Department of Public Safety, State of Hawaii

Financial Statements
Fiscal Year Ended June 30, 2006

March 15, 2007

Ms. Iwalani White
Interim Director
Department of Public Safety
State of Hawaii

Dear Ms. White:

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, 2006. 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, 2006, 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, 2006.

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, 2006, 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

Wilcox Choy
Partner

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PART I

FINANCIAL SECTION

Independent Auditor's 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, 2006, 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 of America. 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, 2006, 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 of the PSD, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, and the respective budgetary comparison of the general fund thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

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In accordance with *Government Auditing Standards*, we have also issued our report dated March 15, 2007, 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 16 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
March 15, 2007

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FISCAL YEAR ENDED JUNE 30, 2006 (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 2006 (FY 2006). 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, 2006 by approximately $84.0 million. Net assets invested in capital assets accounted for nearly all of this amount.

- During the FY 2006, the PSD incurred approximately $235.9 million in expenses of which approximately $221.7 million was funded by general fund revenues.

- Approximately $193 million of governmental funds were expended for incarceration and related inmate programs.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

> **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.

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

Proprietary funds – Proprietary funds are used to account for the same functions reported as business-type activities in the government-wide financial statements; 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, are used to report activity that provides goods or services to other funds, departments, agencies, or other governments on a cost-reimbursement basis in which the reporting government entity is the predominant participant in the activity. The PSD currently does not have any funds classified as internal service funds.

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

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS

The following table presents a condensed government-wide Statement of Net Assets of the PSD as of June 30, 2006 and June 30, 2005.

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

CONDENSED STATEMENT OF NET ASSETS

	Governmental Activities		Business-Type Activities		TOTAL	
	2006	2005	2006	2005	2006	2005
Current and other assets	$ 26,767,373	$ 23,446,891	$ 1,773,437	$ 1,108,190	$ 28,540,810	$ 24,555,081
Capital assets	83,883,488	89,920,315	1,782,242	1,832,385	85,665,730	91,752,700
Total assets	110,650,861	113,367,206	3,555,679	2,940,575	114,206,540	116,307,781
Current liabilities	19,122,444	19,794,794	1,461,277	557,217	20,583,721	20,352,011
Other liabilities	9,482,527	8,587,080	94,556	107,899	9,577,083	8,694,979
Total liabilities	28,604,971	28,381,874	1,555,833	665,116	30,160,804	29,046,990
Net Assets:						
Invested in capital assets, net of related debt	83,883,488	89,920,315	1,778,812	1,814,854	85,662,300	91,735,169
Unrestricted	(1,837,598)	(4,934,983)	221,034	460,605	(1,616,564)	(4,474,378)
Total Net Assets	$ 82,045,890	$ 84,985,332	$ 1,999,846	$ 2,275,459	$ 84,045,736	$ 87,260,791

The PSD's combined total net assets decreased by 3.7% to approximately $84.0 million as of June 30, 2006 from approximately $87.3 million as of June 30, 2005. The decrease in net assets is attributed to a decrease in net depreciable assets of approximately $6.1 million.

Governmental net assets accounted for approximately 97.6% of total net assets that consisted primarily of buildings and improvements at the correctional facilities.

The deficit in unrestricted net assets for governmental activities was approximately $1.8 million and $4.9 million as of June 30, 2006 and June 30, 2005, respectively. This deficit in unrestricted net assets results primarily from program liabilities incurred as of June 30, 2006 for which State-allotted appropriations were not yet available. The largest liability stems from accrued compensated absences payable totaling approximately $14.7 million and $14.1 million as of June 30, 2006 and June 30, 2005, respectively that are not funded by State-allotted appropriations until employees use the earned leave or are paid the cash equivalent upon termination. Therefore, there are no assets currently available to the PSD to pay for the accrued compensated absences liability as of June 30, 2006.

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

CONDENSED CHANGES IN NET ASSETS

	Governmental Activities		Business-type Activities		TOTAL	
	2006	2005	2006	2005	2006	2005
REVENUES:						
Program revenues	$ 8,462,158	$ 9,154,416	$ 4,739,130	$ 4,929,550	$ 13,201,288	$ 14,083,966
General revenues	221,663,693	199,129,293	-		221,663,693	199,129,293
Total Revenues	230,125,851	208,283,709	4,739,130	4,929,550	234,864,981	213,213,259
EXPENSES:						
Confinement	193,090,084	178,019,384	-	-	193,090,084	178,019,384
Law Enforcement	20,109,618	17,718,973	-	-	20,109,618	17,718,973
Parole	4,009,115	3,242,989	-	-	4,009,115	3,242,989
Crime victim comp	1,304,147	1,317,625	-	-	1,304,147	1,317,625
General Support	12,341,775	8,384,791	-	-	12,341,775	8,384,791
Correctional Industries	-	-	5,014,743	4,814,254	5,014,743	4,814,254
Total Expenses	230,854,739	208,683,762	5,014,743	4,814,254	235,869,482	213,498,016
Excess (deficiency) before transfers, lapsed appropriations and contributions	(728,888)	(400,053)	(275,613)	115,296	(1,004,501)	(284,757)
Transfer out	(7,000)	(3,509)	-	-	(7,000)	(3,509)
Lapsed Appropriations	(2,203,554)	(1,421,954)	-	-	(2,203,554)	(1,421,954)
Change in Net Assets	$ (2,939,442)	$ (1,825,516)	$ (275,613)	$ 115,296	$ (3,215,055)	$ (1,710,220)

Total net assets decreased by approximately $3.2 million during the FY 2006 as shown above.

Total revenues for PSD increased by approximately $21.6 million from FY 2005 primarily due to the following:

- 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).

Expenses for the fiscal years ended June 30, 2006 and June 30, 2005 totaled approximately $235.9 million and $213.5 million, respectively. The approximately $22.4 million increase stems from increases in collective bargaining costs, inmate health care costs, and mainland prison expenses.

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

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 84% of total expenses for governmental activities. Approximately $47.1 million and $36.7 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, 2006 and June 30, 2005, respectively.

Business-type Activities

Correctional Industries' (CI) net loss of approximately $276,000 in FY 2006 was due to a decrease in revenue primarily in the office furniture and print vocational programs. Also adding to the loss was the large investment in standard material inventory and equipment to expand and develop several service-based industries.

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 $23 million or 86% of total governmental fund assets as of June 30, 2006, and $20 million or 86% of total governmental fund assets for the fiscal year ended June 30, 2005. 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, 2006 the Correctional Industries reported approximately $2.0 million in total net assets, of which approximately $1.8 million was accounted for by investment in capital assets, net of related debt.

The decrease in sales of approximately $190,000 and the increase in operating expenses of approximately $220,000 resulted in a net loss of approximately $276,000 for FY 2006.

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

BUDGETARY ANALYSIS

As of May 2005, the Council of Revenues projected that general fund tax revenues will grow by 14.6% in FY 2005 and between 4.8% to 6.7% thereafter. However, departments were advised to maintain fiscal discipline in managing resources, as projections of State expenditures continue to show significant growth due to collective bargaining and fringe benefit obligations.

The FY 2006 Budget Execution Policies were formulated under the following overall themes:

- Actions to maintain overall spending within appropriation levels to continue the State's current financial solvency and strength. State agencies were cautioned that allocation adjustments may occur should State revenue projections no longer support expenditure levels.
- Prudence must be exercised in the expenditure of funds and every expenditure must compete for priority in the State's spending plan relative to all other funding requirements of the State.

Accordingly, in FY 2006, the PSD received an allotment of only 90% of general fund collective bargaining appropriations.

BUDGETARY COMPARISON

Program	Original Enc. & Exp.	Final Enc. & Exp.	Actual on Budgetary Basis Enc. & Exp.	Variance Favorable
Confinement	$ 107,728,242	$ 112,653,545	$ 111,810,277	$ 843,268
Law Enforcement	17,094,482	16,255,094	14,992,399	1,262,695
Parole	3,502,139	3,447,871	3,426,003	21,868
General Support	57,529,266	55,432,662	55,189,985	242,677
TOTAL EXPENDITURES	$ 185,854,129	$ 187,789,172	$ 185,418,664	$ 2,370,508

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

GENERAL FUND BUDGETARY COMPARISON

The final total budget of approximately $187.8 million reflects an expenditure ceiling (general and non-general funds). Expenditure ceilings are formulated based on anticipated program needs. Optimally, expenditure ceilings should approximate or equal actual expenditures. However, for non-general funds, actual expenditures are limited to the availability of funds. Therefore, for these non-general funds, the PSD is limited to spending up to the expenditure ceiling or the cash balance, whichever is lower. For FY 2006, the approximately $2.4 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.

CAPITAL ASSETS, NET OF DEPRECIATION

	Governmental Activities		Business-Type Activities		TOTAL	
	2006	2005	2006	2005	2006	2005
Land	$ 107,570	$ 107,570	$ -	$ -	$ 107,570	$ 107,570
Buildings and improvements	80,721,823	86,987,756	1,676,350	1,740,825	82,398,173	88,728,581
Furniture, equipment, vehicles, and land improvements.	3,054,095	2,824,989	105,892	91,560	3,159,987	2,916,549
TOTAL	$ 83,883,488	$ 89,920,315	$ 1,782,242	$1,832,385	$ 85,665,730	$ 91,752,700

CAPITAL ASSETS

As of June 30, 2006, the PSD had approximately $85.6 million invested in capital assets. Capital assets for governmental activities accounted for approximately 97.9% of total capital assets. Building and improvements for correctional facilities totaled approximately $82.4 million, net of accumulated depreciation.

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

Between June 30, 2006 and June 30, 2005, capital assets decreased by approximately $6 million, which is equivalent to the annual depreciation amount.

ECONOMIC FACTORS

In light of Hawaii's strong economic recovery, and the robust gains in State revenues, the FY 2006 Budget Execution Policies provided departments with greater expenditure authority. As mentioned in the budgetary analysis section, the only measure imposed in FY 2006 was the usual allotment of only 90% of general fund collective bargaining.

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, 2006

	Governmental Activities	Business-Type Activities	Total
Assets			
Current Assets:			
Cash and cash equivalents	$ 24,754,855	$ 454,725	$ 25,209,580
Receivables, net	133,283	437,482	570,765
Due from State of Hawaii	2,033,236	-	2,033,236
Due from grantor	15,482	-	15,482
Internal balances	(213,709)	213,709	-
Due from other funds	44,226	-	44,226
Inventories	-	667,521	667,521
Total current assets	26,767,373	1,773,437	28,540,810
Capital Assets:			
Non-depreciable	107,570	-	107,570
Depreciable, net	83,775,918	1,782,242	85,558,160
Total capital assets	83,883,488	1,782,242	85,665,730
Total assets	110,650,861	3,555,679	114,206,540
Liabilities			
Current Liabilities:			
Accrued wages and employee benefits payable	7,455,519	69,452	7,524,971
Vouchers payable	6,413,677	387,300	6,800,977
Deferred revenues	-	942,832	942,832
Capital lease obligations	-	3,430	3,430
Accrued compensated absences	5,192,949	51,782	5,244,731
Due to other funds	60,299	6,481	66,780
Total current liabilities	19,122,444	1,461,277	20,583,721
Accrued Compensated Absences	9,482,527	94,556	9,577,083
Total liabilities	28,604,971	1,555,833	30,160,804
Net Assets			
Invested in Capital Assets, net of related debt	83,883,488	1,778,812	85,662,300
Unrestricted (deficit)	(1,837,598)	221,034	(1,616,564)
Total net assets	$ 82,045,890	$ 1,999,846	$ 84,045,736

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, 2006

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
Functions/Programs	Expenses	Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Confinement	$ 193,090,084	$ 311,515	$ 1,713,032	$ -	$ (191,065,537)	$ -	$ (191,065,537)
Law enforcement	20,109,618	3,809,839	347,313	800,334	(15,152,132)	-	(15,152,132)
Parole	4,009,115	-	-	-	(4,009,115)	-	(4,009,115)
Crime victim compensation	1,304,147	960,725	519,400	-	175,978	-	175,978
General support	12,341,775	-	-	-	(12,341,775)	-	(12,341,775)
Total governmental activities	230,854,739	5,082,079	2,579,745	800,334	(222,392,581)	-	(222,392,581)
Business-type Activities --							
Correctional industries	5,014,743	4,739,130	-	-	-	(275,613)	(275,613)
Total business-type activities	5,014,743	4,739,130	-	-	-	(275,613)	(275,613)
Total	$ 235,869,482	$ 9,821,209	$ 2,579,745	$ 800,334	(222,392,581)	(275,613)	(222,668,194)
General revenues:							
State appropriations					182,065,314	-	182,065,314
State-provided payroll fringe benefits					39,551,943	-	39,551,943
Unrestricted investment earnings					369	-	369
Miscellaneous					46,067	-	46,067
Lapsed appropriations					(2,203,554)	-	(2,203,554)
Transfers, net					(7,000)	-	(7,000)
Total general revenues and transfers					219,453,139	-	219,453,139
Changes in net assets					(2,939,442)	(275,613)	(3,215,055)
Net assets at July 1, 2005					84,985,332	2,275,459	87,260,791
Net assets at June 30, 2006					$ 82,045,890	$ 1,999,846	$ 84,045,736

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Governmental Funds
Balance Sheet
June 30, 2006

	General	Other Governmental Funds	Total
Assets			
Cash and Cash Equivalents	$ 20,962,682	$ 3,792,173	$ 24,754,855
Receivables, net	133,283	-	133,283
Internal Balances	-	-	-
Due from State of Hawaii	2,033,236	-	2,033,236
Due from Other Funds	5,535.00	-	5,535
Internal Balances	-	6,169	6,169
Due from Other Governments	-	15,482	15,482
Total assets	$ 23,134,736	$ 3,813,824	$ 26,948,560
Liabilities and Fund Balances			
Accrued Wages and Employee Benefits Payable	$ 7,397,896	$ 57,623	$ 7,455,519
Vouchers Payable	6,085,885	327,792	6,413,677
Due to Other Funds	-	5,535	5,535
Internal Balances	219,878	-	219,878
Due to Agency Fund	9,233	6,840	16,073
Total liabilities	13,712,892	397,790	14,110,682
Fund Balances:			
Reserved for:			
Encumbrances	13,270,843	1,137,405	14,408,248
Receivables	133,283	-	133,283
Unreserved	(3,982,282)	2,278,629	(1,703,653)
Total fund balances	9,421,844	3,416,034	12,837,878
Total liabilities and fund balances	$ 23,134,736	$ 3,813,824	$ 26,948,560

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, 2006

Total Fund Balances - Governmental Funds		$ 12,837,878
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	187,721,639	
Less accumulated depreciation	(103,838,151)	
		83,883,488
Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds		(14,675,476)
Net Assets of Governmental Activities		$ 82,045,890

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, 2006

	General	Other Governmental Funds	Total
Revenues:			
State allotted appropriations	$ 182,065,314	$ -	$ 182,065,314
State-provided payroll fringe benefits	39,551,943	-	39,551,943
Intergovernmental revenues	-	3,380,079	3,380,079
Charges for services	3,394,652	1,687,427	5,082,079
Unrestricted investment earnings	369	-	369
Miscellaneous	46,067	-	46,067
Total revenues	225,058,345	5,067,506	230,125,851
Expenditures:			
Confinement	184,708,381	1,547,398	186,255,779
Law enforcement	18,812,231	1,769,919	20,582,150
Parole	3,991,833	-	3,991,833
Crime victim compensation	-	1,297,241	1,297,241
General support	12,101,666	-	12,101,666
Total expenditures	219,614,111	4,614,558	224,228,669
Excess of revenues over expenditures	5,444,234	452,948	5,897,182
Other Financing Uses--			
Transfers out	(7,000)	-	(7,000)
Total other financing uses	(7,000)	-	(7,000)
Excess of revenues over expenditures and other uses	5,437,234	452,948	5,890,182
Other Changes in Fund Balances--			
Lapsed appropriations	(2,203,554)	-	(2,203,554)
Net change in fund balances	3,233,680	452,948	3,686,628
Fund Balance, July 1, 2005	6,188,164	2,963,086	9,151,250
Fund Balance, June 30, 2006	$ 9,421,844	$ 3,416,034	$ 12,837,878

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, 2006

Net Change in Fund Balances - Total Governmental Funds		$ 3,686,628
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	942,284	
Net transfer of capital assets	21,355	
Less current fiscal year depreciation	(6,939,867)	
		(5,976,228)
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.		(60,599)
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.		(589,243)
Change in Net Assets - Governmental Activities		$ (2,939,442)

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, 2006

	Original	Final	Actual on Budgetary Basis	Variance Over (Under)
Revenues:				
State allotments	$ 178,979,781	$ 182,065,314	$ 182,065,314	$ -
Charges for services	6,799,283	5,648,793	3,394,652	(2,254,141)
Miscellaneous	75,065	75,065	52,877	(22,188)
	185,854,129	187,789,172	185,512,843	(2,276,329)
Expenditures:				
Confinement	107,728,242	112,653,545	111,810,277	(843,268)
Law enforcement	17,094,482	16,255,094	14,992,399	(1,262,695)
Parole	3,502,139	3,447,871	3,426,003	(21,868)
General support	57,529,266	55,432,662	55,189,985	(242,677)
	185,854,129	187,789,172	185,418,664	(2,370,508)
Excess of revenues over expenditures	-	-	94,179	94,179
Other Financing Uses:				
Transfers out	-	-	(7,000)	(7,000)
Excess of revenues over expenditures and other uses	$ -	$ -	$ 101,179	$ 101,179

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund
Statement of Net Assets
June 30, 2006

Assets		
Current Assets:		
Cash	$	454,725
Receivables, net of allowance for doubtful accounts		437,482
Internal balances		213,709
Inventories		667,521
Total current assets		1,773,437
Capital Assets, Net of Depreciation		1,782,242
Total assets		3,555,679
Liabilities		
Current Liabilities:		
Accrued wages and employee benefits		69,452
Vouchers payable		387,300
Deferred revenues		942,832
Capital lease obligations		3,430
Accrued compensated absences		51,782
Due to agency fund		6,481
Total current liabilities		1,461,277
Noncurrent Liabilities--		
Accrued compensated absences		94,556
Total liabilities		1,555,833
Net Assets		
Invested in Capital Assets, Net of Related Debt		1,778,812
Unrestricted		221,034
Total net assets	$	1,999,846

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2006

Operating Revenues--	
Charges for sales and services	$ 4,739,130
Total operating revenues	4,739,130
Operating Expenses:	
Cost of sales and services	4,877,577
Depreciation and amortization	128,427
Total operating expenses	5,006,004
Operating loss	(266,874)
Non-Operating Expenses--	
Interest expense	(8,739)
Change in net assets	(275,613)
Net Assets, July 1, 2005	2,275,459
Net Assets, June 30, 2006	$ 1,999,846

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund
Statement of Cash Flows
For the Year Ended June 30, 2006

Cash Flows from Operating Activities:	
Receipts from customers	$ 4,298,904
Receipts from interfund services provided	1,072,147
Payments to suppliers	(4,350,272)
Payments to employees	(761,306)
Net cash provided by operating activities	259,473
Cash Flows from Capital and Related Financing Activities:	
Acquisition of capital assets	(78,284)
Principal payments on capital lease obligations	(14,101)
Interest paid on capital lease obligations	(8,739)
Net cash used by capital and related financing activities	(101,124)
Net increase in cash	158,349
Cash at July 1, 2005	296,376
Cash at June 30, 2006	$ 454,725

Reconciliation of operating loss to net cash flows provided by operating activities	
Operating loss	$ (266,874)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation and amortization	128,427
Change in assets and liabilities:	
Receivables	(287,850)
Inventories	(219,464)
Vouchers payable	(14,317)
Accrued wages and compensated absences	(5,525)
Deferred revenues	919,771
Due to other funds	5,305
Net cash provided by operating activities	$ 259,473

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Agency Fund
Statement of Assets and Liabilities
June 30, 2006

	Agency Fund
Assets	
Cash	$ 1,830,494
Due from Others	22,554
Total assets	$ 1,853,048
Liabilities	
Due to Individuals	$ 1,107,048
Due to Others	746,000
Total liabilities	$ 1,853,048

See accompanying notes to the basic financial statements.

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.

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.

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.

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.

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.

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.

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:

Asset Type	Minimum Capitalization Amount	Estimated Useful Life Governmental	Estimated Useful Life Proprietary
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.

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.

3. 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, 2006:

Excess of revenues over expenditures and other uses - actual on budgetary basis	$ 101,179
Reserved for encumbrances at fiscal year-end	13,270,843
Reserved for receivables	133,283
Net change in unreserved liabilities	407,791
Expenditures for liquidation of prior fiscal year encumbrances	(8,468,134)
Net adjustment for commissary revenue accrual	(7,728)
Excess of revenues over expenditures and other uses - GAAP basis	$ 5,437,234

4. Cash and Cash Equivalents

The State Director of Finance is responsible for the 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, 2006, the carrying amount of total bank deposits including time certificates of deposit was approximately $1,022,000 and the corresponding bank balances were approximately $1,236,000. 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.

5. Receivables

Receivables of the PSD, net of an allowance for doubtful accounts, consisted of the following at June 30, 2006:

	General Fund	Enterprise Fund
Salary overpayments	$ 200,283	$ -
Accounts receivable	-	536,081
	200,283	536,081
Less: allowance for doubtful accounts	(67,000)	(98,599)
Receivables, net	$ 133,283	$ 437,482

6. Capital Assets

	Balance June 30, 2005	Additions	Deductions	Transfers	Balance June 30, 2006
Governmental activities:					
Nondepreciable assets --					
Land	$ 107,570	$ –	$ –	$ –	$ 107,570
Depreciable assets:					
Building and improvements	176,087,416	–	–	–	176,087,416
Furniture and equipment	4,934,084	684,061	128,026	–	5,490,119
Vehicles	4,008,137	258,223	52,254	43,867	4,257,973
Land improvements	1,778,561	–	–	–	1,778,561
Total capital assets	186,915,768	942,284	180,280	43,867	187,721,639
Less accumulated depreciation:					
Building and improvements	89,099,660	6,265,933	–	–	95,365,593
Furniture and equipment	3,934,147	319,671	67,427	–	4,186,391
Vehicles	3,605,934	235,692	52,254	22,512	3,811,884
Land improvements	355,712	118,571	–	–	474,283
Total accumulated depreciation	96,995,453	6,939,867	119,681	22,512	103,838,151
Governmental activities - capital assets, net	$ 89,920,315	$ (5,997,583)	$ 60,599	$ 21,355	$ 83,883,488

6. Capital Assets (continued)

	Balance June 30, 2005	Additions	Deductions	Balance June 30, 2006
Business-type activities:				
Building and improvements	$ 2,579,000	$ –	$ –	$ 2,579,000
Equipment	730,100	78,274	3,392	804,982
Equipment under capital lease	675,584	–	–	675,584
Total capital assets	3,984,684	78,274	3,392	4,059,566
Less accumulated depreciation:				
Building and improvements	838,175	64,475	–	902,650
Equipment	745,871	27,941	3,402	770,410
Equipment under capital lease	568,253	36,011	–	604,264
Total accumulated depreciation	2,152,299	128,427	3,402	2,277,324
Business-type activities - capital assets, net	$ 1,832,385	$ (50,153)	$ 10	$ 1,782,242

Depreciation expense was charged to functions as follows:

Governmental activities:	
Confinement	$ 6,475,019
Law enforcement	121,835
Crime victim compensation	1,912
General support	341,101
Total governmental activities depreciation	$ 6,939,867
Business-type activities --	
Correctional industries	$ 128,427

7. 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, 2006, was as follows:

Balance at July 1, 2005	$ 14,086,233
Additions	9,679,349
Reductions	(9,090,106)
Balance at June 30, 2006	$ 14,675,476

The amount of governmental activities compensated absences liability due within one year is $5,192,949. 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, 2006, was as follows:

	Balance June 30, 2005	Additions	Reductions	Balance June 30, 2006	Amount Due Within One Year
Capital lease obligations	$ 17,531	$ -	$ 14,101	$ 3,430	$ 3,430
Accrued compensated absences	171,658	61,435	86,755	146,338	51,782
Total business-type activities long-term liabilities	$ 189,189	$ 61,435	$ 100,856	$ 149,768	$ 55,212

8. 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 $39,551,943 for the fiscal year ended June 30, 2006, have been reported as revenues and expenditures in the general fund of the PSD.

8. 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.

9. Fund Balance Deficits

The general fund had a deficit in the unreserved fund balance at June 30, 2006 of $3,982,282. 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.

10. 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 $6,500 for the fiscal year ended June 30, 2006.

Interest expense of approximately $8,700 is included as a direct function expense of the Correctional Industries Program on the statement of activities for the fiscal year ended June 30, 2006.

At June 30, 2006, the future minimum lease payments together with the present value of net minimum lease payments were as follows:

Fiscal Year Ending June 30,	
2007	$ 3,430
Total minimum lease payments	3,430
Less amounts representing interest at 7.42%	52
Present value of minimum lease payments	$ 3,378

10. 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, 2006, were as follows:

Fiscal Year Ending June 30,	
2007	$ 328,000
2008	189,000
2009	153,000
2010	72,000
2011	19,000
2012-2016	5,000
	$ 766,000

Total rent expense for the fiscal year ended June 30, 2006, was approximately $587,000.

11. 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 comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

11. Retirement Benefits (continued)

a. Employees' Retirement System (continued)

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

Both plan 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.

On July 1, 2006, a new hybrid contributory plan will become effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan will be eligible for retirement at age 62 with 5 years of credited services or age 55 and 30 years of credit service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan.

b. Funding Policy

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. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The PSD's contributions requirements as of June 30, 2006, 2005 and 2004 were approximately $623,000, $513,000 and $444,000, respectively. The contribution rate for the fiscal year ended June 30, 2006 was 13.75%. The contribution rate was 10.82% for the fiscal year ended June 30, 2005, and 9.14% for the fiscal year ended June 30, 2004.

11. Retirement Benefits (continued)

b. Funding Policy (continued)

In addition to providing pension benefits, the PSD 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, 2006, was approximately $299,000.

c. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the PSD, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

For employees hired before July 1, 1996, the PSD pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the PSD makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the PSD pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the PSD pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the PSD pays the entire health care premium.

Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium.

Contributions are financed on a pay-as-you-go basis and are limited by State statute to the actual cost of the benefit coverage. During fiscal 2006, expenditures of approximately $655,000 were recognized for post-retirement health care and life insurance benefits.

Effective July 1, 2003, the EUTF replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

11. Retirement Benefits (continued)

d. Deferred Compensation Plan

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

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

12. 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.

13. 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, 2006, amounted to approximately $21,918,000.

14. New Pronouncements for Financial Reporting

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

- Statement No. 45 “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions” which 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. 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, 2006

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	02-RE-CX-0032	$ 491,207
Pass-through State Department of the Attorney General-- Crime Victim Compensation	16.576	03-VX-GX-0045	268,808
		04-VX-GX-0062	236,263
		05-VC-GX-0024	10,929
			516,000
Byrne Formula Grant Program	16.579	02-DB-15	22,655
		02-DB-27	38,982
		03-DB-14	56,929
		03-DB-20	7,440
		03-DB-22	34,326
		04-DB-13	35,429
			195,761
Electronic Prescription Monitoring Program	16.580	04-PM-VX-0017	168,712
		05-PM-VX-0010	40,861
			209,573
Residential Substance Abuse Treatment for State Prisoners (RSAT)	16.593	01-RT-1	30,031
		02-RT-1	347,003
			377,034
Total U.S. Department of Justice			1,789,575
U.S. Department of Defense			
Pass-through Hawaii Army National Guard-- Master Cooperative Agreement	N/A	DAHA50-05-H1003	7,295
		DAHA50-06-H1003	21,347
Total U.S. Department of Defense			28,642

Department of Public Safety, State of Hawaii

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2006

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	Q331A040012	113,582
Pass-through State Department of Education-- Title I Program for Neglected and Delinquent Children	84.013	S013A020011	72,017
Pass-through University of Hawaii-- Vocational Education - Basic Grants to States	84.048	V048A40011	45,429
Total U.S. Department of Education			231,028
Department of Homeland Security			
Pass-through Department of Defense - State of Hawaii Homeland Security Grant	97.067	03-TE-TX-0192	373,499
		04-GE-T4-K010	340,043
		04-GE-T4-0042	28,800
		05-GE-T5-0034	114,453
Total Department of Homeland Security			856,795
Total Federal Expenditures			$ 2,906,040

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 FINANICAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

KMHLLP

A Hawaii Limited Liability Partnership

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, 2006, and have issued our report thereon dated March 15, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

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 06-01 through 06-03.

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 item 06-01 to be a material weakness.

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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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items 06-04 and 06-05.

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
March 15, 2007

PART III

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

KMHLLP

A Hawaii Limited Liability Partnership

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, 2006. 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.

As described in item 06-04 and 06-05 in the accompanying schedule of findings and questioned costs, PSD did not comply with requirements regarding equipment and real property management and reporting that are applicable to its Homeland Security Grant Program. Compliance with such requirements is necessary, in our opinion, for PSD to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, PSD complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 06-06.

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Internal Control Over Compliance

The management of 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 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.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect PSD's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-04 through 06-06.

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 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. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 06-04 and 06-05 to be material weaknesses.

This report is intended solely for the information and use of management and federal awarding agencies and is not intended to be and should not be used by anyone other than those specified parties.

KMH LLP

KMH LLP

Honolulu, Hawaii
March 15, 2007

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2006

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:	Qualified	
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)
97.067	Homeland Security Grant Program

Dollar threshold used to distinguish between type A and type B programs?	$300,000	
Auditee qualified as low-risk auditee?	___ yes	√ no

Section II – Financial Statement Findings

Finding No.: 06-01

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.

We noted the following conditions regarding the inmate trust accounts for the fiscal year ended June 30, 2006:

- 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, 2006.
- 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.
- Inactive inmate accounts remained on the PSD's financial records.
- The total cash balance of inmate accounts exceeded the adjusted bank balances reported to the State of Hawaii by approximately $24,000 as of June 30, 2006.

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.

Section II – Financial Statement Findings

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.

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 unreconciliable differences should be reported for monitoring purposes as discussed below.

Section II – Financial Statement Findings

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 unreconciliable 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.

Finding No.: 06-02

Maintain Current and Accurate Inventory Records for Correctional Industries
During our review of the inventory at the Correctional Industries, we noted the following conditions as of June 30, 2006:

- There were several instances where invoices could not be found for the inventory items 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 we concluded that some items in the inventory deemed to be slow moving or obsolete should be written off.

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 has aided 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.

Finding No.: 06-03

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, 2006, 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, 2006:

- The salary overpayment receivable balance as of June 30, 2006, was approximately $200,283, representing a 23% decrease from $261,794 as of June 30, 2005. 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 continued reduction in the salary overpayments receivable balance between June 2005 and June 2006 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 decreased from the fiscal year ended June 30, 2000.
- In one instance, a terminated employee who was included in the June 30, 2006 payroll register was excluded from the accrued compensation worksheets which are used to ascertain the liability for the

department at the end of the fiscal year. Based on our discussions with PSD management, the employee was not paid the accrued compensation she was owed as it is department policy to conduct a payroll audit prior to paying off the accrued compensation balance.

- In one instance, the Form G-1, "Application for Leave of Absence," did not have the approval signature, date, and/or hours.

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.

Section III – Federal Award Findings and Questioned Costs

Finding No.: 06-04
CFDA No.: 97.067
Program: Homeland Security Grant Program
Federal Agency: Department of Homeland Security
Award Period: July 1, 2005 – June 30, 2006
Questioned Costs: None

Tracking Equipment Purchases
As a sub-grantee of the Hawaii State Civil Defense (Civil Defense), the PSD is required to track equipment purchases in accordance with the program requirements. To streamline the purchasing process, Civil Defense implemented a central electronic purchasing system called Fisher Safety (Fisher). In the past two fiscal years, the PSD has steadily increased its usage of the Fisher system. By utilizing Fisher, the PSD no longer has to physically issue a check for purchases; instead the funds are paid directly by Civil Defense after being provided evidence of delivery from the Sheriff's Division.

During our audit we noted that the purchases through Fisher of approximately $454,000 were not recorded, and the related equipment received was not tagged or entered into the inventory system for tracking as required by state and federal guidelines. Failure to properly track equipment purchases limits the PSD's ability to assess and evaluate its equipment needs and determine proper utilization. In addition, non-compliance with grant requirements could jeopardize the program's funding.

Recommendation
We recommend that the PSD place in operation controls to ensure that purchases made through Fisher are timely recorded in the general ledger and also in the fixed asset inventory. Such a control could include requiring a reporting package be sent from the Sheriff Division to the PSD's fiscal office upon receipt.

Finding No.: 06-05
CFDA No.: 97.067
Program: Homeland Security Grant Program
Federal Agency: Department of Homeland Security
Award Period: July 1, 2005 – June 30, 2006
Questioned Costs: None

Reporting
During our audit, we noted that the PSD is required to submit quarterly reports to the Civil Defense Department no later than 5 days after the quarter end. During our audit, we noted that the reporting function was not being performed in during the fiscal year. Failure to complete the required reporting in a timely manner may jeopardize the PSD's grant funding.

Section III – Federal Award Findings and Questioned Costs

Recommendation
We recommend that the PSD place in operation controls to ensure compliance with the program reporting requirements. Such a control could include cross-training personnel to ensure that multiple resources are available to assist with program requirements.

Finding No.: 06-06
CFDA No.: 16.586
Program: Serious Violent Offender Reentry Initiative
Federal Agency: Department of Justice
Award Period: July 1, 2005 – June 30, 2006
Questioned Costs: None

Subrecipient Monitoring
The PSD passes through funding under this grant to a third party. Accordingly, the PSD is required to perform subrecipient monitoring according to grant rquirements. Subrecipient monitoring is performed by conducting periodic site visits, regular telephone contact and review of subrecipient report submissions. During our audit, we noted that subrecipient monitoring was not being performed for the period January 2006 through June 2006. Based on our understanding with management, subrecipient monitoring was not performed due to a transition in personnel. Failure to perform subrecipient monitoring activities could jeopardize the PSD's grant funding.

Recommendation
We recommend that PSD ensure subrecipient monitoring activities be performed. In addition to the performance of the subrecipient monitoring activities, we recommend that the PSD maintain documentation of its subrecipient monitoring activities to demonstrate compliance with the requirement.

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, 2005, dated December 30, 2005.

Recommendations	Status
Section II - Financial Statement Findings	
05-1 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. 06-01.
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.	
05-2 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 has stabilized and continue to decline. However, errors in the compensated leaves of absence records continued to occur during the fiscal year ended June 30, 2006. See Reference No. 06-03.

Recommendations	
05-3 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.	Finding resolved.
05-4 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 issues concerning missing invoices and pricing information for inventory items prior to 2004. See Reference No. 06-02.

PART VI

RESPONSE OF THE AFFECTED AGENCY

LINDA LINGLE
GOVERNOR

IWALANI D. WHITE
INTERIM DIRECTOR

Deputy Director
Administration

JEAN M. IRETON
Deputy Director
Corrections

JAMES L. PROPOTNICK
Deputy Director
Law Enforcement

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

No. 2007-809

March 23, 2007

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, 2006; 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:

06-1 Improve Controls Over Inmate Agency Fund Accounts

The Department will continue its efforts in standardizing the reconciliation process to ensure that each facility is maintaining their accounts in the same manner and to identify changes that will need to be made at each facility.

The Department agrees with the auditor's recommendation to consider centralizing the reconciliation process. At the same time the Department will be exploring the idea of centralizing the inmate accounts. A feasibility study will first need to be conducted to determine the cost that will have to be invested (how many positions will be needed, office space, and equipment will be needed) to centralize the process. Additional positions will need to be requested because many of the account clerks in the smaller facility do all the accounting and procurement services for their facility and the function of inmate trust account is just a part of what they do.

The following briefly summarizes the action that PSD will be working on to address this finding:

- Continue standardizing reconciliation process

- Continue meeting with trust account workers to identify common problems
- Look into other state prison trust account systems
- Look into centralizing the reconciliation process
- Look into centralizing the accounts

06-2 Maintain Current and Accurate Inventory Records for Correctional Industries

The contracted accounting firm that assisted the Correctional Industries to address its accounting problems is beginning to show improvement in the handling of financial transactions. We anticipate that this finding will be satisfied by FY 07 audit.

06-3 Strengthen Controls Over Compensated Leaves of Absence

Salary overpayment continues to show improvement and PSD will continue its collection efforts as recommended by the auditors.

Training of time and attendance employees in the proper reporting of year-end reports that are being submitted to the auditors will be conducted during the month of July 2007.

06-4 Tracking Equipment Purchases

PSD agrees with the auditor that the proper recording of equipment being purchased through the Homeland Security Grant was not being done. PSD Fiscal Office will implement the following steps with the Sheriff Division to track equipment purchases:

- The Fiscal Office will establish a "record only" allotment account in the purchase order system that will allow the Sheriff Division to prepare "record only type" purchase orders.
- A "record only" purchase order will be prepared for orders that are placed to Fisher Safety or any vendor being paid through Department Of Defense, Homeland Security Grant.
- As goods/or equipment are received the Sheriff Division Homeland Security Grant Coordinator will clear the orders received with what was ordered on the purchase order.
- For all equipment purchases a copy of the purchase order and the invoice will accompany an inventory form 17A and be sent to the Fiscal Office for recordation into the inventory system.
- The Homeland Security Grant Coordinator will follow-up on all purchase order outstanding items.

06-5 Reporting

The Sheriff Division has assigned a staff to act as the grant coordinator and provide for the timely quarterly reports immediately.

06-6 Subrecipient Monitoring

The grant coordinator will perform the subrecipient monitoring effective immediately and document the monitoring activities.

Should you have any questions on this matter, please call Clifford N. Asato, PSD Fiscal Officer, at 587-2520.

Very Truly Yours,

Iwalani D. White

Iwalani D. White
Interim Director