

Department of Public Safety, State of Hawaii

Financial Statements

Fiscal Year Ended June 30, 2005



February 15, 2006

Mr. Frank J. Lopez
Interim Director
Department of Public Safety
State of Hawaii

Dear Mr. Lopez:

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, 2005. 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, Government Auditing Standards, *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, 2005, and to comply with the requirements of OMB Circular A-133. 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, 2005.

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, 2005, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and compliance.
- 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,



Wilcox Choy
Partner

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PART I
FINANCIAL SECTION



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, 2005, which collectively comprise the PSD's basic financial statements as listed in the preceding table of contents. These financial statements are the responsibility of the PSD's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, 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, 2005, 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, 2005, and the respective changes in financial position and cash flows, where applicable, and the respective budgetary comparison for the general fund thereof 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 February 15, 2006, 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. The purpose of that report is to describe 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 on pages 8 through 17 is not a required part of the basic financial statements but is supplementary information required by GAAP. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming 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.

KMH LLP

KMH LLP

Honolulu, Hawaii
February 15, 2006

**Department of Public Safety
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (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, 2005 (FY 2005). 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, 2005 by approximately \$87.3 million. Net assets invested in capital assets accounted for nearly this entire amount.
- During the FY 2005, the PSD incurred approximately \$213.5 million in expenses of which approximately \$199.1 million was funded by general fund revenues.
- The PSD expended approximately \$178 million in governmental funds 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 comprise three parts: (1) government-wide financial statements, (2) fund financial statements, and 3) notes to the 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 the approach used by private-sector companies. The financial statements provide 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.

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

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

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 cover 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, reconciliation between the two is provided following the governmental fund financial statements.

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FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

Proprietary funds – Proprietary funds are used to account for the same functions reported as business-type activities in the government-wide financial statements; however, 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 is 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 and jail inmates, monies for law enforcement-related equipment purchases for the State 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.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

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, 2004 and June 30, 2005.

CONDENSED STATEMENT OF NET ASSETS

| | <u>Governmental Activities</u> | | <u>Business-Type Activities</u> | | <u>TOTAL</u> | |
|---|--------------------------------|-------------------------------------|---------------------------------|--------------------|---------------------|-------------------------------------|
| | <u>2005</u> | <u>2004</u> <u>(As Restated)</u> | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> <u>(As Restated)</u> |
| Current and Other Assets | \$23,446,891 | \$22,316,058 | \$1,108,190 | \$856,733 | \$24,555,081 | \$23,172,791 |
| Capital Assets | 89,920,315 | 95,677,285 | 1,832,385 | 2,011,512 | 91,752,700 | 97,688,797 |
| Total Assets | \$113,367,206 | \$117,993,343 | \$2,940,575 | \$2,868,245 | \$116,307,781 | \$120,861,588 |
| Current Liabilities | \$19,794,794 | \$21,486,154 | \$557,217 | \$555,526 | \$20,352,011 | \$22,041,680 |
| Other Liabilities | 8,587,080 | 9,696,341 | 107,899 | 152,556 | 8,694,979 | 9,848,897 |
| Total Liabilities | \$28,381,874 | \$31,182,495 | \$665,116 | \$708,082 | \$29,046,990 | \$31,890,577 |
| Net Assets: | | | | | | |
| Invested in Capital Assets, Net of Related Debt | \$89,920,315 | \$95,677,285 | \$1,814,854 | \$1,980,895 | \$91,735,169 | \$97,658,180 |
| Unrestricted (Deficit) | (4,934,983) | (8,866,437) | 460,605 | 179,268 | (4,474,378) | (8,687,169) |
| TOTAL NET ASSETS | \$84,985,332 | \$86,810,848 | \$2,275,459 | \$2,160,163 | \$87,260,791 | \$88,971,011 |

The PSD's combined total net assets decreased by 1.9% from \$89.0 million as of June 30, 2004 to \$87.3 million as of June 30, 2005. Governmental net assets accounted for 97% of total net assets that consisted primarily of buildings and building improvements at the correctional facilities.

The deficit in unrestricted net assets for governmental activities was approximately \$4.9 million and \$8.9 million as of June 30, 2005 and June 30, 2004, respectively. This deficit in unrestricted net assets results primarily from program liabilities incurred as of June 30, 2005 for which State-allotted appropriations were not yet available. The largest liability stems from accrued wages payable totaling \$7.6 million and \$9.4 million as of June 30, 2005 and June 30, 2004, respectively, as a result of the State's statutory payroll lag and after-the-fact payroll.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
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CONDENSED CHANGES IN NET ASSETS

| | <u>Governmental Activities</u> | | <u>Business-Type Activities</u> | | <u>TOTAL</u> | |
|---|--------------------------------|-------------------------------|---------------------------------|--------------------|----------------------|-------------------------------|
| | <u>2005</u> | <u>2004 (As Restated)</u> | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004 (As Restated)</u> |
| REVENUES: | | | | | | |
| Program Revenues | \$9,154,416 | \$7,660,527 | \$4,929,550 ¹ | \$3,640,335 | \$14,083,966 | \$11,300,862 |
| General Revenues | 199,129,293 | 186,426,419 | - | - | 199,129,293 | 186,426,419 |
| Total Revenues | \$208,283,709 | \$194,086,946 | \$4,929,550¹ | \$3,640,335 | \$213,213,259 | \$197,727,281 |
| EXPENSES: | | | | | | |
| Confinement | \$178,019,384 | \$162,380,749 | \$ - | \$ - | \$178,019,384 | \$162,380,749 |
| Law Enforcement | 17,718,973 | 17,291,097 | - | - | 17,718,973 | 17,291,097 |
| Parole | 3,242,989 | 2,691,989 | - | - | 3,242,989 | 2,691,989 |
| Crime Victim Comp | 1,317,625 | 1,274,812 | - | - | 1,317,625 | 1,274,812 |
| General Support | 8,384,791 | 12,136,196 | - | - | 8,384,791 | 12,136,196 |
| Correctional Industries | - | - | 4,814,254 ¹ | 3,600,546 | 4,814,254 | 3,600,546 |
| Total Expenses | \$208,683,762 | \$195,774,843 | \$4,814,254¹ | \$3,600,546 | \$213,498,016 | \$199,375,389 |
| Excess (Deficiency) Before Transfers, Lapsed Appropriations, and Contributions | (\$400,053) | (\$1,687,897) | \$115,296 | \$39,789 | (\$284,757) | (\$1,648,108) |
| Transfer-Out | (3,509) | (332,750) | - | - | (3,509) | (332,750) |
| Lapsed Appropriations | (1,421,954) | (3,692,951) | - | - | (1,421,954) | (3,692,951) |
| Contributions | - | - | - | 5,000 | - | 5,000 |
| Change in Net Assets | (\$1,825,516) | (\$5,713,598) | \$115,296 | \$44,789 | (\$1,710,220) | (\$5,668,809) |

Total net assets decreased by approximately \$1.7 million during the FY 2005 as shown above.

Total revenues for PSD increased by \$15.5 million. The revenue increase is attributed primarily to:

- Funding augmentation to cover collective bargaining costs (\$6.6 million).
- Increasing inmate health care costs and corresponding Medicaid reimbursements (\$3 million).
- Increased appropriations for contracting mainland prison bed space (\$5.7 million).

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

Expenses for the fiscal years ended June 30, 2005 and June 30, 2004 totaled approximately \$213.5 million and \$199.1 million, respectively. The \$14 million increase primarily stems from increases in collective bargaining costs, inmate health care costs, and mainland prison expenses.

Governmental Activities

Governmental activities accounted for over 98% 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 \$31 million and \$29 million was expended for the housing and care of inmates in the Federal Detention Center and in out-of-State correctional facilities for the fiscal years ended June 30, 2005 and June 30, 2004, respectively.

Business-Type Activities

Total operating revenue for Correctional Industries (CI) increased by \$1.3 million in FY 2005. Sales and Services increased by \$1.3 million. Operating expenses increased by \$1.2 million in FY 2005. As shown in the Condensed Changes in Net Assets, CI's expenses increased by 34%, from \$3.6 million in FY 2004 to \$4.8 in FY 2005. At the same time, revenues increased by 36%, from \$3.6 in FY 2004 to \$4.9 in FY 2005. A net profit of \$115,296 was recorded for FY 2005.

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 principal funding source is the general fund, which accounted for approximately \$20 million or 86% of total governmental fund assets as of June 30, 2005; and \$19 million or 87% of total governmental fund assets for the fiscal year ended June 30, 2004. The general fund revenues consisted primarily of State-allotted appropriations.

Proprietary Fund

The Correctional Industries Revolving Fund is the PSD's only proprietary fund. As of June 30, 2005, the Correctional Industries reported over \$2.2 million in total net assets, of which approximately \$1.8 million was accounted for by investment in capital assets, net of related debt.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

The \$1.3 million increase in sales and services resulted in a \$1.2 million increase in operating expenses, yielding a profit of \$115,296 for FY 2005.

BUDGETARY ANALYSIS

As of May 2004, the Council on Revenues retained its previous forecast of moderate general fund tax revenue growth for FY 2004 and thereafter. However, the State general fund's annual budget had not been in balance since FY 2002. That is, general fund expenditures were greater than general fund revenues, resulting in annual deficits that continued to erode the State's once-prudent balance in the general fund.

Therefore, the FY 2005 budget execution policies were formulated under the following overall themes:

- Actions to reduce overall spending in FY 2005 were deemed a necessary first step in addressing the structural imbalance in the budget. State agencies were cautioned to expect further spending reductions for the upcoming fiscal biennium 2005-2007 as the State developed a plan to bring recurring expenses to a level that could be supported by recurring revenues.
- Utmost care and prudence must be taken in all expenditure and hiring decisions as every expenditure must compete for its priority in the State spending plan relative to all other funding requirements of the State.

Accordingly, the following measures were imposed in FY 2005:

- A 1% across-the-board efficiency savings restriction on the full-year FY 2005 departmental allocation.
- Targeted restrictions on specific items or categories.
- As in the past, allotment of only 90% of general fund collective bargaining appropriations.
- Unless specifically addressed, all other provisions of the FY 2004 Budget Execution Policies and Instructions continued to be in force.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

GENERAL FUND BUDGETARY COMPARISON

| <u>Program</u> | <u>Original Enc. & Exp.</u> | <u>Final Enc. & Exp.</u> | <u>Actual on Budgetary Basis Enc. & Exp.</u> | <u>Variance Favorable (Unfavorable)</u> |
|--------------------|-------------------------------------|----------------------------------|--|---|
| Confinement | \$137,977,420 | \$144,380,878 | \$144,275,102 | \$105,776 |
| Law Enforcement | 14,911,838 | 15,663,578 | 13,912,691 | 1,750,887 |
| Parole | 3,311,755 | 3,207,556 | 2,866,356 | 341,200 |
| General Support | <u>10,296,204</u> | <u>10,296,204</u> | <u>9,200,306</u> | <u>1,095,898</u> |
| TOTAL EXPENDITURES | <u>\$166,497,217</u> | <u>\$173,548,216</u> | <u>\$170,254,455</u> | <u>\$3,293,761</u> |

GENERAL FUND BUDGETARY COMPARISON

The final total budget of \$173.5 million 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 PSD is limited to spending up to the expenditure ceiling or the cash balance, whichever amount is lower. For the FY 2005, the \$3 million variance between the final budget and actual expenditures on a budgetary basis is attributed to a combination of the following factors:

- The overall cash balance was less than the expenditure ceiling.
- The PSD experienced personnel recruitment and retention difficulties in certain areas.
- Certain programs were able to reduce overtime payroll expenditures.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

CAPITAL ASSETS, NET OF DEPRECIATION

| | <u>Governmental Activities</u> | | <u>Business-Type Activities</u> | | <u>TOTAL</u> | |
|---|--------------------------------|-------------------------------------|---------------------------------|--------------------|---------------------|-------------------------------------|
| | <u>2005</u> | <u>2004</u> <u>(As Restated)</u> | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> <u>(As Restated)</u> |
| Land | \$107,570 | \$107,570 | \$ - | \$ - | \$107,570 | \$107,570 |
| Buildings and Improvements | 86,987,756 | 92,752,481 | 1,740,825 | 1,805,300 | 88,728,581 | 94,557,781 |
| Furniture, Equipment, Vehicles, and Land Improvements | 2,824,989 | 2,817,234 | 91,560 | 206,212 | 2,916,549 | 3,023,446 |
| TOTAL | \$89,920,315 | \$95,677,285 | \$1,832,385 | \$2,011,512 | \$91,752,700 | \$97,688,797 |

CAPITAL ASSETS

As of June 30, 2005, the PSD had \$91.8 million invested in capital assets. Capital assets for governmental activities accounted for 98% of total capital assets. Building and building improvements at correctional facilities totaled approximately \$87 million, net of accumulated depreciation.

Capital assets increased by \$0.7 million or 0.7% net of depreciation, from June 30, 2004 to June 30, 2005.

ECONOMIC FACTORS

As discussed previously in the budgetary analysis section, at the beginning of FY 2005, the following measures were imposed:

- A 1% across-the-board efficiency savings restriction on the full-year FY 2005 departmental allocation.
- Targeted restrictions on specific items or categories.
- As in the past, allotment of only 90% of general fund collective bargaining appropriations.
- Unless specifically addressed, all other provisions of the FY 2004 Budget Execution Policies and Instructions remained in force.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2005 (UNAUDITED)**

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 funds it receives. Questions concerning any of the information provided in this report, or requests 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, 2005

| | <u>Governmental Activities</u> | <u>Business-Type Activities</u> | <u>Total</u> |
|---|------------------------------------|-------------------------------------|----------------------|
| <u>Assets</u> | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 21,397,926 | \$ 296,376 | \$ 21,694,302 |
| Receivables, net | 151,794 | 178,570 | 330,364 |
| Due from State of Hawaii | 2,044,044 | - | 2,044,044 |
| Internal balances | (185,187) | 185,187 | - |
| Due from other funds | 38,314 | - | 38,314 |
| Inventories | - | 448,057 | 448,057 |
| Total current assets | <u>23,446,891</u> | <u>1,108,190</u> | <u>24,555,081</u> |
| Capital Assets: | | | |
| Non-depreciable | 107,570 | - | 107,570 |
| Depreciable, net | 89,812,745 | 1,832,385 | 91,645,130 |
| Total capital assets | <u>89,920,315</u> | <u>1,832,385</u> | <u>91,752,700</u> |
| Total assets | <u>113,367,206</u> | <u>2,940,575</u> | <u>116,307,781</u> |
| <u>Liabilities</u> | | | |
| Current Liabilities: | | | |
| Accrued wages and employee benefits payable | 7,626,672 | 49,657 | 7,676,329 |
| Vouchers payable | 6,511,317 | 405,698 | 6,917,015 |
| Deferred revenues | 91,663 | 18,980 | 110,643 |
| Capital lease obligations | - | 14,277 | 14,277 |
| Accrued compensated absences | 5,499,153 | 67,013 | 5,566,166 |
| Due to other funds | 65,989 | 1,592 | 67,581 |
| Total current liabilities | <u>19,794,794</u> | <u>557,217</u> | <u>20,352,011</u> |
| Capital Lease Obligations | - | 3,254 | 3,254 |
| Accrued Compensated Absences | 8,587,080 | 104,645 | 8,691,725 |
| Total liabilities | <u>28,381,874</u> | <u>665,116</u> | <u>29,046,990</u> |
| <u>Net Assets</u> | | | |
| Invested in Capital Assets, net of related debt | 89,920,315 | 1,814,854 | 91,735,169 |
| Unrestricted (deficit) | (4,934,983) | 460,605 | (4,474,378) |
| Total net assets | <u>\$ 84,985,332</u> | <u>\$ 2,275,459</u> | <u>\$ 87,260,791</u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Statement of Activities

For the Fiscal Year Ended June 30, 2005

| Functions/Programs | Program Revenues | | | Net (Expense) Revenue and Changes in Net Assets | | |
|--|-----------------------|----------------------|------------------------------------|---|--------------------------|----------------------|
| | Expenses | Services | Operating Grants and Contributions | Governmental Activities | Business-Type Activities | Total |
| Governmental Activities: | | | | | | |
| Confinement | \$ 178,019,384 | \$ 297,345 | \$ 1,992,064 | \$ (175,729,975) | \$ - | \$ (175,729,975) |
| Law enforcement | 17,718,973 | 4,735,489 | 689,180 | (12,294,304) | - | (12,294,304) |
| Parole | 3,242,989 | - | - | (3,242,989) | - | (3,242,989) |
| Crime victim compensation | 1,317,625 | 939,354 | 500,984 | 122,713 | - | 122,713 |
| General support | 8,384,791 | - | - | (8,384,791) | - | (8,384,791) |
| Total governmental activities | <u>208,683,762</u> | <u>5,972,188</u> | <u>3,182,228</u> | <u>(199,529,346)</u> | <u>-</u> | <u>(199,529,346)</u> |
| Business-type Activities -- | | | | | | |
| Correctional industries | 4,814,254 | 4,929,550 | - | - | 115,296 | 115,296 |
| Total business-type activities | <u>4,814,254</u> | <u>4,929,550</u> | <u>-</u> | <u>-</u> | <u>115,296</u> | <u>115,296</u> |
| Total | <u>\$ 213,498,016</u> | <u>\$ 10,901,738</u> | <u>\$ 3,182,228</u> | <u>(199,529,346)</u> | <u>115,296</u> | <u>(199,414,050)</u> |
| General revenues: | | | | | | |
| State appropriations | | | | 166,862,311 | - | 166,862,311 |
| State-provided payroll fringe benefits | | | | 32,224,817 | - | 32,224,817 |
| Unrestricted investment earnings | | | | 5,242 | - | 5,242 |
| Miscellaneous | | | | 36,923 | - | 36,923 |
| Lapsed appropriations | | | | (1,421,954) | - | (1,421,954) |
| Transfers, net | | | | (3,509) | - | (3,509) |
| Total general revenues and transfers | | | | <u>197,703,830</u> | <u>-</u> | <u>197,703,830</u> |
| Changes in net assets | | | | (1,825,516) | 115,296 | (1,710,220) |
| Net assets at July 1, 2004, as restated (see Note 3) | | | | 86,810,848 | 2,160,163 | 88,971,011 |
| Net assets at June 30, 2005 | | | | <u>\$ 84,985,332</u> | <u>\$ 2,275,459</u> | <u>\$ 87,260,791</u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Governmental Funds

Balance Sheet

June 30, 2005

| | <u>General</u> | <u>Other Governmental Funds</u> | <u>Total</u> |
|---|----------------------|---|----------------------|
| <u>Assets</u> | | | |
| Cash and Cash Equivalents | \$ 18,080,967 | \$ 3,316,959 | \$ 21,397,926 |
| Receivables, net | 151,794 | - | 151,794 |
| Due from State of Hawaii | 2,044,044 | - | 2,044,044 |
| Due from Other Funds | 56,202 | 5,753 | 61,955 |
| Total assets | <u>\$ 20,333,007</u> | <u>\$ 3,322,712</u> | <u>\$ 23,655,719</u> |
| <u>Liabilities and Fund Balances</u> | | | |
| Accrued Wages and Employee Benefits Payable | \$ 7,585,008 | \$ 41,664 | \$ 7,626,672 |
| Vouchers Payable | 6,306,564 | 204,753 | 6,511,317 |
| Deferred Revenues | - | 91,663 | 91,663 |
| Due to Other Funds | 253,271 | 21,546 | 274,817 |
| Total liabilities | <u>14,144,843</u> | <u>359,626</u> | <u>14,504,469</u> |
| Fund Balances: | | | |
| Reserved for: | | | |
| Encumbrances | 9,430,783 | 1,829,120 | 11,259,903 |
| Receivables | 151,794 | - | 151,794 |
| Unreserved | <u>(3,394,413)</u> | <u>1,133,966</u> | <u>(2,260,447)</u> |
| Total fund balances | <u>6,188,164</u> | <u>2,963,086</u> | <u>9,151,250</u> |
| Total liabilities and fund balances | <u>\$ 20,333,007</u> | <u>\$ 3,322,712</u> | <u>\$ 23,655,719</u> |

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, 2005

| | | |
|--|---------------------|-----------------------------|
| Total Fund Balances, Governmental Funds | | \$ 9,151,250 |
| Amounts reported for governmental activities in the statement of net assets are different because: | | |
| Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of: | | |
| Governmental capital assets | \$ 185,655,768 | |
| Less accumulated depreciation | <u>(95,735,453)</u> | |
| | | 89,920,315 |
| Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds | | <u>(14,086,233)</u> |
| Net Assets of Governmental Activities | | <u><u>\$ 84,985,332</u></u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances

For the Fiscal Year Ended June 30, 2005

| | General | Other Governmental Funds | Total |
|--|---------------------|--------------------------------|---------------------|
| Revenues: | | | |
| State allotted appropriations | \$ 166,862,311 | \$ - | \$ 166,862,311 |
| State-provided payroll fringe benefits | 32,224,817 | - | 32,224,817 |
| Operating grants and contributions | - | 3,182,228 | 3,182,228 |
| Charges for services | 4,331,059 | 1,641,129 | 5,972,188 |
| Unrestricted investment earnings | 5,242 | - | 5,242 |
| Miscellaneous | 36,923 | - | 36,923 |
| Total revenues | <u>203,460,352</u> | <u>4,823,357</u> | <u>208,283,709</u> |
| Expenditures: | | | |
| Confinement | 170,983,414 | 2,407,412 | 173,390,826 |
| Law enforcement | 17,179,249 | 836,042 | 18,015,291 |
| Parole | 3,188,465 | - | 3,188,465 |
| Crime victim compensation | - | 1,325,668 | 1,325,668 |
| General support | 8,324,254 | - | 8,324,254 |
| Total expenditures | <u>199,675,382</u> | <u>4,569,122</u> | <u>204,244,504</u> |
| Excess of revenues over expenditures | <u>3,784,970</u> | <u>254,235</u> | <u>4,039,205</u> |
| Other Financing Sources (Uses): | | | |
| Transfers in | - | 571 | 571 |
| Transfers out | (4,080) | - | (4,080) |
| Total other financing sources (uses) | <u>(4,080)</u> | <u>571</u> | <u>(3,509)</u> |
| Excess of revenues over expenditures and other uses | 3,780,890 | 254,806 | 4,035,696 |
| Other Changes in Fund Balances: | | | |
| Lapsed appropriations | (1,421,954) | - | (1,421,954) |
| Net change in fund balances | 2,358,936 | 254,806 | 2,613,742 |
| Fund Balance, July 1, 2004 | <u>3,829,228</u> | <u>2,708,280</u> | <u>6,537,508</u> |
| Fund Balance, June 30, 2005 | <u>\$ 6,188,164</u> | <u>\$ 2,963,086</u> | <u>\$ 9,151,250</u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2005

| | | |
|--|--------------------|------------------------------|
| Net Change in Fund Balances, total governmental funds | | \$ 2,613,742 |
| Amounts reported for governmental activities in the statement of activities are different because: | | |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is depreciated over their estimated useful lives. | | |
| Expenditures for capital assets | \$ 602,309 | |
| Net transfer of capital assets | 8,500 | |
| Less current fiscal year depreciation | <u>(6,353,887)</u> | |
| | | (5,743,078) |
| 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. | | (13,892) |
| 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. | | <u>1,317,712</u> |
| Change in Net Assets of Governmental Activities | | <u><u>\$ (1,825,516)</u></u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

General Fund

Statement of Revenues and Expenditures - Budget and Actual

For the Fiscal Year Ended June 30, 2005

| | <u>Original</u> | <u>Final</u> | <u>Actual on Budgetary Basis</u> | <u>Variance Over (Under)</u> |
|---|--------------------|--------------------|--|----------------------------------|
| Revenues: | | | | |
| State allotments | \$ 160,114,506 | \$ 166,862,311 | \$ 166,862,311 | \$ - |
| Charges for services | 6,307,646 | 6,610,840 | 4,331,059 | (2,279,781) |
| Miscellaneous | 75,065 | 75,065 | 37,088 | (37,977) |
| | <u>166,497,217</u> | <u>173,548,216</u> | <u>171,230,458</u> | <u>(2,317,758)</u> |
| Expenditures: | | | | |
| Confinement | 137,977,420 | 144,380,878 | 144,275,102 | 105,776 |
| Law enforcement | 14,911,838 | 15,663,578 | 13,912,691 | 1,750,887 |
| Parole | 3,311,755 | 3,207,556 | 2,866,356 | 341,200 |
| General support | 10,296,204 | 10,296,204 | 9,200,306 | 1,095,898 |
| | <u>166,497,217</u> | <u>173,548,216</u> | <u>170,254,455</u> | <u>3,293,761</u> |
| Excess of revenues over expenditures | - | - | 976,003 | 976,003 |
| Other Financing Uses: | | | | |
| Transfers out | - | - | 4,080 | 4,080 |
| Excess of revenues over expenditures and other uses | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 971,923</u> | <u>\$ 971,923</u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund
Statement of Net Assets
June 30, 2005

| <u>Assets</u> | |
|---|--------------|
| Current Assets: | |
| Cash | \$ 296,376 |
| Receivables, net of allowance for doubtful accounts | 178,570 |
| Internal balances | 185,187 |
| Inventories | 448,057 |
| Total current assets | 1,108,190 |
| Capital Assets, net of depreciation | 1,832,385 |
| Total assets | 2,940,575 |
| <u>Liabilities</u> | |
| Current Liabilities: | |
| Accrued wages and employee benefits | 49,657 |
| Vouchers payable | 405,698 |
| Deferred revenues | 18,980 |
| Capital lease obligations | 14,277 |
| Accrued compensated absences | 67,013 |
| Due to other funds | 1,592 |
| Total current liabilities | 557,217 |
| Noncurrent Liabilities: | |
| Capital lease obligations | 3,254 |
| Accrued compensated absences | 104,645 |
| Total liabilities | 665,116 |
| <u>Net assets</u> | |
| Invested in Capital Assets, net of related debt | 1,814,854 |
| Unrestricted | 460,605 |
| Total net assets | \$ 2,275,459 |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund

Statement of Revenues, Expenses, and Changes in Fund Net Assets

For the Fiscal Year Ended June 30, 2005

| | |
|---|----------------------------|
| Operating Revenues: | |
| Charges for sales and services | \$ 4,929,550 |
| Less provision for uncollectible accounts | <u>(25,749)</u> |
| Total operating revenues | <u>4,903,801</u> |
| Operating Expenses: | |
| Cost of sales and services | 4,580,996 |
| Depreciation and amortization | <u>204,953</u> |
| Total operating expenses | <u>4,785,949</u> |
| Operating income | 117,852 |
| Non-Operating Expenses: | |
| Interest expense | <u>(2,556)</u> |
| Change in net assets | 115,296 |
| Net Assets, July 1, 2004 | <u>2,160,163</u> |
| Net Assets, June 30, 2005 | <u><u>\$ 2,275,459</u></u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund

Statement of Cash Flows

For the Fiscal Year Ended June 30, 2005

Cash Flows from Operating Activities:

| | |
|---|--------------|
| Receipts from customers | \$ 4,587,145 |
| Receipts from interfund services provided | 268,240 |
| Payments to suppliers | (3,871,929) |
| Payments to employees | (760,101) |
| | <hr/> |
| Net cash provided by operating activities | 223,355 |

Cash Flows from Capital and Related Financing Activities

| | |
|---|----------|
| Principal payments on capital lease obligations | (38,912) |
| Interest paid on capital lease obligations | (2,556) |
| | <hr/> |
| Net cash used by capital and related financing activities | (41,468) |

Net decrease in cash 181,887

Cash at July 1, 2004

 114,489

Cash at June 30, 2005

 \$ 296,376

Reconciliation of operating income to net cash flows provided by operating activities

| | |
|---|------------|
| Operating income | \$ 117,852 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Depreciation expense | 204,953 |
| Provision for uncollectible accounts | 25,749 |
| Change in assets and liabilities: | |
| Receivables | 46,952 |
| Inventories | (144,573) |
| Vouchers payable | (57,115) |
| Accrued wages and compensated absences | 152,865 |
| Deferred revenues | (121,117) |
| Due to other funds | (2,211) |
| | <hr/> |
| Net cash provided by operating activities | \$ 223,355 |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Agency Fund
Statement of Assets and Liabilities
June 30, 2005

| | <u>Assets</u> | <u>Agency Fund</u> |
|--------------------|--------------------|----------------------------|
| Cash | | \$ 1,829,117 |
| Due from Others | | <u>67,581</u> |
| Total assets | | <u><u>\$ 1,896,698</u></u> |
| | <u>Liabilities</u> | |
| Due to Other Funds | | \$ 38,314 |
| Due to Individuals | | 1,161,862 |
| Due to Others | | <u>696,522</u> |
| Total liabilities | | <u><u>\$ 1,896,698</u></u> |

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

1. Financial Reporting Entity

Effective July 1, 1990, Act 211, Session Laws of Hawaii (SLH) 1989, established 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 Sheriffs' 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:

a. 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.

b. Law Enforcement

Law Enforcement assists in guarding state property and facility, 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.

c. Corrections

Administers, through subordinate staff offices and line divisions programs, services and facilities for the detention, custody, care and redirection of persons committed to the control of the department pursuant to law.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

1. Financial Reporting Entity (continued)

c. Corrections (continued)

i. Institutions Division

This division operates the state correctional facilities (prisons), and the state community correctional centers (jails). 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.

ii. 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.

iii. 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.

iv. 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.

v. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

1. Financial Reporting Entity (continued)

c. Corrections (continued)

vi. 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.

d. 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.

e. 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.

2. Significant Accounting Policies

a. Basis of Presentation

The government-wide financial statements report all assets, liabilities, and activities of the PSD as a whole. The fiduciary fund is 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, net assets, revenues, and expenditures.

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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

2. Significant Accounting Policies (continued)

b. 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 for.

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

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.

c. 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.

d. 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.

e. 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 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

2. Significant Accounting Policies (continued)

f. Governmental Funds Financial Statements

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. Expenditures are generally recorded when the related fund liabilities are incurred.

g. 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.

The agency fund is purely custodial (assets equal liabilities) and thus does not involve the measurement of results of operations.

h. 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.

i. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

2. Significant Accounting Policies (continued)

j. 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.

k. 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 Division.

l. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

2. Significant Accounting Policies (continued)

l. Capital Assets (continued)

The State has adopted the following capitalization policy and depreciation on all assets is provided for on a straight-line basis over the following estimated useful lives:

| <u>Asset Type</u> | <u>Minimum Capitalization Amount</u> | <u>Estimated Useful Life</u> | |
|----------------------------|--|------------------------------|--------------------|
| | | <u>Governmental</u> | <u>Proprietary</u> |
| 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 |

m. Due to Individuals

Due to individuals represents assets held by the PSD primarily in an agency capacity for the inmate population.

n. Accumulated Vacation

Employees are credited with vacation at the rate of up to 168 hours per calendar year, based on seniority. 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.

o. 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.

p. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

2. Significant Accounting Policies (continued)

q. Program Revenues

Program revenues are derived 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.

r. 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.

s. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

3. Restated Beginning Net Assets

During the current year, the PSD recognized certain assets that were not recorded in the prior year. The recording of these assets resulted in the following adjustments to net assets for the governmental activities at June 30, 2004:

| | |
|---|-----------------------------|
| Net assets as of June 30, 2004, as previously reported | \$ 82,456,696 |
| Addition of buildings and improvements, net of accumulated depreciation | <u>4,354,152</u> |
| Net assets as of June 30, 2004, as restated | <u><u>\$ 86,810,848</u></u> |

4. 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. 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, 2005:

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

4. Budgeting and Budgetary Control (continued)

| | |
|---|---------------------|
| Excess of revenues over expenditures and other uses - actual on budgetary basis | \$ 971,923 |
| Reserved for encumbrances at fiscal year-end | 9,430,783 |
| Reserved for receivables | 151,794 |
| Net change in unreserved liabilities | 37,337 |
| Expenditures for liquidation of prior fiscal year encumbrances | (6,816,025) |
| Net adjustment for commissary revenue accrual | 5,078 |
| Excess of revenues over expenditures and other uses - GAAP basis | <u>\$ 3,780,890</u> |

5. 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. 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, 2005, the carrying amount of total bank deposits including time certificates of deposit was approximately \$1,087,000 and the corresponding bank balances were approximately \$1,220,000. PSD and State deposits were exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the PSD's or the State's deposits may not be returned to it. For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk. The use of daily available bank balances to determine collateral requirements results in the available balances being under collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60 percent of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

6. Receivables

Receivables of the PSD, net of an allowance for doubtful accounts, consisted of the following at June 30, 2005:

| | General Fund | Enterprise Fund |
|---------------------------------------|-------------------|--------------------|
| Salary overpayments | \$ 261,794 | \$ - |
| Accounts receivable | - | 277,169 |
| Less: allowance for doubtful accounts | (110,000) | (98,599) |
| Receivables, net | <u>\$ 151,794</u> | <u>\$ 178,570</u> |

7. Capital Assets

| | Balance June 30, 2004 (As restated) | Additions | Deductions | Transfers | Balance June 30, 2005 |
|---|---|-----------------------|------------------|-----------------|--------------------------|
| Governmental activities: | | | | | |
| Nondepreciable assets -- | | | | | |
| Land | \$ 107,570 | \$ - | \$ - | \$ - | \$ 107,570 |
| Depreciable assets: | | | | | |
| Building and improvements | 176,087,416 | - | - | - | 176,087,416 |
| Furniture and equipment | 4,648,238 | 337,498 | 51,652 | - | 4,934,084 |
| Vehicles | 3,730,514 | 264,811 | 135,674 | 148,486 | 4,008,137 |
| Land improvements | 1,778,561 | - | - | - | 1,778,561 |
| Total capital assets | <u>186,352,299</u> | <u>602,309</u> | <u>187,326</u> | <u>148,486</u> | <u>186,915,768</u> |
| Less accumulated depreciation: | | | | | |
| Building and improvements | 83,334,935 | 5,764,725 | - | - | 89,099,660 |
| Furniture and equipment | 3,654,775 | 325,794 | 46,422 | - | 3,934,147 |
| Vehicles | 3,388,877 | 204,083 | 127,012 | 139,986 | 3,605,934 |
| Land improvements | 296,427 | 59,285 | - | - | 355,712 |
| Total accumulated depreciation | <u>90,675,014</u> | <u>6,353,887</u> | <u>173,434</u> | <u>139,986</u> | <u>96,995,453</u> |
| Governmental activities - capital assets, net | <u>\$ 95,677,285</u> | <u>\$ (5,751,578)</u> | <u>\$ 13,892</u> | <u>\$ 8,500</u> | <u>\$ 89,920,315</u> |

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

7. Capital Assets (continued)

| | Balance June 30, 2004 | Additions | Deductions | Balance June 30, 2005 |
|---|--------------------------|---------------------|-------------|--------------------------|
| Business-type activities: | | | | |
| Building and improvements | \$ 2,579,000 | \$ - | \$ - | \$ 2,579,000 |
| Equipment | 730,100 | - | - | 730,100 |
| Equipment under capital lease | 649,758 | 25,826 | - | 675,584 |
| Total capital assets | <u>3,958,858</u> | <u>25,826</u> | <u>-</u> | <u>3,984,684</u> |
| Less accumulated depreciation: | | | | |
| Building and improvements | 773,700 | 64,475 | - | 838,175 |
| Equipment | 652,882 | 92,989 | - | 745,871 |
| Equipment under capital lease | 520,764 | 47,489 | - | 568,253 |
| Total accumulated depreciation | <u>1,947,346</u> | <u>204,953</u> | <u>-</u> | <u>2,152,299</u> |
| Business-type activities - capital assets, net | <u>\$ 2,011,512</u> | <u>\$ (179,127)</u> | <u>\$ -</u> | <u>\$ 1,832,385</u> |

Depreciation expense was charged to functions as follows:

| | |
|--|---------------------|
| Governmental activities: | |
| Confinement | \$ 5,967,629 |
| Law enforcement | 99,640 |
| Crime victim compensation | 2,313 |
| General support | 284,305 |
| Total governmental activities depreciation | <u>\$ 6,353,887</u> |
| Business-type activities -- | |
| Correctional industries | <u>\$ 204,953</u> |

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

8. 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, 2005, was as follows:

| | |
|--------------------------|----------------------|
| Balance at July 1, 2004 | \$ 15,403,945 |
| Additions | 8,949,993 |
| Reductions | <u>(10,267,705)</u> |
| Balance at June 30, 2005 | <u>\$ 14,086,233</u> |

The amount of governmental activities compensated absences liability due within one year is \$5,499,153. 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, 2005, was as follows:

| | <u>Balance June 30, 2004</u> | <u>Additions</u> | <u>Reductions</u> | <u>Balance June 30, 2005</u> | <u>Amount Due Within One Year</u> |
|--|----------------------------------|------------------|-------------------|----------------------------------|---|
| Capital lease obligations | \$ 30,617 | \$ 25,826 | \$ 38,912 | \$ 17,531 | \$ 14,277 |
| Accrued compensated absences | <u>225,968</u> | <u>71,728</u> | <u>126,038</u> | <u>171,658</u> | <u>67,013</u> |
| Total business-type activities long-term liabilities | <u>\$ 256,585</u> | <u>\$ 97,554</u> | <u>\$ 164,950</u> | <u>\$ 189,189</u> | <u>\$ 81,290</u> |

9. 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 \$32,224,817 for the fiscal year ended June 30, 2005, have been reported as revenues and expenditures in the general fund of the PSD.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

9. Non-Imposed Employee Fringe Benefits (continued)

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.

10. Fund Balance Deficits

The general fund had a deficit in the unreserved fund balance at June 30, 2005 of \$3,394,413. 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.

11. Lease Commitments

a. 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. The leased equipment is 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 \$47,500 for the fiscal year ended June 30, 2005.

Interest expense of approximately \$2,500 is included as a direct function expense of the Correctional Industries Program on the statement of activities for the fiscal year ended June 30, 2005.

At June 30, 2005, the future minimum lease payments together with the present value of net minimum lease payments were as follows:

| | Fiscal Year <u>Ending June 30,</u> | |
|---|---------------------------------------|------------------|
| | 2006 | \$ 14,277 |
| | 2007 | <u>3,254</u> |
| Total minimum lease payments | | 17,531 |
| Less amounts representing interest at 5.50% - 7.58% | | <u>684</u> |
| Present value of minimum lease payments | | <u>\$ 16,847</u> |

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

11. Lease Commitments (continued)

b. 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, 2005, were as follows:

| Fiscal Year <u>Ending June 30,</u> | |
|---------------------------------------|-------------------|
| 2006 | \$ 441,000 |
| 2007 | 192,000 |
| 2008 | 76,000 |
| 2009 | 48,000 |
| 2010 | 7,000 |
| Thereafter | <u>1,000</u> |
| | <u>\$ 765,000</u> |

Total rent expense for the fiscal year ended June 30, 2005, was approximately \$510,000.

12. Retirement Benefits

a. Employees' Retirement System

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 is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. 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. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

12. Retirement Benefits (continued)

b. Post-Retirement Health Care and Life Insurance Benefits

contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Both options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 27 years from June 30, 2002.

Contributions by the PSD for the fiscal years ended June 30, 2005, 2004 and 2003 were approximately \$513,000, \$444,000 and \$445,000, respectively. The contribution rate for the fiscal year ended June 30, 2005 was 10.82%. The contribution rate was 9.14% for the fiscal year ended June 30, 2004, and 8.87% for the fiscal year ended June 30, 2003.

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 year ended June 30, 2005, was approximately \$313,000.

c. 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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

12. Retirement Benefits (continued)

c. Deferred Compensation Plan

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.

13. 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; natural disasters; and workers' compensation. The State generally retains the first \$250,000 per occurrence of property losses and the first \$4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$100 million for named hurricane, \$25 million for earthquake, and flood, \$50 million for terrorism, and the annual aggregate for general liability losses per occurrence is \$10 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$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
For the Fiscal Year Ended June 30, 2005

14. 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, 2005, amounted to approximately \$20,581,000.

15. New Pronouncements for Financial Reporting

The Governmental Accounting Standards Board (GASB) has issued the following Statements applicable to the Department:

- Statement No. 42 “Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,” establishes accounting and financial reporting standards for the impairment of capital assets and clarifies and establishes accounting requirements for insurance recoveries. This Statement is effective for financial statements for periods beginning after December 15, 2004 and is not expected to have a material effect on the Department’s financial statements.
- Statement No. 45 “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions” establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities/assets, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. This Statement is effective for financial statements for periods beginning after December 15, 2007. The Department has not yet analyzed the potential effect on the financial statements, if any, of adopting Statement No. 45.
- Statement No. 46 “Net Assets Restricted by Enabling Legislation – An Amendment of GASB Statement No. 34” clarifies the definition of the legally enforceability of an enabling legislation restriction, specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated, and requires governments to disclose the portion of total net assets that is restricted by enabling legislation. This Statement is effective for financial statements for periods beginning after June 15, 2005 and is not expected to have a material effect on the Department’s financial statements.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2005

15. New Pronouncements for Financial Reporting (continued)

- Statement No. 47 “Accounting for Termination Benefits” establishes standards for the measurement, recognition, and display of termination expense/expenditures and related liabilities/assets, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. This Statement is effective for financial statements periods beginning after June 15, 2005 and is not expected to have a material effect on the Department’s financial statements.

SUPPLEMENTARY INFORMATION

Department of Public Safety, State of Hawaii

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2005

| Federal Grantor/Pass-through Grantor and Program Title | Federal CFDA Number | Pass-through Entity Identifying Number | Federal Expenditures ¹ |
|--|---------------------------|--|---|
| U.S Department of Justice | | | |
| Serious Violent Offender Re-entry Initiative | 16.202 | -- | <u>\$ 434,899</u> |
| Pass-through State Department of the Attorney General: | | | |
| Crime Victim Compensation | 16.576 | 02-VX-GX-0015 03-VX-GX-0045 | 258,714 239,394 <u>498,108</u> |
| Byrne Formula Grant Program | 16.579 | 02-DB-06 02-DB-12 02-DB-15 02-DB-27 03-DB-14 03-DB-08 | 15,076 31,374 58,719 5,574 13,950 33,680 <u>158,373</u> |
| Electronic Prescription Monitoring Program | 16.580 | 04-PM-VX-0017 | <u>126,051</u> |
| Residential Substance Abuse Treatment for State Prisoners (RSAT) | 16.593 | 00-RT-1 01-RT-1 02-RT-1 | 31,307 318,497 2,295 <u>352,099</u> |
| Total U.S. Department of Justice | | | <u>\$ 1,569,530</u> |
| U.S. Department of Defense | | | |
| Pass-through Hawaii Army National Guard: | | | |
| Master Cooperative Agreement | N/A | DAHA50-04-H1003 DAHA50-05-H1003 | \$ 67,973 <u>35,933</u> |
| Total U.S. Department of Defense | | | <u>\$ 103,906</u> |

Department of Public Safety, State of Hawaii

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2005

| Federal Grantor/Pass-through Grantor and Program Title | Federal CFDA Number | Pass-through Entity Identifying Number | Federal Expenditures ¹ |
|--|---------------------------|---|---|
| U.S. Department of Education | | | |
| Grants to States for Incarcerated Youth Offenders | 84.331 | V331A030008 Q331A040012 | \$ 29,547 60,364 <u>89,911</u> |
| Pass-through State Department of Education: | | | |
| Title I Program for Neglected and Delinquent Children | 84.013 | S013A020011 S013A030011 | 12,466 83,577 <u>96,043</u> |
| Pass-through University of Hawaii: | | | |
| Vocational Education - Basic Grants to States | 84.048 | V048A40011 | <u>58,259</u> |
| Total U.S. Department of Education | | | <u>\$ 244,213</u> |
| Department of Homeland Security | | | |
| Pass-through Department of Defense - State of Hawaii | | | |
| Homeland Security Grant | 97.067 | 03-TE-TX-0192 03-MU-T3-0043 | \$ 124,197 58,563 <u>\$ 182,760</u> |
| Total Department of Homeland Security | | | <u>\$ 182,760</u> |
| Total Federal Expenditures | | | <u><u>\$ 2,100,409</u></u> |

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

PART II

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



**Report on Internal Control Over Financial Reporting and on Compliance and Other Matters
Based on an Audit of 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, 2005, and have issued our report thereon dated February 15, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the PSD's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion 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 05-1 through 05-4.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in 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, of the reportable conditions described above, we consider items 05-1, 05-3 and 05-4 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 February 15, 2006.

Compliance and Other Matters

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 grant agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

KMH LLP

KMH LLP

Honolulu, Hawaii
February 15, 2006

PART III

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

**Report on Compliance with Requirements Applicable to Each Major Program
and on 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, 2005. The PSD's major federal programs are identified in the summary of auditor's 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, 2005.

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 caused by error or fraud 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.

KMH LLP

KMH LLP

Honolulu, Hawaii
February 15, 2006

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, 2005**

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 that are not considered to be material weaknesses? yes ___ none reported

Noncompliance material to financial statements noted? ___ yes no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ___ yes no
- Reportable condition(s) identified that are not considered to be material weaknesses? ___ yes none reported

Type of auditor’s report issued on compliance for major programs: Unqualified

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

Identification of major programs:

| CFDA Number | Name of Federal Program or Cluster |
|-------------|--|
| 16.202 | Serious and Violent Offender Re-entry Initiative |
| 16.576 | Crime Victim Compensation |
| 16.593 | Residential Substance Abuse Treatment for State Prisoners (RSAT) |

Dollar threshold used to distinguish between type A and type B programs? \$300,000

Auditee qualified as low-risk auditee? ___ yes no

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

Section II - Financial Statement Findings

Ref

No. Internal Control Findings

05-1 Improve Controls Over Inmate Agency Fund Accounts*

As noted in the prior years, the controls over the inmate agency fund accounts need improvement. We realize that the PSD is aware of the needed improvements and efforts have been made to rectify the problems. The prior year's corrective action plan by the PSD was to explore the possibility of contracting with a vendor who could assist the facilities with the reconciliation process and complete a review of each inactive inmate account to the point where the PSD could properly escheat these funds to the State. From our discussion with management, management concluded that hiring a consultant is not feasible based on the current situation due to a lack of funding. Management also stated that segregation of duties for the Oahu Community Correctional Center has been implemented, which was verified during the audit.

We noted the following conditions regarding the inmate trust accounts for the fiscal year ended June 30, 2005:

- We were unable to reconcile the inmate trust account balance, which provides detail on the balance of each inmate, per the Inmate Trust Accounting (ITA) system's printed trial balance report to the reconciled cash balance as of June 30, 2005.
- 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. One other facility prepared the bank reconciliation as of June 30, 2005, that was not accurate.
- Inactive inmate accounts remained on the PSD's financial records.
- Stale-dated checks over one-year old were not escheated to the State Treasury for at least one of the facilities.
- The adjusted bank balances exceeded the total cash balance of inmate accounts reported to the State of Hawaii by approximately \$42,000 as of June 30, 2005.

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

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 (DAGS), 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

The findings listed above have been occurring for many years despite the efforts of the PSD to make certain changes such as the installation of software to maintain the trust accounts, regular monitoring of the progress of the findings and even the establishment of a working group to address the many problems each facility encounters with reconciling the inmate trust accounts. We can appreciate the PSD's concern with a recommendation that "reconciling items should be investigated and resolved" would not be useful nor actionable.

During our audit, we noted that the reconciling differences from prior year have changed. This is an indication that the current reconciling process is creating additional items to consider. In order to stabilize this situation, the PSD needs to assess its current processes to isolate and address any current year "reconciling" items. Once the unreconciled differences are identified, the PSD can start with a static balance and move forward. In consideration of this, we believe that the PSD should take the following steps towards reconciling its inmate trust accounts and prevent future differences. The process can be summarized as follows:

1. Restructure and centralize the process
2. Standardize reconciliations
3. Performance of reconciliations
4. Monitoring and process reengineering

Restructure/Centralize the Process

Currently, each facility is responsible for its own reconciliation process. Ultimately, each facility reports to the Deputy Director of Corrections. The PSD should consider whether there is any need for reorganization of roles and responsibilities to ensure that there is adequate oversight over the reconciliation process. Options that the PSD may consider is having staff with available time and the accounting background to identify and fix problems in the reconciliation process that currently exist or occur in the future.

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

In addition, the PSD should consider centralizing the reconciliation function regardless of which Division has governance over the process (i.e., Administration or Corrections). Despite the progress made by each facility, transfers of inmates between facilities cause timing differences that make the reconciliation process more difficult. The centralization of the reconciliation process would eliminate the timing differences caused by inmate transfers.

Standardize Reconciliations

The ITA working group has taken steps towards the standardization of the reconciliation process. However, there are facilities that continue to prepare the reconciliations differently. The PSD should continue to develop a standard reconciliation form that lists all potential reconciling items to help ensure that all reconciling items are identified. The centralization of the process as mentioned above will aid in the implementation of a standard form.

Performance of Reconciliations

The performance of accurate and timely reconciliations for the facilities is a key part of the process. The Department should see increased accuracy and more timely reconciliations as a result of the previous steps. Any unreconcilable differences should be reported for monitoring purposes as discussed below.

Monitoring/Process Reengineering

Under the governance established under the restructuring of the process, those charged with monitoring the reconciliation should ensure that reconciliations are performed accurately and timely. Any unreconcilable difference should also be investigated and the reconciliation process should be modified accordingly.

This process will eventually identify all reconciling items such that the unreconciled difference remains the same from period to period. Once the difference has not changed for a defined period (e.g., six months to one year) the Department should write-off or escheat, as applicable, the unreconciled difference. The Department should consult with the State of Hawaii Attorney General's office for the appropriate disposition of the unreconciled difference.

The aforementioned process is based on our high-level understanding of the process and further analysis is necessary to effectively implement the above process. Our consideration of the Department's internal control and processes over financial reporting of the inmate liability accounts was primarily to determine our auditing procedures. A detailed study of the process was not performed. Consequently we recommend that the Department consider hiring an outside consultant for further assistance.

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

**Ref
No.**
05-2

**Internal Control Findings
Strengthen Controls Over Compensated Leaves of Absence**

The PSD acknowledges a need to strengthen the controls over the compensated leave of absence process. The corrective action plan for the prior year's findings was to conduct periodic audits of leave records maintained by program units in order to promote accurate and timely recordation of leaves and to conduct scheduled training sessions on the leave records maintenance procedures for all programs. As of June 30, 2005, the audit of four programs had been completed. There has been no training provided on the maintenance procedures to properly complete the leave records.

The following conditions were noted during our review of leave records for the fiscal year ended June 30, 2005:

- The salary overpayment receivable balance as of June 30, 2005, was approximately \$261,794, representing an 80% decrease from \$1,296,000 as of June 30, 2004. Previously, under HRS Section 78-12, the PSD was required to conduct a hearing in contested cases prior to recovering overpayments to employees. This law was changed by Act 253 in the 2000 legislative session and took effect July 1, 2002. HRS Section 78-12 as amended now requires that PSD initiate immediate recovery of any overpayments regardless of contested indebtedness. The considerable reduction in the salary overpayments receivable balance between June 2004 and June 2005 is attributable primarily to approval by the Department of the Attorney General (AG) to write off uncollectible overpayments to former PSD employees. To a lesser extent, PSD collection of overpayments through repayment plans contributed to the reduction. In addition, the AG succeeded in collecting repayments from individuals who were placed in the State's tax setoff program. Most of the salary overpayments occurred because of the timing requirements for processing payroll data under the State's payroll system. For employees hired on or after 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.
- In five instances, the wage rate used in calculating the employees vacation for the leave accrual report, did not agree to the Employee Personnel Action Report (EPAR).
- In two instances, the employees had carryover hours in excess of seven hundred twenty into the new calendar year.
- In one instance, the Form G-1, "Application for Leave of Absence," did not have the approval signature, date, and/or hours.

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

- In one instance, a terminated employee was included in the compensated absence balance.
- There were eight instances where the approval date on the Form G-1, "Application for Leave of Absence," was several days after the vacation period requested.

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.
- To ensure that each program is completing the leave information accurately and correctly, training should be provided to all personnel with this responsibility.

**Ref
No.**

**05-3 Internal Control Findings
Properly Account for Capital Assets***

The PSD's corrective action plan in the prior year was to establish a procedure where the Capital Improvements Programs (CIP) Coordinator would submit documentation of completed CIP projects to the respective program for inventory recordation and submit an informational copy to the PSD Fiscal Office for use in monitoring the change in inventory. We did note that the procedures have been established to ensure that requests to add or delete inventory items are submitted to DAGS on a timely basis.

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

However, 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 \$217,000 in capital assets actually acquired prior to the fiscal year ended June 30, 2004, was recorded as current fiscal year additions.
- Building and building improvement costs amounting to approximately \$61 million were not recorded on the State's Annual inventory Report of Property as of June 30, 2004. Most of the costs were for the construction of capital assets for which the PSD was not the expending agency.
- During our review of the Department's detail listing of the Capital Assets Additions, Disposals, Transfers and Changes by Department Report, we noted several projects that had costs that were incurred in previous years but were not previously reported in the Fixed Assets Listing. As such, a restatement of the Department's beginning net assets was required to properly reflect the fixed assets in the current year. Failure to accurately track and report fixed assets may lead to future restatements.

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. Each program should take inventory of capital assets and inform the fiscal office of any discrepancies.

**Ref
No.
05-4**

**Internal Control Findings
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, 2005:

- 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.
- In several instances, the unit cost per the inventory listing as of June 30, 2005, did not agree to the invoice.
- There were several instances where invoices could not be found for the inventory items

*Denotes material weakness.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

tested. It appears that invoices for inventory items purchased prior to fiscal year 2004 were not easily located. The PSD has indicated that the primary cause is due to a change in accounting personnel during the year.

- There were instances where not all of the accounting transactions were recorded into the accounting system. The absence of this information caused internal financial statements provided at the beginning of the engagement to be misstated. The areas most affected were the accounts receivable, vouchers payable, postage payable, and cash.

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. Correctional Industries should ensure that proper documentation is maintained to support financial transactions. A filing system should be established and maintained to ensure that supporting documentation is available regardless of personnel turnover.

It is our understanding that Correctional Industries has acquired the services of an outside accounting service that will aid in the accounting functions for the division. However, it is imperative that Correctional Industries realize that the bookkeeping function is still their responsibility and the financial statements produced will remain inaccurate unless all of the transactions are recorded on a timely basis.

**Department of Public Safety
State of Hawaii**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)
FISCAL YEAR ENDED June 30, 2005**

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, 2004, dated December 30, 2004.

Recommendations

Status

Section II - Financial Statement Findings

04-1 Improve Controls Over Inmate Agency Fund Accounts

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.

Not accomplished. See Reference No. 05-1.

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.

04-2 Strengthen Controls Over Compensated Leaves of Absence

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 purposes is accurately prepared and reviewed by responsible personnel prior to being submitted to the PSD Fiscal Office.

Partially accomplished. The number of salary overpayment occurrences have stabilized. However, errors in the compensated leaves of absence records continued to occur during the fiscal year ended June 30, 2005. See Reference No. 05-2.

Recommendations

Status

04-3 Properly Account for Capital Assets

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, in a timely manner.

Partially accomplished. PSD resolved difference between DAGS records and PSD's records related to a building that was demolished. However, there continues to be issues with making sure that capital assets paid for by DAGS gets recorded by PSD on a timely and accurate basis. See Reference No. 05-3.

04-4 Maintain Current and Accurate Financial Records for Correctional Industries

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 recording of capital assets into their internal general ledger software with the reporting of capital asset information to DAGS.

Partially accomplished. 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. 05-4.

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

FRANK J. LOPEZ
INTERIM DIRECTOR

CLAIRE Y. NAKAMURA
Deputy Director
Administration

Deputy Director
Corrections

JAMES L. PROPOTNICK
Deputy Director
Law Enforcement

No. 2006-874

March 29, 2006

Mr. Wilcox W.K. Choy, Partner
KMH LLP
737 Bishop Street, Suite 2900
Honolulu, HI 96813

Dear Mr. Choy:

SUBJECT: State Department of Public Safety's Response to the Financial Audit Findings for the Fiscal Year Ended June 30, 2005; Part IV—Schedule of Findings and Questioned Costs

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

05-1 Improve Controls Over Inmate Agency Fund Accounts

The inmate trust accounting (ITA) system reflects inmate transactions including but not limited to: child support payments, court fees/fines, legal fees, postage costs, photocopy costs, victim restitution payments, medical/dental copayments or prostheses, monthly payroll deposits, monetary gifts from authorized friends and family members, and weekly commissary purchases. As noted in the audit report, PSD has taken corrective action including the installation of software to maintain the trust accounts, regular monitoring of progress made on prior findings, and establishment of a user group to address problems each facility encounters in reconciling inmate trust accounts. Complicating the reconciliation effort is the sheer volume of transactions for the more than 10,000 inmates moving through the State's adult corrections system each year, and inmate transfers between/among correctional institutions (each with their respective ITA checking account) for programming and other reasons.

The ITA User Group, comprising the correctional facilities' business managers and account clerks Statewide, was reconvened in FY 2006 for the purposes of: (a) developing a standardized form of all reconciling items, (b) diagramming workflow, and (c) preparing a detailed FY 2007 calendar of work sessions and milestones for synchronizing the ITA reconciliation process across all eight facilities. The standardized reconciliation form is currently being tested at selected facilities in an effort to isolate variables that may contribute to the widely fluctuating balances in each facility's monthly reconciliation, and to facilitate timely writeoff or escheatment of funds as appropriate.

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Upon achieving the foregoing basic objectives and stabilizing ITA reconciliation discrepancies, the PSD Administration will be better equipped to evaluate organizational and staffing alternatives.

05-2 Strengthen Controls Over Compensated Leaves of Absence

In FY 2005, the Department of Public Safety completed its audit of time and attendance personnel records against actual payroll records for all salary overpayment cases involving former employees, and transmitted writeoff requests for approval--or placement of the debtor in the State's tax setoff program--by the Department of the Attorney General. PSD can now focus on resolving its most difficult cases involving historical overpayments to current employees, who are entitled to a hearing in contested cases under then-existing provisions of §78-12, Hawaii Revised Statutes. The Department has been fortunate to secure the voluntary services of former State deputies attorney general to serve as PSD hearings officers. These officers began conducting salary overpayment hearings and rendering written decisions in February 2006.

With respect to the after-the-fact approval date on the Form G-1, "Application for Leave of Absence," PSD defends those instances where an employee is required to take emergency vacation leave as opposed to scheduled vacation leave. Such emergency situations require that the employee verbally notify the supervisor, and then complete and forward the Form G-1 to the supervisor upon returning to work.

The Department has also developed a training program on the proper completion of leave records, taking into account both uniformed and non-uniformed employees, as well as shift and non-shift workers, with the following planned milestones:

- April 30, 2006—Complete and circulate the time and attendance (T&A) training manual in draft form, for internal review and comment by PSD administrators, supervisors, and appropriate others.
- May 31, 2006—Finalize the time and attendance training manual for internal use.
- July 1, 2006—Begin training all Time and Attendance Unit (TAU) clerks.
- September 30, 2006—Complete training for all TAU clerks Statewide.
- October 1, 2006—Schedule annual training for all TAU clerks on any procedural changes, using updated training manuals. Thereafter, conduct training as needed.

In Summer 2005, PSD developed a partially mechanized time and attendance database application to streamline and manage employee payroll claims for other than base salary. A pilot project was implemented in Fall 2005 beginning with the Neighbor Island correctional institutions. The T&A system centers on the use of standardized sign-in/sign-out logs for daily T&A recordkeeping for non-shift workers as well as three employee shifts per day. In the case of uniformed officers, the Watch Commander submits the sign-in/sign-out logs, through the Chief of Security and the Warden, to the TAU clerk. Similarly, supervisors of civilian employees would submit the logs, through the chain of command, to the TAU clerk. The TAU clerk enters the time worked into a database that performs calculations based on the TAU clerk's knowledge and application of seven collective bargaining agreements, and corresponding entry of appropriate data elements. The semi-automated processing of compensation claims produces a machine-generated Form D-55, "Individual Timesheet," and Form 10, "Notification of Temporary Assignment." The centralized, semi-automated production of such payroll forms has: curbed salary overpayments, minimized manual computation errors, resulted in the timely payment of employee compensation, and facilitated the

alignment of budgets with expenditures. This T&A program represents work-in-progress for PSD in concert with the labor unions for seven bargaining units. Based on the favorable results experienced by PSD, the pilot project will be expanded in Spring 2006 to include the Department's Oahu correctional institutions, the Law Enforcement Division, and the Central Administration offices.

05-3 Properly Account for Capital Assets

The Department of Accounting and General Services (DAGS), rather than the Department of Public Safety, is the expending agency for PSD's capital improvements program (CIP) projects. As such, PSD lacks ready access to the procurement and disbursement records required to place DAGS-procured buildings and building improvements on PSD's capital assets inventory. Although PSD receives the monthly DAGS MCD Report 300, "Project Cost by Appropriation, and by Job," the report is not effective as a standalone report. It does not provide a breakdown between the: (a) costs relating to construction of the capital asset; and (b) costs of furnishings, fixtures, and equipment installed by the construction contractor.

With respect to previous audit findings for FYE June 30, 2004, PSD reviewed the MCD Report 300 for FY 2002 through FY 2004 to ensure that inventory updates were recorded for buildings and building improvements. DAGS provided access to its manual files for PSD research and retrieval of some historical data on CIP project expenditures. While these efforts resulted in the addition of previously unrecorded capital assets to the inventory, a natural consequence of the catchup work was the recordation of prior-year acquisitions belatedly in FY 2005, thereby necessitating a restatement of PSD's FY 2005 beginning net assets.

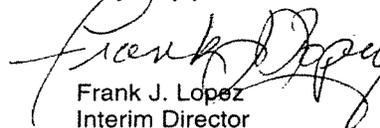
The Department will request DAGS' assistance in institutionalizing the systematic transmittal of CIP cost data to PSD to enable the capital assets inventory recordation, from construction-in-progress through contract completion and final valuation of assets. While the proper recordation of capital assets was not previously emphasized, compliance with the recently adopted GASB No. 34 may require improvements to the State's current MCD Report 300 information system.

05-4 Maintain Current and Accurate Financial Records for Correctional Industries

Correctional Industries (CI) has contracted with an accounting firm to reconcile its internal (Peachtree software) accounting reports with the State's FAMIS reports through January 31, 2006. In addition, CI plans to address its systemic fiscal accounting and financial reporting deficiencies by soliciting competitive proposals for longer-term bookkeeping services from a provider with experience in retail-type (vs. governmental) accounting practices and methods.

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

Very truly yours,



Frank J. Lopez
Interim Director