spending restrictions, the Correctional Industries (CI) was forced to cut expenses including payroll, stock items, and operating supplies. As shown in the Condensed Changes in Net Assets, the CI's expenses dropped by 13.3% from the previous fiscal year. At the same time, however, the CI's revenues also decreased by 9.8%.

**FINANCIAL ANALYSIS OF THE FUND FINANCIAL STATEMENTS**

As noted earlier, the PSD uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Following are financial analyses of the PSD's governmental and proprietary funds.

**Governmental Funds**

The PSD's major fund is the general fund, which accounted for approximately \$17 million or 84% of total governmental fund assets as of June 30, 2003, and \$185 million or 98% of total governmental fund revenues for the fiscal year ended June 30, 2003. The general fund revenues consisted primarily of state allotted appropriations.

**Proprietary Fund**

The Correctional Industries is the PSD's only enterprise fund. As of June 30, 2003, the Correctional Industries reported over \$2 million in net assets of which approximately \$2 million was accounted for by investment in capital assets, net of related debt.

With recent state mandates to reduce spending, the Correctional Industries experienced decreased revenues from its major customer base and a net loss for the fiscal year ended June 30, 2003.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**BUDGETARY ANALYSIS**

Based on projections by the Council on Revenues as of September 2002, projected general fund revenues were not sufficient to support expenditure trends. To bring expenditures in line with projected revenues, a reduction in expenditures for FY 2003 was imposed on certain FY 2003 appropriations. Accordingly, in December 2002, the PSD was informed by the Department of Budget and Finance that its FY 2003 appropriation was to be restricted by 5% or \$7.2 million. The 5% restriction was applied to the full-year appropriation.

Because the 5% restriction was being implemented after half of the fiscal year had elapsed and six months of costs had been incurred, the restriction translated to a 10% reduction. With half a year remaining, the PSD determined it would be difficult to meet the \$7.2 million reduction without reducing essential services, releasing inmates, or exacerbating an already serious overcrowding problem in the correctional facilities. After considering the adverse impact to the public's safety, the Department of Budget and Finance recommended no restriction on the PSD's FY20 03 budget.

At the end of March, in anticipation of revenue shortfalls resulting from the Iraqi war and its negative effect on the State's economy, departments were again advised to curtail spending. From April through June 2003, spending restrictions were applied to all discretionary appropriations for equipment and furniture, training, supplies, motor vehicles, and consultant service contracts.

**General Fund Budgetary Comparison**

	Budget		Actual on Budgetary Basis	Favorable (Unfavorable) Variance
	Original	Final		
Confinement	\$ 132,615,452	\$ 134,103,786	\$ 131,694,420	\$ 2,409,366
Law enforcement	14,602,935	14,950,455	13,134,433	1,816,022
Parole	2,305,760	2,320,760	2,283,910	36,850
General support	9,906,754	7,322,520	6,818,849	503,671
<b>Total expenditures</b>	<b>\$ <u>159,430,901</u></b>	<b>\$ <u>158,697,521</u></b>	<b>\$ <u>153,931,612</u></b>	<b>\$ <u>4,765,909</u></b>

The amount for the total final budget of \$158,697,521 reflects an expenditure ceiling. Generally, expenditure ceilings are formulated based on anticipated program needs. Optimally, expenditure ceilings should be close or equal to actual expenditures. However, actual expenditures are limited to the availability of funds. Therefore, the

**Department of Public Safety  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

PSD's limited to spending either the expenditure ceiling or the cash balance, whichever amount is lower. For the fiscal year ended June 30, 2003, the \$4,765,909 variance between the final budget and actual expenditures on a budgetary basis is attributed to a combination of the following factors:

1. The overall cash balance was less than the expenditure ceiling.
2. The PSD experienced personnel recruitment and retention difficulties.
3. Certain programs were able to reduce overtime expenditures.

**CAPITAL ASSETS**

As of June 30, 2003, the PSD had approximately \$99 million invested in capital assets. Capital assets for governmental activities accounted for 98% of total capital assets. Building and improvements for correctional facilities totaling approximately \$95 million, net of accumulated depreciation.

There was approximately \$6 million or a 5% decrease in capital assets, net of depreciation, from the end of the last fiscal year. This decrease is primarily a result of annual depreciation totaling approximately \$6 million.

**Capital Assets, Net of Depreciation  
(in thousand of dollars)**

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Land	\$ 107	\$ 107	\$ --	\$ --	\$ 107	\$ 107
Buildings and improvements	95,519	100,852	1,870	1,934	97,389	102,786
Furniture, equipment and vehicles	<u>1,517</u>	<u>1,633</u>	<u>326</u>	<u>492</u>	<u>1,843</u>	<u>2,125</u>
Total	\$ <u>97,143</u>	\$ <u>102,592</u>	\$ <u>2,196</u>	\$ <u>2,426</u>	\$ <u>99,339</u>	\$ <u>105,018</u>

**ECONOMIC FACTORS**

As discussed earlier in the budgetary analysis section, at the end of March 2003, departments were again advised to curtail spending in anticipation of revenue shortfalls resulting from the war in Iraq and its negative effect on the State's economy. From April through June 2003, spending restrictions were applied to all discretionary appropriations for equipment and furniture, training, supplies, motor vehicles, and consultant service contracts.

**Department of Public Safety  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

In formulating the Executive branch's operating and capital improvement expenditures for the fiscal biennium July 1, 2003 through June 30, 2005, the State Legislature noted that it had never faced the level of fiscal uncertainty that it had in that session. Declining projected revenues, coupled with increasing fiscal needs, had greatly impacted the manner in which the finance committees had to choose among valid competing needs and set forth its budget priorities.

The budget included several additions for biennium budget requests in the areas of inmate health care (\$2.87 million in FY2004 and \$3.08 million in FY2005), law enforcement for Big Island courts (five deputy sheriffs), and substance abuse treatment for parolees (\$100,000). The budget bill also included vital CIP funding for the construction of a new sewage treatment system at the Kulani Correctional Facility. The PSD must install a new sewage treatment system by April 2005 to be in compliance with federal EPA and state regulations. Penalties for non-compliance could result in fines of up to \$75,000 per day of non-compliance or closure of the facility.

The additions were offset by reductions for vacancies, overtime and travel. The PSD's operating base budget was reduced by \$2.5 million (2%) in FY2004 and \$3.3 million (2.3%) in FY2005. The reductions to the base will hurt the PSD because the inmate population and the level of services required in corrections, law enforcement, and parole continue to increase. Moreover, the bed day rate for housing inmates in the mainland facilities increased by 2.5% on July 1, 2003; and the daily rate for leasing beds at the Federal Detention Center increased by 2.25% retroactive to October 1, 2002. No additional funds were authorized to address the increase in the contract bed costs.

**REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the PSD's finances and to demonstrate the PSD's accountability for the money it receives. Questions concerning any of the information provided in this report or request for additional information should be addressed in writing to the following:

Office of the Deputy Director for Administration  
Department of Public Safety  
State of Hawaii  
919 Ala Moana Boulevard, Suite 400  
Honolulu, Hawaii 96814

**Department of Public Safety  
State of Hawaii  
STATEMENT OF NET ASSETS  
June 30, 2003**

	Governmental Activities	Business-type Activities	Total
<b>ASSETS</b>			
Cash and cash equivalents	\$ 18,366,746	\$ 114,606	\$ 18,481,352
Receivables	405,972	344,472	750,444
Due from State of Hawaii	1,448,617	--	1,448,617
Internal balances	19,679	(19,679)	--
Due from other funds	39,205	--	39,205
Inventories	--	300,398	300,398
Total current assets	20,280,219	739,797	21,020,016
Capital assets			
Non-depreciable	107,570	--	107,570
Depreciable, net	97,035,621	2,195,501	99,231,122
Total assets	\$ 117,423,410	\$ 2,935,298	\$ 120,358,708
<b>LIABILITIES</b>			
Accrued wages and employee benefits payable	\$ 6,391,580	\$ 60,529	\$ 6,452,109
Vouchers payable	7,540,141	232,651	7,772,792
Deferred revenues	124,199	169,358	293,557
Capital lease obligations	--	94,865	94,865
Accrued compensated absences	5,365,705	80,509	5,446,214
Due to other funds	91,611	20,020	111,631
Total current liabilities	19,513,236	657,932	20,171,168
Capital lease obligations	--	30,635	30,635
Accrued compensated absences	9,964,880	131,357	10,096,237
Total liabilities	29,478,116	819,924	30,298,040
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	97,143,191	2,070,001	99,213,192
Restricted for public safety programs	1,761,583	--	1,761,583
Unrestricted (deficit)	(10,959,480)	45,373	(10,914,107)
Total net assets	\$ 87,945,294	\$ 2,115,374	\$ 90,060,668

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2003**

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets		Total
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-type Activities	
<b>Governmental activities:</b>						
Confinement	\$ 161,787,740	\$ --	\$ 812,052	\$ (160,975,688)	\$ --	\$ (160,975,688)
Law enforcement	17,024,599	4,220,408	333,186	(12,471,005)	--	(12,471,005)
Parole	2,651,642	--	--	(2,651,642)	--	(2,651,642)
Crime victim compensation	1,736,187	1,014,054	374,673	(347,460)	--	(347,460)
General support	<u>9,220,485</u>	<u>--</u>	<u>--</u>	<u>(9,220,485)</u>	<u>--</u>	<u>(9,220,485)</u>
Total governmental activities	<u>192,420,653</u>	<u>5,234,462</u>	<u>1,519,911</u>	<u>(185,666,280)</u>	<u>--</u>	<u>(185,666,280)</u>
<b>Business-type activities:</b>						
Correctional industries	<u>4,526,650</u>	<u>4,210,187</u>	<u>--</u>	<u>--</u>	<u>(316,463)</u>	<u>(316,463)</u>
Total business-type activities	<u>4,526,650</u>	<u>4,210,187</u>	<u>--</u>	<u>--</u>	<u>(316,463)</u>	<u>(316,463)</u>
Total	\$ <u>196,947,303</u>	\$ <u>9,444,649</u>	\$ <u>1,519,911</u>	\$ <u>(185,666,280)</u>	\$ <u>(316,463)</u>	\$ <u>(185,982,743)</u>
<b>General revenues:</b>						
State allotments				153,001,070	--	153,001,070
State-provided payroll fringe benefits				27,595,229	--	27,595,229
Unrestricted investment earnings				56,922	3,597	60,519
Miscellaneous				62,577	--	62,577
Lapsed appropriations				(4,237,604)	--	(4,237,604)
Transfers, net				<u>(555,290)</u>	<u>--</u>	<u>(555,290)</u>
Total general revenues and transfers				<u>175,922,904</u>	<u>3,597</u>	<u>175,926,501</u>
Changes in net assets				(9,743,376)	(312,866)	(10,056,242)
NET ASSETS AT JULY 1, 2002				<u>97,688,670</u>	<u>2,428,240</u>	<u>100,116,910</u>
NET ASSETS AT JUNE 30, 2003				\$ <u>87,945,294</u>	\$ <u>2,115,374</u>	\$ <u>90,060,668</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
June 30, 2003**

	General	Capital Projects	Other Funds	Total
<b>ASSETS</b>				
Cash and cash equivalents	\$ 15,198,780	\$ 250	\$ 3,167,716	\$ 18,366,746
Receivables	405,972	--	--	405,972
Due from State of Hawaii	1,448,617	--	--	1,448,617
Due from other funds	73,113	--	33,177	106,290
Total assets	\$ 17,126,482	\$ 250	\$ 3,200,893	\$ 20,327,625
<b>LIABILITIES AND FUND BALANCES</b>				
<b>LIABILITIES</b>				
Accrued wages and employee benefits payable	\$ 6,348,616	\$ --	\$ 42,964	\$ 6,391,580
Vouchers payable	7,486,139	--	54,002	7,540,141
Deferred revenues	--	250	123,949	124,199
Due to other funds	104,213	--	34,804	139,017
Total liabilities	13,938,968	250	255,719	14,194,937
<b>FUND BALANCES</b>				
Reserved for:				
Encumbrances	6,040,785	--	2,264,644	8,305,429
Receivables	405,972	--	--	405,972
Unreserved	(3,259,243)	--	680,530	(2,578,713)
Total fund balances	3,187,514	--	2,945,174	6,132,688
Total liabilities and fund balances	\$ 17,126,482	\$ 250	\$ 3,200,893	\$ 20,327,625

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF NET ASSETS  
June 30, 2003**

<b>Total fund balances - governmental funds</b>	<b>\$</b>	<b>6,132,688</b>
 <b>Amounts reported for governmental activities in the statement of net assets are different because:</b>		
 Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.		
Governmental capital assets	\$	180,370,605
Less accumulated depreciation		<u>(83,227,414)</u>
		97,143,191
 Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds.		
		<u>(15,330,585)</u>
 <b>Net assets of governmental activities</b>	 <b>\$</b>	 <b><u>87,945,294</u></b>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
Fiscal Year Ended June 30, 2003**

	<u>General</u>	<u>Capital Projects</u>	<u>Other Funds</u>	<u>Total</u>
<b>REVENUES</b>				
State allotted appropriations	\$ 153,001,070	\$ --	\$ --	\$ 153,001,070
State-provided payroll fringe benefits	27,595,229	--	--	27,595,229
Operating grants and contributions	--	--	1,519,911	1,519,911
Charges for services	3,906,067	--	1,328,395	5,234,462
Unrestricted investment earnings	--	--	56,922	56,922
Miscellaneous	<u>62,577</u>	<u>--</u>	<u>--</u>	<u>62,577</u>
	<u>184,564,943</u>	<u>--</u>	<u>2,905,228</u>	<u>187,470,171</u>
<b>EXPENDITURES</b>				
Confinement	153,906,917	--	1,078,821	154,985,738
Law enforcement	15,915,267	--	543,017	16,458,284
Parole	2,597,036	--	--	2,597,036
Crime victim compensation	--	--	1,735,074	1,735,074
General support	<u>8,964,653</u>	<u>--</u>	<u>--</u>	<u>8,964,653</u>
	<u>181,383,873</u>	<u>--</u>	<u>3,356,912</u>	<u>184,740,785</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<u>3,181,070</u>	<u>--</u>	<u>(451,684)</u>	<u>2,729,386</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	--	--	1,651	1,651
Transfers out	<u>--</u>	<u>--</u>	<u>(556,941)</u>	<u>(556,941)</u>
	<u>--</u>	<u>--</u>	<u>(555,290)</u>	<u>(555,290)</u>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER USES</b>	3,181,070	--	(1,006,974)	2,174,096
<b>OTHER CHANGES IN FUND BALANCES</b>				
Lapsed appropriations	<u>(4,237,604)</u>	<u>--</u>	<u>--</u>	<u>(4,237,604)</u>
<b>NET CHANGE IN FUND BALANCES</b>	(1,056,534)	--	(1,006,974)	(2,063,508)
<b>FUND BALANCES AT JULY 1, 2002</b>	<u>4,244,048</u>	<u>--</u>	<u>3,952,148</u>	<u>8,196,196</u>
<b>FUND BALANCES AT JUNE 30, 2003</b>	<u>\$ 3,187,514</u>	<u>\$ --</u>	<u>\$ 2,945,174</u>	<u>\$ 6,132,688</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
RECONCILIATION OF THE CHANGE IN FUND BALANCES OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2003**

<b>Net change in fund balances - total governmental funds</b>		<b>\$ (2,063,508)</b>
<b>Amounts reported for governmental activities in the statement of activities are different because:</b>		
<p>Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is depreciated over their estimated useful lives.</p>		
Expenditures for capital assets	\$ 564,601	
Less current fiscal year depreciation	<u>(6,011,710)</u>	(5,447,109)
<p>Loss on the disposition of capital assets reported in the statement of activities does not require the use of current financial resources and therefore is not reported as an expenditure in governmental funds.</p>		
		(2,012)
<p>Change in long-term compensated absences reported in the statement of activities does not require the use of current financial resources and therefore is not reported as an expenditure in governmental funds.</p>		
		<u>(2,230,747)</u>
<b>Change in net assets of governmental activities</b>		<b>\$ <u>(9,743,376)</u></b>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF NET ASSETS  
PROPRIETARY FUND  
June 30, 2003**

**ASSETS**

Current assets		
Cash	\$	114,606
Receivables, net of allowance for doubtful accounts		344,472
Due from other funds		13,498
Inventories		<u>300,398</u>
Total current assets		772,974
Capital assets, net of depreciation		<u>2,195,501</u>
Total assets	\$	<u><u>2,968,475</u></u>

**LIABILITIES**

Current liabilities		
Accrued wages and employee benefits	\$	60,529
Vouchers payable		232,651
Due to other funds		53,197
Deferred revenues		169,358
Capital lease obligations		94,865
Accrued compensated absences		<u>80,509</u>
Total current liabilities		<u>691,109</u>
Noncurrent liabilities		
Capital lease obligations		30,635
Accrued compensated absences		<u>131,357</u>
		<u>161,992</u>
Total liabilities		<u>853,101</u>

**NET ASSETS**

Invested in capital assets, net of related debt		2,070,001
Unrestricted		<u>45,373</u>
Total net assets	\$	<u><u>2,115,374</u></u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
PROPRIETARY FUND  
Fiscal Year Ended June 30, 2003**

	<u>Enterprise Fund</u>
<b>OPERATING REVENUES</b>	
Charges for sales and services	\$ 4,220,287
Less provision for uncollectible accounts	<u>(10,100)</u>
	<u>4,210,187</u>
<b>OPERATING EXPENSES</b>	
Cost of sales and services	4,271,584
Depreciation and amortization	<u>239,531</u>
	<u>4,511,115</u>
<b>OPERATING LOSS</b>	<u>(300,928)</u>
<b>NON-OPERATING INCOME (EXPENSE)</b>	
Interest income	3,597
Interest expense	<u>(15,535)</u>
	<u>(11,938)</u>
<b>NET LOSS</b>	(312,866)
<b>NET ASSETS AT JULY 1, 2002</b>	<u>2,428,240</u>
<b>NET ASSETS AT JUNE 30, 2003</b>	<u>\$ 2,115,374</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUND  
Fiscal Year Ended June 30, 2003**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Receipts from customers	\$ 4,240,385
Receipts from interfund services provided	89,846
Payments to suppliers	(2,499,370)
Payments to employees	<u>(1,734,781)</u>
Net cash provided by operating activities	<u>96,080</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Interest received on investments	<u>3,597</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Purchases of capital assets	(9,284)
Principal payments on capital lease obligations	(135,308)
Interest paid on capital lease obligations	<u>(15,535)</u>
Net cash used by capital and related financing activities	<u>(160,127)</u>
<b>NET DECREASE IN CASH</b>	<b>(60,450)</b>
<b>CASH AT JULY 1, 2002</b>	<u>175,056</u>
<b>CASH AT JUNE 30, 2003</b>	<b>\$ <u>114,606</u></b>

**Department of Public Safety**  
**State of Hawaii**  
**STATEMENT OF CASH FLOWS (Continued)**  
**PROPRIETARY FUND**  
**Fiscal Year Ended June 30, 2003**

**RECONCILIATION OF OPERATING INCOME TO NET CASH  
 PROVIDED BY OPERATING ACTIVITIES**

Operating loss	\$ (300,928)
Adjustment to reconcile operating income to net cash used in operating activities:	
Depreciation	239,531
Provision for uncollectible accounts	10,100
Change in assets and liabilities	
(Increase) decrease in:	
Receivables, net	101,849
Due from other funds	13,260
Inventories	16,518
Increase (decrease) in:	
Vouchers payable	11,474
Accrued wages and employee benefits payable	(27,125)
Accrued compensated absences	(4,507)
Due to other funds	41,073
Deferred revenues	<u>(5,165)</u>
Net cash provided by operating activities	<u>\$ 96,080</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET  
AND ACTUAL - GENERAL FUND  
Fiscal Year Ended June 30, 2003**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Revenues</b>				
State allotments	\$ 153,001,070	\$ 153,001,070	\$ 153,001,070	\$ --
Charges for services	6,354,766	5,621,386	3,906,067	(1,715,319)
Miscellaneous	<u>75,065</u>	<u>75,065</u>	<u>83,751</u>	<u>8,686</u>
	<u>159,430,901</u>	<u>158,697,521</u>	<u>156,990,888</u>	<u>(1,706,633)</u>
<b>Expenditures</b>				
Confinement	132,615,452	134,103,786	131,694,420	2,409,366
Law enforcement	14,602,935	14,950,455	13,134,433	1,816,022
Parole	2,305,760	2,320,760	2,283,910	36,850
General support	<u>9,906,754</u>	<u>7,322,520</u>	<u>6,818,849</u>	<u>503,671</u>
	<u>159,430,901</u>	<u>158,697,521</u>	<u>153,931,612</u>	<u>4,765,909</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>\$ <u>          --</u></b>	<b>\$ <u>          --</u></b>	<b>\$ <u>  3,059,276</u></b>	<b>\$ <u>  3,059,276</u></b>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
STATEMENT OF ASSETS AND LIABILITIES  
AGENCY FUND  
Fiscal Year Ended June 30, 2003**

<b>ASSETS</b>	
Cash	\$ 2,164,189
Due from others	<u>111,631</u>
Total assets	\$ <u>2,275,820</u>
<b>LIABILITIES</b>	
Vouchers payable	\$ 29,063
Due to other funds	39,205
Due to individuals	1,126,238
Due to others	<u>1,081,314</u>
Total liabilities	\$ <u>2,275,820</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE A - FINANCIAL REPORTING ENTITY**

Effective July 1, 1990, Act 281, Session Laws of Hawaii (SLH) 1990, created the Department of Public Safety of the State of Hawaii (PSD). This Act transferred to the PSD, the administration of the state correctional facilities and related services formerly administered by the State Department of Corrections. This Act also transferred to the PSD on July 1, 1990, all functions and powers to administer the Sheriff's Office, formerly administered by the State Judiciary, and the Narcotics Enforcement Division, formerly administered by the State Department of the Attorney General.

The PSD is part of the executive branch of the State of Hawaii (State). The PSD's basic financial statements reflect only its portion of the fund type categories. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually which includes the PSD's financial activities.

The accompanying basic financial statements reflect the financial position, results of operations and cash flows of the following divisions of the PSD:

**Departmental Administration:** Departmental Administration includes management, accounting, data processing and other administrative services provided by the PSD. Also included in Departmental Administration is activity related to certain federal financial assistance programs. Its operations are reported in both the general and special revenue funds.

**Law Enforcement:** Law Enforcement assists in guarding state property and facilities, preserving the peace and protecting the public in designated areas, and serving process papers in civil and criminal proceedings. Included in Law Enforcement are the Protective Services, Narcotics Enforcement and Sheriff Divisions, and the Executive Protective Services. Its operations are reported in both the general and special revenue funds.

**Community Correctional Centers Division:** This division operates the state community correctional centers. Its public safety mission includes the confinement, care, supervision, rehabilitation and release of persons committed to those facilities. Its operations are reported in both the general and special revenue funds.

**Institutions Division:** This division operates the state correctional facilities other than the state community correctional centers. Its public safety mission includes the confinement, care, supervision, rehabilitation and release of persons committed to those facilities. Its operations are reported in both the general and special revenue funds.

**Intake Service Centers Division:** This division provides service delivery coordination to the State's criminal justice agencies through intake, assessment, program services and administrative functions. Its operations are reported in both the general and special revenue funds.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE A - FINANCIAL REPORTING ENTITY (Continued)**

**Corrections Program Services Division:** This division develops operational guidelines and standards and provides technical and administrative support and assistance to all correctional institutions for the effective and efficient conduct of programs and services. It also assists in coordinating and maintaining oversight of institutional operations, programs and services. Its operations are reported in both the general and special revenue funds.

**Health Care Division:** This division develops and maintains a program of health care services involving both in-house and community resources (public health, contract and volunteer) for all correctional institutions. It also oversees the operation of such services to ensure adherence to contemporary standards and fiscal responsibility, uniformity of quality health care, and integration/coordination among health care providers. Its operations are reported in the general fund.

**Inmate Stores:** The inmate stores are operated by the PSD within the state correctional facilities. The PSD contracts with an outside vendor to provide consumer goods for sale to the inmate population. The stores' operations are reported in the general fund.

**Correctional Industries Division:** This division employs inmates who receive employment training and who provide printing, sewing, construction and miscellaneous services to other operations of the PSD, other state agencies, and the private sector. Its operations are reported in the enterprise fund.

**Crime Victim Compensation Commission (administratively attached to the PSD):** This commission assists victims of criminal acts by providing compensation to victims or survivors of deceased victims of certain crimes. Its operations are reported in the special revenue funds.

**Hawaii Paroling Authority (administratively attached to the PSD):** This authority is a quasi-judicial body which establishes minimum terms of imprisonment, considers requests for parole and provides supervision for those granted parole. Its operations are reported in the general fund.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

- (1) **Basis of Presentation** - The government-wide financial statements report all assets, liabilities, and activities of the PSD as a whole. The fiduciary funds are excluded from the government-wide financial statements because the PSD cannot use those assets to finance its operations.

The financial transactions of the PSD 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, retained earnings, revenues, and expenditures.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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

**Governmental Fund Types**

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

**Special Revenue Funds** - Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes.

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

**Proprietary Fund Type**

**Enterprise Fund** - The enterprise fund is used to account for operations for which a fee is charged to external users for goods or services and the activity (a) is financed with debt that is solely secured by a pledge of the net revenues, (b) has third party requirements that the cost of providing services, including capital costs, be recovered with fees and charges, or (c) establishes fees and charges based on a pricing policy designed to recover similar costs.

Proprietary fund operating revenues are those that result from providing goods and services. It also includes revenues not related to capital and related financing activities, non-capital financing activities, or investing activities, if any.

**Fiduciary Fund Type**

**Agency Fund** - The agency fund is used to account for assets held by the PSD on behalf of outside parties, including other governments, or on behalf of individuals.

(2) ***Measurement Focus and Basis of Accounting***

**Government-wide Financial Statements** - The economic resources measurement focus and accrual basis of accounting is used for reporting the government-wide financial statements. With this measurement focus, all assets and liabilities associated

**Department of Public Safety**  
**State of Hawaii**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

with the operations of the PSD are included in the statement of net assets. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded when they are incurred.

**Governmental Funds** - All governmental funds are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become both measurable and available. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after fiscal year-end to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include federal grants and funds appropriated by the State Legislature and allotted by the Governor. Expenditures are generally recorded when the related fund liabilities are incurred.

**Proprietary and Agency Funds** - All proprietary and agency funds are accounted for on a flow of economic resources measurement focus and accrual basis of accounting. In accordance with standards promulgated by the Governmental Accounting Standards Board, the PSD has elected not to apply the Financial Accounting Standards Board pronouncements on accounting and financial reporting that were issued after November 30, 1989.

- (3) **Use of Estimates** - The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.
- (4) **Cash and Cash Equivalents** - Cash and cash equivalents, for the purpose of the statement of cash flows, includes all cash and investments with original maturities of three months or less.
- (5) **Receivables** - Receivables in the general fund consist primarily of amounts due from individuals for whom salaries were overpaid by the PSD. Receivables in the enterprise fund consist primarily of amounts due from other state agencies for services provided to those agencies for a fee. The amounts reported as net receivables were established based on management's estimate of amounts collectible.

Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as internal balances.

- (6) **Inventories** - Inventory of goods, materials and supplies is valued at cost (first-in, first-out method). Inventory in the enterprise fund consists primarily of printing, construction, and sewing supplies to be used in the Correctional Industries Program.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (7) **Capital Assets** - The accounting treatment over capital assets depends on whether the assets are used in governmental fund or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible or intangible 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 used in proprietary fund operations are accounted for on the same basis as in the government-wide financial statements.

Capital assets are valued at cost where historical cost 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.

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

The State has adopted the following capitalization policy:

Asset Type	Minimum Capitalization Amount	Estimated Useful Life	
		Governmental	Proprietary
Land	All	Not applicable	Not applicable
Land improvements	\$100,000	15 years	Not applicable
Buildings and improvements	\$100,000	30 years	40 years
Furniture and equipment	\$5,000	7 years	5 years
Motor vehicles	\$5,000	5 years	5 years

- (8) **Due to Individuals** - Due to individuals represents assets held by the PSD primarily in an agency capacity for the inmate population.
- (9) **Accumulated Vacation** - Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.
- (10) **Restricted Net Assets** - Net assets are restricted when constraints placed on net assets are imposed by grantors, contributors, or laws and regulations of authorizing governments. When both restricted and unrestricted net assets are available, the PSD generally applies unrestricted resources before restricted resources for expenses incurred.

**Department of Public Safety**  
**State of Hawaii**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (11) **Appropriations** - Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.
- (12) **Program Revenues** - Program revenues derive directly from the programs of the PSD or from parties outside of the PSD 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 the goods, services, or privileges provided. Revenues in this category include fees charged for specific services, such as controlled substance registration fees, security service fees and state law and court imposed crime victim compensation fees. Payments from other governments that are exchange transactions are also reported as charges for services.

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.

- (13) **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.
- (14) **Risk Management** - The PSD 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.

**NOTE C - BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the statement of revenue and expenditures - budget and actual - general fund 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.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)**

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 special revenue funds.

For purposes of budgeting, the PSD's budgetary fund structure and accounting principles differ from those utilized to present the governmental fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The PSD's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase order and contract obligations, (2) the recognition of certain receivables, and (3) special revenue fund operating grant accruals and deferrals. These differences represent a departure from GAAP. The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the general fund for the fiscal year ended June 30, 2003.

	<u>Amount</u>
Excess of revenues over expenditures and other uses - actual on budgetary basis	\$ 3,059,276
Reserved for encumbrances at fiscal year-end	6,040,785
Reserved for receivables	405,972
Expenditures for liquidation of prior fiscal year encumbrances	(6,161,942)
Net change in unreserved liabilities	(141,847)
Net adjustment for commissary revenue accrual	<u>(21,174)</u>
Excess of revenues over expenditures and other uses - GAAP basis	<u>\$ 3,181,070</u>

**NOTE D - CASH AND CASH EQUIVALENTS**

The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Hawaii Revised Statutes authorize the State Director of Finance to invest in 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. Cash and deposits with financial institutions are collateralized in accordance with state statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE D - CASH AND CASH EQUIVALENTS (Continued)**

The PSD also maintains cash in banks and time certificates of deposit, which are held separately from cash in the State Treasury. As of June 30, 2003, the carrying amount of total bank deposits including time certificates of deposit was approximately \$1,075,000 and the corresponding bank balances which are represented were approximately \$1,106,000.

**NOTE E - RECEIVABLES**

Receivables of the PSD, net of an allowance for doubtful accounts, consisted of the following at June 30, 2003:

	<u>General Fund</u>	<u>Enterprise Fund</u>
Salary overpayments	\$ 1,162,972	\$ --
Accounts receivable	<u>          --</u>	<u>404,472</u>
	1,162,972	404,472
Less allowance for doubtful accounts	<u>757,000</u>	<u>60,000</u>
Receivables, net	\$ <u>405,972</u>	\$ <u>344,472</u>

**NOTE F - CAPITAL ASSETS**

The changes in capital assets were as follows:

	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2003</u>
Governmental activities:				
Nondepreciable assets				
Land	\$ 107,570	\$ --	\$ --	\$ 107,570
Depreciable assets				
Building and improvements	172,084,272	--	--	172,084,272
Furniture and equipment	4,221,407	277,377	29,920	4,468,864
Vehicles	<u>3,511,880</u>	<u>287,225</u>	<u>89,206</u>	<u>3,709,899</u>
Total at historical cost	<u>179,925,129</u>	<u>564,602</u>	<u>119,126</u>	<u>180,370,605</u>
Less accumulated depreciation for:				
Building and improvements	71,232,510	5,333,187	--	76,565,697
Furniture and equipment	3,078,639	299,879	27,908	3,350,610
Vehicles	<u>3,021,668</u>	<u>378,645</u>	<u>89,206</u>	<u>3,311,107</u>
	<u>77,332,817</u>	<u>6,011,711</u>	<u>117,114</u>	<u>83,227,414</u>
Governmental activities capital assets, net	\$ <u>102,592,312</u>	\$ <u>(5,447,109)</u>	\$ <u>2,012</u>	\$ <u>97,143,191</u>

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE F - CAPITAL ASSETS (Continued)**

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003
<b>Business-type activities:</b>				
Building and improvements	\$ 2,579,000	\$ --	\$ --	\$ 2,579,000
Equipment	2,103,437	9,284	--	2,112,721
Equipment under capital lease	649,758	--	--	649,758
Total at historical cost	<u>5,332,195</u>	<u>9,284</u>	<u>--</u>	<u>5,341,479</u>
<b>Less accumulated depreciation for:</b>				
Building and improvements	644,750	64,475	--	709,225
Equipment	1,918,875	94,036	--	2,012,911
Equipment under capital lease	342,822	81,020	--	423,842
Total accumulated depreciation	<u>2,906,447</u>	<u>239,531</u>	<u>--</u>	<u>3,145,978</u>
<b>Business-type activities capital assets, net</b>	<b>\$ <u>2,425,748</u></b>	<b>\$ <u>(230,247)</u></b>	<b>\$ <u>--</u></b>	<b>\$ <u>2,195,501</u></b>

Depreciation expense was charged to functions as follows:

	Amount
<b>Governmental activities:</b>	
Confinement	\$ 5,607,634
Law enforcement	123,223
Parole	1,290
Crime victim compensation	2,714
General support	<u>276,850</u>
Total governmental activities depreciation	6,011,711
<b>Business-type activities:</b>	
Correctional industries	<u>239,531</u>
Total depreciation expense	\$ <u>6,251,242</u>

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE G - LONG-TERM LIABILITIES**

The only long-term liability for governmental activities is for accrued compensated absences. Long-term liability activity during the fiscal year ended June 30, 2003, was as follows:

	<u>Amount</u>
Balance at July 1, 2002	\$ 13,099,838
Additions	10,481,640
Reductions	<u>(8,250,893)</u>
Balance at June 30, 2003	\$ <u>15,330,585</u>

The amount of governmental activities compensated absences liability due within one year is \$5,365,705. The compensated absences liability has been paid primarily by the general fund in the past.

Long-term liability activity for business-type activities during the fiscal year ended June 30, 2003, was as follows:

	<u>Balance</u>		<u>Balance</u>		<u>Amount</u>
	<u>July 1, 2002</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2003</u>	<u>Due Within</u>
					<u>One Year</u>
Capital lease obligations	\$ 260,808	\$ --	\$ 135,308	\$ 125,500	\$ 94,865
Accrued compensated absences	<u>216,373</u>	<u>127,924</u>	<u>132,431</u>	<u>211,866</u>	<u>80,509</u>
Total business-type activities long-term liabilities	\$ <u>477,181</u>	\$ <u>127,924</u>	\$ <u>267,739</u>	\$ <u>337,366</u>	\$ <u>175,374</u>

**NOTE H - NON-IMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the PSD's employees funded by state appropriations (general fund) are assumed by the State and are not charged to the PSD's operating funds. These costs, totaling approximately \$27,595,000 for the fiscal year ended June 30, 2003, have been reported as revenues and expenditures in the general fund of the PSD.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the PSD's special revenue funds.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE I - FUND BALANCE DEFICITS**

The general fund had a deficit in the unreserved fund balance at June 30, 2003, of \$3,259,243. The deficit resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when the funds are measurable and available.

**NOTE J - CHANGES IN ASSETS AND LIABILITIES OF THE AGENCY FUND**

The agency fund is purely custodial (assets equal liabilities) and thus does not involve the measurement of results of operations. The changes in assets and liabilities of the agency fund for the fiscal year ended June 30, 2003, were as follows:

	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2003</u>
<b>Assets</b>				
Cash and other assets held in trust	\$ <u>4,628,140</u>	\$ <u>5,555,777</u>	\$ <u>7,908,097</u>	\$ <u>2,275,820</u>
<b>Liabilities</b>				
Due to individuals and others	\$ <u>4,628,140</u>	\$ <u>5,555,777</u>	\$ <u>7,908,097</u>	\$ <u>2,275,820</u>

**NOTE K - LEASE COMMITMENTS**

- (1) **Capital Leases** - The PSD's Correctional Industries Program has long-term equipment leases expiring through October 2006, that are accounted for as capital leases in the enterprise fund. These leased equipment are amortized using the straight-line method over the estimated useful lives of the equipment. The amortization is included in depreciation and amortization expense of the enterprise fund and amounted to approximately \$81,000 for the fiscal year ended June 30, 2003.

Interest expense of \$15,535 is included as a direct function expense of the Correctional Industries Program on the statement of activities for the fiscal year ended June 30, 2003.

At June 30, 2003, the future minimum lease payments together with the present value of net minimum lease payments (obligations under capital leases) were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2004	\$ 101,064
2005	18,782
2006	10,443
2007	<u>3,481</u>
Total minimum lease payments	133,770
Less amounts representing interest at 7.42% - 10.47%	<u>8,270</u>
Present value of minimum lease payments	\$ <u>125,500</u>

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE K - LEASE COMMITMENTS (Continued)**

- (2) **Operating Leases** - The PSD leases office facilities from third party lessors as well as equipment on a long-term basis that are reported in the general and enterprise funds. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2003, were as follows:

Fiscal Year Ending June 30,	Amount
2004	\$ 414,000
2005	368,000
2006	283,000
2007	119,000
2008	8,000
	<b>\$ 1,192,000</b>

Total rent expense for the fiscal year ended June 30, 2003, was approximately \$419,000.

**NOTE L - RETIREMENT BENEFITS**

**Employees' Retirement System**

Substantially all eligible employees of the PSD are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the PSD hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the PSD is required to contribute to both options at an actuarially determined rate. Contributions by the PSD for the fiscal years ended June 30, 2003, 2002 and 2001 were approximately \$445,000, nil and \$71,000, respectively. The contribution rate for the fiscal year ended June 30, 2003 was 8.87%. The contribution rate was 5.78% from July 1, 2000 to November 15, 2000, and nil for the remainder of the fiscal year ended June 30, 2001 and for the fiscal year ended June 30, 2002.

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE L - RETIREMENT BENEFITS (Continued)**

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

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired state employees. Contributions are financed on a pay-as-you-go basis. The PSD's special revenue fund share of the post-retirement health care and life insurance benefits expense for the fiscal years ended June 30, 2003, was approximately \$361,000.

**Deferred Compensation Plan**

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

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

**NOTE M - RISK MANAGEMENT**

The PSD 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 \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$25 million (\$10 million for earthquake, named hurricane, and flood) and the annual aggregate for general liability losses per occurrence is \$7 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$30 million per occurrence with no annual aggregate limit.

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

**Department of Public Safety  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE N - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2003, amounted to approximately \$19,600,000.

**SUPPLEMENTARY INFORMATION**

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2003**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>
<b>U.S. Department of Justice</b>			
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	--	<u>56,442</u>
Public Safety Partnership and Community Policing Grants	16.710	--	<u>196,137</u>
Federal Equitable Sharing Program	N/A <sup>2</sup>	--	<u>31,569</u>
<b>Pass-through State Department of the Attorney General</b>			
Crime Victim Compensation	16.576	00-VC-GX-4015 01-VC-GX-0015 02-VX-GX-0015	254,754 44,326 <u>18,784</u> <u>317,864</u>
Byrne Formula Grant Program	16.579	01-DB-07 01-DB-16 02-DB-06 02-DB-14	76,299 61,960 1,325 <u>53,918</u> <u>193,502</u>
Residential Substance Abuse Treatment for State Prisoners (RSAT)	16.593	98-RT-1 99-RT-1	20,993 <u>300,348</u> <u>321,341</u>
<b>Total U.S. Department of Justice</b>			<b>\$ <u>1,116,855</u></b>

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2003**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>
<b>U.S. Department of Education</b>			
Grants to States for Incarcerated Youth Offenders	84.331	--	\$ 55,830
Pass-through State Department of Education			
Title I Program for Neglected and Delinquent Children	84.013	S013A990011	88,997
Pass-through University of Hawaii			
Vocational Education - Basic Grants to States	84.048	V048A40011	<u>67,020</u>
<b>Total U.S. Department of Education</b>			<u>211,847</u>
<b>U.S. Department of Defense</b>			
Pass-through Hawaii Army National Guard			
Master Cooperative Agreement	N/A <sup>2</sup>	DAHA50-02-H1003	11,981
		DAHA50-03-H1003	<u>42,945</u>
<b>Total U.S. Department of Defense</b>			<u>54,926</u>
<b>TOTAL FEDERAL EXPENDITURES</b>			<b>\$ <u>1,383,628</u></b>

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<sup>1</sup> The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.

<sup>2</sup> Not applicable.

**PART II**

**AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**



NISHIHAMA & KISHIDA, CPA'S, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN SAVINGS BANK TOWER  
1001 BISHOP STREET, SUITE 1700  
HONOLULU, HAWAII 96813-3696  
TELEPHONE (808) 524-2255  
FAX (808) 523-2090

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN  
AUDIT OF THE BASIC FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Director  
Department of Public Safety  
State of Hawaii

We have audited the basic financial statements of the Department of Public Safety of the State of Hawaii (PSD), as of and for the fiscal year ended June 30, 2003, and have issued our report thereon dated January 16, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

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

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the PSD's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our

attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the PSD's ability to record, process, summarize and report financial data consistent with the assertions of management in the basic financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-1 through 03-5.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider all of the reportable conditions described above to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to the management of the PSD in a separate letter dated January 16, 2004.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
January 16, 2004

**PART III**

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



NISHIHAMA & KISHIDA, CPA'S, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

AMERICAN SAVINGS BANK TOWER  
1001 BISHOP STREET, SUITE 1700  
HONOLULU, HAWAII 96813-3696  
TELEPHONE (808) 524-2255  
FAX (808) 523-2090

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Director  
Department of Public Safety  
State of Hawaii

**Compliance**

We have audited the compliance of the Department of Public Safety of the State of Hawaii (PSD) with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2003. The PSD's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the PSD's management. Our responsibility is to express an opinion on the PSD's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the PSD's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the PSD's compliance with those requirements.

In our opinion, the PSD complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2003.

## Internal Control Over Compliance

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

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Nishihama & Kishida, CPA's, Inc.*

Honolulu, Hawaii  
January 16, 2004

**PART IV**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ended June 30, 2003**

**SECTION I - SUMMARY OF AUDITORS' RESULTS**

**Financial Statements**

Type of auditors' report issued: Unqualified  
 Internal control over financial reporting:  
   Material weakness(es) identified?  yes  no  
   Reportable condition(s) identified  
     not considered to be material weaknesses?  yes  none reported  
 Noncompliance material to the financial statements  
 noted?  yes  no

**Federal Awards**

Internal control over major program:  
   Material weakness(es) identified?  yes  no  
   Reportable condition(s) identified  
     not considered to be material weaknesses?  yes  none reported

Type of auditors' report issued on compliance for  
 major programs: Unqualified

Any audit findings disclosed that are required to be  
 reported in accordance with OMB Circular A-133,  
 Section .510(a)?  yes  no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
16.576	Crime Victim Compensation
16.593	Residential Substance Abuse Treatment for State Prisoners
16.710	Public Safety Partnership and Community Policing Grants
N/A	Federal Equitable Sharing Program

Dollar threshold used to distinguish between Type A  
 and Type B programs: \$300,000

Auditee qualified as a low-risk auditee?  yes  no

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref.**

**No. Internal Control Findings**

**03-1 Improve Controls Over Inmate Agency Fund Accounts**

The PSD serves as a custodian for monies belonging to inmates while incarcerated. There are eight facilities under the PSD. Each facility has its own bank account(s) at a financial institution. The financial activities of the inmates are accounted for using the Inmate Trust Accounting (ITA) system. As custodian, the PSD is responsible for ensuring the propriety of individual balances through proper internal control policies and procedures.

In addition to the eight facilities, the PSD also maintains a separate bank account to maintain the funds of inactive inmate accounts. These balances are accounted for in the ITA system. The Oahu Community Correctional Center is the custodian of this account.

We noted the following conditions regarding the inmate trust accounts as of June 30, 2003:

- We were unable to reconcile the inmate trust account balance per the ITA system's printed trial balance to the reconciled cash balance as of June 30, 2003. The unreconciled difference totaled approximately \$36,000.
- Halawa Correctional Facility and the Women's Community Correctional Center did not prepare bank reconciliations during the current fiscal year. The Women's Community Correctional Center has not performed monthly bank reconciliations since May 31, 1996. Two other facilities prepared bank reconciliations as of June 30, 2003, that were not accurate.
- Inactive inmate accounts remained on the PSD's financial records.
- There was no segregation of duties related to the cash account maintained at the Oahu Community Correctional Center to account for funds of inactive inmate accounts. One employee is responsible for receipting, recording, depositing, disbursing, and reconciling the bank account.
- Stale-dated checks over one-year old were not escheated to the State Treasury.
- The total cash balance of inmate accounts reported to the State of Hawaii exceeded the adjusted bank balances by approximately \$10,000 as of June 30, 2003.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

Bank reconciliations and reconciliations of inmate trust account balances to the bank balances are a key internal control component in assuring that transactions are accurately recorded, cash is properly deposited and safeguarded, and inmate trust account balances are reconciled.

In regards to monthly accounting and reconciliation, paragraph 4.5.d.1 of PSD Policy No. COR.02.12 states in part, "...The amounts of the bank statements, less interest, shall be reconciled to the individual ledgers."

Hawaii Revised Statutes (HRS) Section 523A-3 states in part, "Unless otherwise provided in this part or by other statute of this State, intangible property is subject to the custody of this State as unclaimed property if the conditions raising a presumption of abandonment ... are satisfied...." HRS Section 523A-13 states, "Intangible property held for the owner by a court, state, or other government, governmental subdivision or agency, public corporation, or public authority which remains unclaimed by the owner for more than one year after becoming payable or distributable is presumed abandoned." HRS Section 523A-1 defines intangible property to include checks and drafts.

It is important to keep accurate and complete accounting records to ensure that the PSD can uphold its fiduciary duty to maintain current and accurate inmate trust account balances. Since transactions in this area are not subject to the centralized internal controls of the State Department of Accounting and General Services, it is imperative that the PSD implement and enforce strict internal controls over these transactions. Immediate attention should be given to this area by the PSD's management to reduce the possibility of misappropriation of cash.

**Recommendation**

Management should take corrective action to strictly enforce the policy requiring monthly reconciliations to be submitted to the PSD Fiscal Office in a timely manner. Required monthly reconciliations include a bank reconciliation and reconciliation between the reconciled bank balance and the inmate ledger balance. Reconciling items should be investigated and resolved by the facilities each month. Existing unreconciled differences should be investigated and should be corrected or written-off.

Internal controls over inmate trust account transactions should be strengthened. This includes adequate segregation of duties and timely reconciliations of inmate trust account balances to the bank balances. Management should consider having independent reviews performed by the PSD Audit and Compliance Office to ensure that internal controls are functioning properly and that departmental procedures are followed.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**Ref.**

**No. Internal Control Findings (Continued)**

**03-2 Strengthen Controls Over Compensated Leaves of Absence**

The following conditions were noted during our review of leave records as of June 30, 2003:

- The salary overpayment receivable balance as of June 30, 2003, was approximately \$1,163,000. Prior to January 1995, the PSD was able to garnish any overpaid wages from the employees' next paycheck. However, according to HRS Section 78-12, the PSD must conduct a hearing to recover these overpayments. The PSD submitted a list of overpayments to the State Department of the Attorney General (AG) and held the required hearings. Most of the salary overpayments occurred because of the timing requirements for processing payroll data under the State's payroll system. For employees hired effective July 1, 1998, paychecks are prepared after the payroll period rather than before the end of the payroll period to provide time to make any payroll adjustments to prevent salary overpayments. We noted that the occurrences of salary overpayments have stabilized from the fiscal year ended June 30, 2000.
- The employee leave schedule prepared for financial reporting purposes erroneously omitted the number of hours added and deducted for 25 employees during the fiscal year.
- In nine instances, the employee leave schedule prepared by the PSD did not agree to the Form DPS-7, "Employee Leave Record." The discrepancies generally resulted from corrections to the Form DPS-7 after the employee leave schedule was prepared.
- In three instances, the Form G-1, "Application for Leave of Absence," was not on file.
- In eight instances, leave hours per the Form DPS-7, "Employee Leave Record," were not supported by Form G-1, "Application for Leave of Absence."
- In several instances, the Form G-1, "Application for Leave of Absence," did not have the approval signature, date, and/or hours.
- In two instances, the Form DPS-7, "Employee Leave Record," was not mathematically accurate.
- There were several instances where the approval date on the Form G-1, "Application for Leave of Absence," was several days after the vacation period requested.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

Leave records should be maintained accurately to ensure that each employee is compensated for absences as allowed by the employment agreement and paid the correct amount of unused credits upon termination of employment.

**Recommendation**

The PSD should strengthen controls over compensated leaves of absence by performing the following procedures:

- Continue collection efforts in the repayment of salary overpayments.
- Ensure that leave information for financial statement reporting purposes is accurately prepared, reviewed, and corrected, if necessary, by responsible personnel prior to submission to the PSD Fiscal Office.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**Ref.  
No. Internal Control Findings (Continued)**

**03-3 Maintain Current and Accurate Financial Records for Correctional Industries**

During our review of the accounting records at the Correctional Industries, we noted the following conditions as of June 30, 2003:

- There was an unreconciled difference in cash of approximately \$35,000 between the Correctional Industries' internal general ledger and the financial reports printed from the Financial Accounting and Management Information System (FAMIS). The Correctional Industries was unable to explain the difference.
- Total fixed assets reported on the State's *Annual Inventory Report of Property* was less than the amount recorded on the Correctional Industries' accounting records by approximately \$1,436,000 as of June 30, 2003.
- For 9 out of 16 inventory items tested, the unit cost per the inventory listing as of June 30, 2003, did not agree to the invoice. The misstatement of the unit cost averaged at approximately ten percent of the invoiced unit cost with a range from 1 to 51 percent of the invoiced unit cost.

**Recommendation**

Correctional Industries should maintain current and accurate financial records to facilitate proper analysis and management decisions that are critical to maintaining a self-supporting operation. This includes maintaining the integrity of the historical, financial information in their internal general ledger, reconciling their internal financial information to the reports printed from FAMIS on a monthly basis, investigating unreconciled differences for correction or write-off, and developing procedures to coordinate the recording of capital assets into their internal general ledger software with the reporting of capital asset information to DAGS.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**Ref.**  
**No. Internal Control Findings (Continued)**

**03-4 Adhere to Established Policies and Procedures for Inmate Stores**

The Halawa Correctional Facility (HCF), Oahu Community Correctional Center (OCCC) and the Waiawa Correctional Facility (WCF) each have a special revolving fund to account for inmate store sale activities. Paragraph 3.1 of PSD Policy No. 493.02.01 pertaining to the operations of inmate stores states, "Branch Administrators shall provide for the establishment and operation of an inmate store or other acceptable means for the purchase of approved items by inmates."

Each of the three facilities contracts with an outside vendor to provide and deliver goods such as personal hygiene products, food, and other items for inmate consumption. The vendor invoices the respective facilities at 2.5% less than the amount charged to the inmate for purchases. The 2.5% discount represents gross profit.

Paragraph 4.5 of PSD Policy No. COR.02.01 states in part, ". . . Facilities that operate an inmate store with contracted services shall transfer 100 percent of the fiscal year's net profit to the Administrator/Inmate Activity Fund. Expenditures shall be made in accordance with the Department Policy COR.02.05, Administrator/Inmate Activity Fund. This section is applicable to all prior fiscal years for any inmate store with contracted services for those years."

We noted that all three facilities continued to deposit a large portion of net profits to the special revolving fund. The total amount of net profits for the fiscal year ended June 30, 2003, that was deposited into the special revolving fund approximated \$33,000.

**Recommendation**

The PSD should send written reminders to the facilities to ensure the following:

- All facilities must comply with established PSD policies and procedures pertaining to inmate stores.
- All facilities should transfer net profits earned currently and retroactively from outsourced inmate store services to the Administrator/Inmate Activity Fund.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**Ref.  
No. Internal Control Findings (Continued)**

**03-5 Properly Account for Capital Assets**

During our review of the capital asset records of the PSD, we noted the following:

- Capital asset transactions were not reported to the State in a timely manner. As a result, approximately \$140,000 in capital assets actually acquired prior to the fiscal year ended June 30, 2003, was recorded as current fiscal year additions.
- Building and building improvement costs amounting to approximately \$60 million were not recorded on the State's *Annual Inventory Report of Property* as of June 30, 2003. Most of the costs were for the construction of capital assets for which the PSD was not the expending agency.
- A demolished building with a recorded cost of approximately \$2.6 million was not removed from the State's property inventory records.

HRS Section 103D-1206 states in part, "...the administrative heads of the executive departments, and all other persons, offices, and boards of public character...shall prepare and file with the administrator of the state procurement office an annual inventory return of all state property in the possession, custody, control, or use of the officer making the return, or of the department or office of the government over which the officer presides...."

**Recommendation**

The PSD should record all acquired capital assets in its possession, custody, control, or use, including completed capital projects paid by another state department, and remove disposed assets from the state property records, as appropriate in a timely manner.

**Department of Public Safety  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**SECTION III - FEDERAL AWARD FINDINGS**

**None.**

**PART V**  
**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

## STATUS REPORT

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2002, dated February 28, 2003.

<u>Recommendations</u>	<u>Status</u>
<b>SECTION II - FINANCIAL STATEMENT FINDINGS</b>	
<b>02-1 Improve Controls Over Inmate Agency Fund Accounts (pages 55-56)</b>	
<p>Management should take corrective action to strictly enforce the policy requiring monthly reconciliations to be submitted to the PSD Fiscal Office in a timely manner. Required monthly reconciliations include a bank reconciliation and reconciliation between the reconciled bank balance and the inmate ledger balance. Reconciling items should be investigated and resolved by the facilities each month. Existing unreconciled differences should be investigated and should be corrected or written-off.</p> <p>Internal controls over inmate trust account transactions should be strengthened. This includes adequate segregation of duties and timely reconciliations of inmate trust account balances to the bank balances. Management should consider having independent reviews performed by the PSD Audit and Compliance Office to ensure that internal controls are functioning properly and that departmental procedures are followed.</p>	<p>Not accomplished. See Reference No. 03-1.</p>
<b>02-2 Strengthen Controls Over Compensated Leaves of Absence (pages 57-58)</b>	
<p>The PSD should strengthen controls over compensated leaves of absence by performing the following procedures:</p> <ul style="list-style-type: none"><li>• Continue collection efforts in the repayment of salary overpayments.</li><li>• Continue to work on using the KRONOS system to provide up-to-date and accurate compensated leaves of absence records.</li></ul>	<p>Partially accomplished. The number of salary overpayment occurrences have stabilized. However, the KRONOS system has been put on hold due to required upgrades to the system and is no longer in operation at the PSD. In addition, errors in the compensated leaves of absence records continued to occur during the fiscal year ended June 30, 2003. See Reference No. 03-2.</p>

**02-2 Strengthen Controls Over Compensated Leaves of Absence (Continued)(pages 57-58)**

- Ensure that leave information for financial statement purposes is accurately prepared and reviewed by responsible personnel prior to being submitted to the PSD Fiscal Office. Leave schedules should be prepared at or near the end of the fiscal year and any subsequent adjustment to the leave information should be made prior to submitting to the PSD Fiscal Office.
- Require all employees to submit the completed Form G-1, "Application for Leave of Absence," with proper approval, prior to taking vacation or compensatory time-off. The completed Form G-1 for sick leave taken should be submitted immediately upon returning to work.

**02-3 Maintain Current and Accurate Financial Records for Correctional Industries (pages 59-60)**

Correctional Industries should maintain current and accurate financial records to facilitate proper analysis and management decisions that are critical to maintaining a self-supporting operation. This includes maintaining the integrity of the historical financial information in their internal general ledger, reconciling their internal financial information to the reports printed from FAMIS on a monthly basis, and developing procedures to coordinate the recording of capital assets into their internal general ledger software with the reporting of capital asset information to DAGS.

In addition, the PSD should consider conducting an annual physical inventory count on the last working day(s) of the fiscal year and closing the warehouse during the count to facilitate a more accurate count.

Partially accomplished. Correctional Industries improved its procedures for the annual physical inventory count. In addition, Correctional Industries has implemented procedures to reconcile their internal financial records to the Financial Accounting and Management Information System (FAMIS). However, there continues to be unreconciled differences in financial records. See Reference No. 03-3.

**02-4 Adhere to Established Policies and Procedures for Inmate Stores (page 61)**

The PSD should send written reminders to the facilities to ensure the following:

- All facilities must comply with established PSD policies and procedures pertaining to inmate stores.

Not accomplished. See Reference No. 03-4.

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Recommendations

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Status

**02-4 Adhere to Established Policies and Procedures for Inmate Stores (Continued)(page 61)**

- The HCF and OCCC should transfer net profits earned from commissary operations retroactively to the Administrator/Inmate Activity Fund.

**02-5 Properly Account for Capital Assets (page 62)**

The PSD should record all acquired capital assets in its possession, custody, control, or use, including completed capital projects paid by another state department, and remove disposed assets from the state property records, as appropriate in a timely manner.

Not accomplished. See Reference No. 03-5.

Recommendations	Federal CFDA Number	Status
<b>SECTION III - FEDERAL AWARD FINDINGS</b>		
<b>02-6 Report Costs Properly (pages 63-64)</b>		
<p>The PSD should properly report the amount of allowable corrections officers' salaries for the State Criminal Alien Assistance Program (SCAAP). This includes using actual salary costs and properly deducting the amount of reimbursements received from the U.S. Marshal from the amount of corrections officers' salaries. In addition, the PSD should ensure that any retroactive payments reported do not include unallowable benefits and overtime payments. Because the award is not the usual dollar-for-dollar cost reimbursement, the PSD needs to work with the federal grantor as to the amount of questioned costs, if any.</p>	16.606	<p>Partially accomplished. The PSD is currently working with the Federal grantor agency to resolve questioned costs that may have resulted from audit findings of the prior fiscal years. SCAAP expenditures reported for the fiscal year ended June 30, 2003, properly excluded retroactive salaries.</p>

**PART VI**  
**RESPONSE OF THE AFFECTED AGENCY**

LINDA LINGLE  
GOVERNOR



STATE OF HAWAII  
**DEPARTMENT OF PUBLIC SAFETY**  
919 Ala Moana Boulevard, 4th Floor  
Honolulu, Hawaii 96814

JOHN F. PEYTON, JR.  
DIRECTOR

CLAIRE Y. NAKAMURA  
Deputy Director  
Administration

FRANK J. LOPEZ  
Deputy Director  
Corrections

JAMES L. PROPOTNICK  
Deputy Director  
Law Enforcement

No. 2004-1177

March 29, 2004

Mr. Ronald T. Shiigi, Principal  
Nishihama & Kishida, CPA's, Inc.  
1001 Bishop Street, Suite 1700  
Honolulu, Hawaii 96813-3696

Dear Mr. Shiigi:

**SUBJECT: State Department of Public Safety's Response to the Financial Audit Findings for the Fiscal Year Ended June 30, 2003**

In response to the subject audit findings on internal controls, the State Department of Public Safety (PSD) provides the following comments:

**03-01 Improve Controls Over Inmate Agency Fund Accounts**

- We agree with the need for monthly reconciliation by each of the eight facilities between: (a) the bank balance and the inmate ledger balance; and (b) the inmate ledger balance and the individual inmate account balances. However, since unreconciled inmate trust account balances apparently have been cited annually since FY 1988, the FY 2003 audit recommendation "that reconciling items should be investigated and resolved by the facilities each month" is neither useful nor actionable. Instead, PSD management will explore the possibility of contracting with a vendor who can assist the facilities with the reconciliation process to the point where each facility can start with a "clean slate" and move forward. Once this is accomplished, the PSD Inspection and Investigation Office will perform periodic internal audits to ensure that each facility complies with the requirement for a complete monthly reconciliation of its inmate trust account balances. Each of the facility wardens shall be responsible for enforcing the reconciliation requirement.
- We agree that inactive inmate accounts have inappropriately remained on PSD's financial records. In an effort to review and dispose of these accounts, the ITA working group of facility staff representatives has segregated the inactive from the active accounts. The inactive inmate accounts for all facilities are maintained in a separate bank account under the purview of the Oahu Community Correctional Center (OCCC), so as not to impede the reconciliation of current inmate accounts. PSD management will explore the possibility of contracting with a vendor who is able to complete a review of each inactive inmate account to the point where OCCC can properly escheat these funds to the State.
- Segregation of duties has been achieved with respect to the cash account maintained at OCCC for the inactive inmate accounts.

**03-2 Strengthen Controls Over Compensated Leaves of Absence**

- PSD agrees with the need to strengthen controls over the decentralized processing and maintenance of leave accrual records. The Personnel Office will continue to conduct periodic audits of leave records maintained by program units in order to promote accurate and timely recordation of leaves. That office will also conduct scheduled training sessions on leave records maintenance procedures for all PSD programs beginning in April 2004.
- Unfortunately, the automated time and attendance system, Kronos, has been suspended indefinitely since October 2003 by the Department of Accounting and General Services (DAGS) due to unresolved problems with the vendor. Reactivation of Kronos, or implementation of a similar system by DAGS, would facilitate timely and accurate maintenance of leave records at OCCC which is the State's designated pilot project site.
- The PSD Fiscal Office and Personnel Office continue to pursue recovery of salary overpayments to the extent allowed by statutory and administrative provisions. Many of the salary overpayment cases stem from predecessor departments that were incorporated under the Department of Public Safety upon its July 1, 1990 establishment. Steps are being taken to write off longstanding cases which the Department of Attorney General deems uncollectible.

**03-3 Maintain Current and Accurate Financial Records for Correctional Industries**

- Correctional Industries (CI) agrees with the audit findings and recommendations, and has taken steps to comply. CI now reconciles its internal software program (Peachtree retail accounting) ledgers monthly with the State's Financial Accounting and Management Information System (FAMIS) reports.
- By June 30, 2004, CI plans to complete reconciliation of its internal ledgers with the State's Annual Inventory Report of Property.

**03-4 Adhere to Established Policies and Procedures for Inmate Stores**

- PSD agrees with the audit finding that currently and retroactively earned net profits are not being transferred in a timely manner from the Inmate Store Revolving Fund to the Administrator/Inmate Activity Trust Fund. Henceforth, Halawa Correctional Facility (HCF), OCCC, and Waiawa Correctional Facility (WCF) shall be responsible for depositing net profits from store activities into the Administrator/Inmate Activity Trust Fund within 60 days of the close of the prior fiscal year. Sixty days should be sufficient time for each facility to calculate net profits for the year just ended and deposit that sum at the opening of the subsequent fiscal year.

**03-5 Properly Account for Capital Asset Transactions**

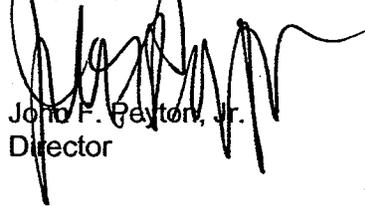
- PSD agrees with the audit finding and recommendation that all capital asset transactions, including those funded by other State agencies, should be reported to the State in a timely manner. The Fiscal Office has established a procedure whereby the Capital Improvements

Mr. Ronald T. Shiigi  
Nishihama & Kishida, CPA's, Inc.  
March 29, 2004  
Page 3

Program (CIP) Coordinator will submit documentation of completed CIP projects to the respective program for inventory recordation, and an information copy of such documentation to the PSD Fiscal Office for use in monitoring required additions to, or deletions from, inventory.

Should you have any questions on this matter, please call Claire Nakamura, Deputy Director for Administration, at 587-1251. Thank you for the opportunity to comment.

Very truly yours,

A handwritten signature in black ink, appearing to read "John F. Rayton, Jr.", written over the typed name and title.

John F. Rayton, Jr.  
Director

c: Deputy Director/Administration Claire Nakamura  
Deputy Director/Corrections Frank Lopez  
Deputy Director/Law Enforcement James Propotnick  
Special Assistant Tommy Herring