

Department of Public Safety, State of Hawaii

Financial Statements

Fiscal Year Ended June 30, 2009

Submitted by

**THE AUDITOR
STATE OF HAWAII**

Department of Public Safety, State of Hawaii

Financial Statements
Fiscal Year Ended June 30, 2009

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**THE AUDITOR
STATE OF HAWAII**



March 29, 2010

Ms. Marion Higa
State Auditor
Office of the Auditor
State of Hawaii

Dear Ms. Higa:

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, 2009. 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, 2009, 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, 2009.

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, 2009, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and compliance.
- Part III – Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV – The schedule of findings and questioned costs.
- Part V – The summary schedule of prior audit findings.
- Part VI – Response of the affected agency.

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

Sincerely,



Wilcox Choy
Partner

TABLE OF CONTENTS

	Page
PART I FINANCIAL SECTION	
Independent Auditor's Report	6 - 7
Management's Discussion and Analysis	8 - 16
Basic Financial Statements:	
Government-Wide Financial Statements:	
Statement of Net Assets	17
Statement of Activities	18
Fund Financial Statements:	
Balance Sheet - Governmental Funds	19
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	20
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds	21
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities	22
Statement of Revenues and Expenditures - Budget and Actual - General Fund	23
Statement of Net Assets - Proprietary Fund	24
Statement of Revenues, Expenses, and Changes in Net Assets - Proprietary Fund	25
Statement of Cash Flows - Proprietary Fund	26
Statement of Assets and Liabilities - Agency Fund	27
Notes to the Basic Financial Statements	28 - 46
Supplementary Information --	
Schedule of Expenditures of Federal Awards	48 - 49

TABLE OF CONTENTS (continued)

	Page	
PART II	INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	51 – 52
PART III	INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	54 – 56
PART IV	SCHEDULE OF FINDINGS AND QUESTIONED COSTS	58 – 66
PART V	SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS	68 - 70
PART VI	RESPONSE OF THE AFFECTED AGENCY	72 - 73

PART I
FINANCIAL SECTION



Independent Auditor's Report

To Auditor
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, 2009, 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 opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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, 2009, 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, 2009, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2010, 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 the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 16 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming 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 29, 2010

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis
Fiscal Year Ended June 30, 2009 (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 2009 (FY 2009). 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, 2009 by approximately \$83.8 million. Net assets invested in capital assets accounted for \$75.8 million of this amount.
- During the FY 2009, the PSD incurred approximately \$294.3 million in expenses of which approximately \$268.0 million was funded by general fund revenues.
- Approximately \$243.7 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.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

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

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

Business-type activities – reflect the business-type operations of the Correctional Industries, which charges fees for goods and services that 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.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (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, 2009 and June 30, 2008.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

CONDENSED STATEMENT OF NET ASSETS						
	Governmental Activities		Business-Type Activities		TOTAL	
	2009	2008	2009	2008	2009	2008
Current and other assets	\$ 48,221,294	\$ 49,857,458	\$ 2,714,691	\$ 2,220,329	\$ 50,935,985	\$ 52,077,787
Capital assets	74,121,613	79,441,359	1,653,655	1,695,728	75,775,268	81,137,087
Total assets	\$ 122,342,907	\$ 129,298,817	\$ 4,368,346	\$ 3,916,057	\$ 126,711,253	\$ 133,214,874
Current liabilities	\$ 26,378,436	\$ 26,147,490	\$ 1,057,793	\$ 822,617	\$ 27,436,229	\$ 26,970,107
Other liabilities	14,835,991	14,600,509	561,476	354,780	15,397,467	14,955,289
Total liabilities	\$ 41,214,427	\$ 40,747,999	\$ 1,619,269	\$ 1,177,397	\$ 42,833,696	\$ 41,925,396
Net Assets						
Invested in capital assets, net of related debt	\$ 74,121,613	\$ 79,441,359	\$ 1,653,655	\$ 1,695,728	\$ 75,775,268	\$ 81,137,087
Restricted						
Unrestricted	7,006,867	9,109,459	1,095,422	1,042,932	8,102,289	10,152,391
TOTAL NET ASSETS	\$ 81,128,480	\$ 88,550,818	\$ 2,749,077	\$ 2,738,660	\$ 83,877,557	\$ 91,289,478

The PSD's combined total net assets decreased by 8.1% from \$91.3 million as of June 30, 2008 to \$83.9 million as of June 30, 2009. The decrease in Net Assets is attributed to:

- Decrease in capital assets of approximately \$5.3 million.

Governmental net assets accounted for 97% of total net assets that consisted primarily of buildings and improvements at the correctional facilities.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

CONDENSED CHANGES IN NET ASSETS						
	Governmental Activities		Business-Type Activities		TOTAL	
	2009	2008	2009	2008	2009	2008
REVENUES						
Program revenues	\$ 12,977,447	\$ 9,054,895	\$ 5,995,665	\$ 6,623,006	\$ 18,973,112	\$ 15,677,901
General revenues	283,522,646	271,690,272	-	-	283,522,646	271,690,272
Total Revenues	\$296,500,093	\$280,745,167	\$ 5,995,665	\$ 6,623,006	\$302,495,758	\$287,368,173
EXPENSES						
Confinement	\$243,729,774	\$234,107,514	\$ -	\$ -	\$243,729,774	\$234,107,514
Law Enforcement	26,069,623	24,726,205	-	-	26,069,623	24,726,205
Parole	4,350,150	4,261,908	-	-	4,350,150	4,261,908
Crime Victim Comp.	1,874,991	1,538,491	-	-	1,874,991	1,538,491
General Support	12,354,911	8,105,335	-	-	12,354,911	8,105,335
Correctional Industries	-	-	5,912,351	6,363,785	5,912,351	6,363,785
Total Expenses	\$288,379,449	\$272,739,453	\$ 5,912,351	\$ 6,363,785	\$294,291,800	\$279,103,238
Excess before transfers, lapsed-appropriations and contributions	\$ 8,120,644	\$ 8,005,714	\$ 83,314	\$ 259,221	\$ 8,203,958	\$ 8,264,935
Other expense	(102,880)	-	(72,897)	-	(175,777)	-
Transfer In	127,345	52,420	-	-	127,345	52,420
Lapsed Appropriations	(15,567,447)	(3,931,932)	-	-	(15,567,447)	(3,931,932)
Change in Net Assets	\$ (7,422,338)	\$ 4,126,202	\$ 10,417	\$ 259,221	\$ (7,411,921)	\$ 4,385,423

Total net assets decreased by approximately \$7.4 million during the FY 2009 as shown above.

Total revenues for PSD increased by \$15.1 million. The revenue increase is attributed primarily to:

- Collective bargaining augmentation of \$10.6M
- Additional appropriations authorized by the Legislature for Food Services and Health Care costs (\$3.5M)

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

Expenses for the fiscal years ended June 30, 2009 and June 30, 2008 totaled approximately \$294.3 million and \$279.1 million, respectively. The \$15.2 million increase stems primarily from increases in collective bargaining costs, inmate health care costs, and mainland prison expenses.

Governmental Activities

Governmental activities accounted for approximately 98% of total expenses in each fiscal year, with program expenses for the confinement of inmates accounting for approximately 85% of total expenses for governmental activities. Approximately \$58.2 million and \$58 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, 2009 and June 30, 2008, respectively.

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 \$44.0 million or 90% of total governmental fund assets as of June 30, 2009 and \$45.6 million or 91% of total governmental fund assets for the fiscal year ended June 30, 2008. The general fund revenues consisted primarily of State-allotted appropriations.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

Proprietary Fund

The Correctional Industries Revolving Fund is the PSD's only Proprietary Fund. As of June 30, 2009 the Correctional Industries reported approximately \$2.8 million in total net assets of which approximately \$1.7 million was accounted for by investment in capital assets, net of related debt.

The Correctional Industries Revolving Fund's sales decreased by approximately \$628,000, (and decreased expenses by approximately \$451,000) resulting in a gross profit of approximately \$10,000 for FY 2009. Decline in sales for FY 2009 was a direct reflection of the downturn in economic conditions. The Correctional Industries Revolving Funds sales generating areas such as print, saw a considerable decline in work orders, together with the end of department of taxation contract. Installation saw decline in departmental renovation, purchase and assembling of modular systems. Furthermore, Department of Education contracts for refurbishing furniture also came to an end. The Correctional Industries Revolving Fund will continue to see decline in sales as long as state budget tightens, impacting departmental spending which are large contributors towards the Correctional Industries income.

BUDGETARY ANALYSIS

The FY 2009 Budget Execution Policies were formulated to be mindful of the developments that currently affect Hawaii and impact the State's financial condition. The budget executive policies are, by necessity, cautionary and restrictive to ensure that the State lives within its means. The goal is to achieve fiscal prudence and balance, not only in the immediate time frame but also for the upcoming fiscal biennium:

An executive restriction of 4% on FY 09 general fund appropriations was imposed for all departments. The restriction applies to discretionary operating expenses only. While every effort is made to trim operating expenses, departments were encouraged to accelerate the implementation of capital improvement programs (CIP). The energy and expenditures generated by moving the CIP projects quickly and efficiently through the system will serve the infrastructure needs and, at the same time, provide a good stimulus to Hawaii's economy.

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

GENERAL FUND BUDGETARY COMPARISON

The final total budget of approximately \$239 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 2009, the approximately \$13.1 million in variance (favorable) between the final budget and actual expenditures on a budgetary basis is attributed to a combination of the following factors:

- The PSD experienced personnel recruitment and retention difficulties in certain areas.
- There were delays in planned expenditures for programs that received additional appropriation from the Legislature.

CAPITAL ASSETS, NET OF DEPRECIATION

	Governmental Activities		Business-Type Activities		TOTAL	
	2009	2008	2009	2008	2009	2008
Land	\$ 107,570	\$ 107,570	\$ -	\$ -	\$ 107,570	\$ 107,570
Construction in Progress	628,386	-	-	-	628,386	-
Buildings and Improvements	62,922,336	74,334,437	1,482,925	1,547,400	64,405,261	75,881,837
Furniture, equipment, vehicles, and land improvements	10,463,321	4,999,352	170,730	148,328	10,634,051	5,147,680
TOTAL	\$ 74,121,613	\$ 79,441,359	\$ 1,653,655	\$ 1,695,728	\$ 75,775,268	\$ 81,137,087

Department of Public Safety, State of Hawaii

Management's Discussion and Analysis (continued)
Fiscal Year Ended June 30, 2009 (Unaudited)

CAPITAL ASSETS

As of June 30, 2009, the PSD had \$76 million invested in capital assets. Capital assets for governmental activities accounted for 98% of total capital assets.

Between June 30, 2008 and June 30, 2009, capital assets decreased by \$5,361,819 which represented the depreciation expense that exceeded additions to depreciable assets.

ECONOMIC FACTORS

The Council of Revenues reduced its forecast of general fund tax revenues from 3.9% to 3.3% for FY 2008 and from 4.1% to 2.0% for FY 2009. Projections were also lowered for the years between 2010 and 2014. Compared to earlier estimates and including changes in non-tax revenues, these latest revisions translate to a reduction of \$(137.5) million for the current FB 2007-09 and \$(354.2) million for the next biennium.

The restrictive policies for FY 2009 are the first step in managing the changes brought about by a new fiscal environment. This cautionary stance plus other fiscal measures are necessary to safeguard the State's General Fund.

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, 2009

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
<u>Assets</u>			
Current Assets:			
Cash and cash equivalents	\$ 46,004,498	\$ 1,662,723	\$ 47,667,221
Receivables, net	104,165	362,476	466,641
Due from State of Hawaii	2,417,969	-	2,417,969
Internal balances	(370,265)	370,265	-
Due from other funds	64,927	-	64,927
Inventories	-	319,227	319,227
Total current assets	<u>48,221,294</u>	<u>2,714,691</u>	<u>50,935,985</u>
Capital Assets:			
Non-depreciable	735,956	-	735,956
Depreciable, net	<u>73,385,657</u>	<u>1,653,655</u>	<u>75,039,312</u>
Total capital assets	<u>74,121,613</u>	<u>1,653,655</u>	<u>75,775,268</u>
Total assets	<u>122,342,907</u>	<u>4,368,346</u>	<u>126,711,253</u>
<u>Liabilities</u>			
Current Liabilities:			
Accrued wages and employee benefits payable	8,572,189	81,133	8,653,322
Vouchers payable	9,920,337	243,041	10,163,378
Deferred revenues	424,610	650,915	1,075,525
Accrued compensated absences	6,795,971	77,173	6,873,144
Workers' compensation reserve	626,672	-	626,672
Due to other funds	<u>38,657</u>	<u>5,531</u>	<u>44,188</u>
Total current liabilities	26,378,436	1,057,793	27,436,229
Post-retirement Health Care Benefits Payable	-	428,585	428,585
Accrued Compensated Absences	11,702,631	132,891	11,835,522
Workers' Compensation Reserve	<u>3,133,360</u>	<u>-</u>	<u>3,133,360</u>
Total liabilities	<u>41,214,427</u>	<u>1,619,269</u>	<u>42,833,696</u>
<u>Net Assets</u>			
Invested in Capital Assets, net of related debt	74,121,613	1,653,655	75,775,268
Unrestricted	<u>7,006,867</u>	<u>1,095,422</u>	<u>8,102,289</u>
Total net assets	<u>\$ 81,128,480</u>	<u>\$ 2,749,077</u>	<u>\$ 83,877,557</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Statement of Activities

For the Fiscal Year Ended June 30, 2009

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
	Expenses	Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Confinement	\$ 243,729,774	\$ 458,713	\$ 3,604,213	\$ -	\$ (239,666,848)	\$ -	\$ (239,666,848)
Law enforcement	26,069,623	5,681,916	772,803	677,001	(18,937,903)	-	(18,937,903)
Parole	4,350,150	-	-	-	(4,350,150)	-	(4,350,150)
Crime victim compensation	1,874,991	1,188,191	594,610	-	(92,190)	-	(92,190)
General support	12,354,911	-	-	-	(12,354,911)	-	(12,354,911)
Total governmental activities	<u>288,379,449</u>	<u>7,328,820</u>	<u>4,971,626</u>	<u>677,001</u>	<u>(275,402,002)</u>	<u>-</u>	<u>(275,402,002)</u>
Business-Type Activities --							
Correctional Industries	5,912,351	5,995,665	-	-	-	83,314	83,314
Total business-type activities	<u>5,912,351</u>	<u>5,995,665</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>83,314</u>	<u>83,314</u>
Total	<u>\$ 294,291,800</u>	<u>\$ 13,324,485</u>	<u>\$ 4,971,626</u>	<u>\$ 677,001</u>	<u>(275,402,002)</u>	<u>83,314</u>	<u>(275,318,688)</u>
General revenues:							
State appropriations					232,368,131	-	232,368,131
State-provided payroll fringe benefits					51,104,666	-	51,104,666
Unrestricted investment earnings					908	-	908
Miscellaneous					48,941	-	48,941
Other expense					(102,880)	(72,897)	(175,777)
Lapsed appropriations					(15,567,447)	-	(15,567,447)
Transfers, net					127,345	-	127,345
Total general revenues and transfers					<u>267,979,664</u>	<u>(72,897)</u>	<u>267,906,767</u>
Changes in net assets					(7,422,338)	10,417	(7,411,921)
Net assets at July 1, 2008					88,550,818	2,738,660	91,289,478
Net assets at June 30, 2009					<u>\$ 81,128,480</u>	<u>\$ 2,749,077</u>	<u>\$ 83,877,557</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Governmental Funds
Balance Sheet
June 30, 2009

	General	Other Governmental Funds	Total
<u>Assets</u>			
Cash and Cash Equivalents	\$ 41,471,438	\$ 4,533,060	\$ 46,004,498
Receivables, net	104,165	-	104,165
Due from State of Hawaii	2,417,969	-	2,417,969
Internal Balances	-	1,226	1,226
Due from Other Funds	27,455	-	27,455
Due from Agency Fund	27,281	(1,011)	26,270
Total assets	<u>\$ 44,048,308</u>	<u>\$ 4,533,275</u>	<u>\$ 48,581,583</u>
<u>Liabilities and Fund Balances</u>			
Accrued Wages and Employee Benefits Payable	\$ 8,516,280	\$ 55,909	\$ 8,572,189
Vouchers Payable	9,608,434	311,903	9,920,337
Due to Other Funds	-	27,455	27,455
Deferred Revenues	-	424,610	424,610
Internal Balances	371,491	-	371,491
Total liabilities	<u>18,496,205</u>	<u>819,877</u>	<u>19,316,082</u>
Fund Balances:			
Reserved for:			
Encumbrances	31,457,496	2,029,633	33,487,129
Receivables	104,165	-	104,165
Unreserved (deficit)	<u>(6,009,558)</u>	<u>1,683,765</u>	<u>(4,325,793)</u>
Total fund balances	<u>25,552,103</u>	<u>3,713,398</u>	<u>29,265,501</u>
Total liabilities and fund balances	<u>\$ 44,048,308</u>	<u>\$ 4,533,275</u>	<u>\$ 48,581,583</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2009

Total Fund Balances - Governmental Funds		\$ 29,265,501
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	198,541,681	
Less accumulated depreciation	<u>(124,420,068)</u>	
		74,121,613
Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds		(18,498,602)
Workers' compensation liability is not due in the current period and therefore is not reported in the governmental funds		<u>(3,760,032)</u>
Net Assets of Governmental Activities		<u>\$ 81,128,480</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances

For the Fiscal Year Ended June 30, 2009

	<u>General</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Revenues:			
State allotted appropriations	\$ 232,368,131	\$ -	\$ 232,368,131
State-provided payroll fringe benefits	51,104,666	-	51,104,666
Intergovernmental revenues	-	5,648,627	5,648,627
Charges for services	5,187,197	2,141,623	7,328,820
Unrestricted investment earnings	908	-	908
Miscellaneous	48,942	-	48,942
Total revenues	<u>288,709,844</u>	<u>7,790,250</u>	<u>296,500,094</u>
Expenditures:			
Confinement	232,985,362	4,149,413	237,134,775
Law enforcement	24,411,336	1,795,339	26,206,675
Parole	4,357,796	-	4,357,796
Crime victim compensation	-	1,907,050	1,907,050
General support	12,979,066	-	12,979,066
Total expenditures	<u>274,733,560</u>	<u>7,851,802</u>	<u>282,585,362</u>
Excess (deficit) of revenues over expenditures	<u>13,976,284</u>	<u>(61,552)</u>	<u>13,914,732</u>
Nonoperating Expense--			
Other expense	<u>-</u>	<u>(102,880)</u>	<u>(102,880)</u>
Other Changes in Fund Balances--			
Lapsed appropriations	<u>(15,567,447)</u>	<u>-</u>	<u>(15,567,447)</u>
Net change in fund balances	(1,591,163)	(164,432)	(1,755,595)
Fund Balance, July 1, 2008	<u>27,143,266</u>	<u>3,877,830</u>	<u>31,021,096</u>
Fund Balance, June 30, 2009	<u>\$ 25,552,103</u>	<u>\$ 3,713,398</u>	<u>\$ 29,265,501</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2009

Net Change in Fund Balances - Total Governmental Funds		\$ (1,755,595)
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	2,292,913	
Net transfer of capital assets	127,345	
Less current fiscal year depreciation	<u>(7,740,004)</u>	
		(5,319,746)
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.		(729,810)
Change in long-term workers' compensation reported in the statement of activities does require the use of current financial resources and therefore is reported as an expenditure in governmental funds.		<u>382,813</u>
Change in Net Assets - Governmental Activities		<u><u>\$ (7,422,338)</u></u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

General Fund

Statement of Revenues and Expenditures - Budget and Actual

For the Fiscal Year Ended June 30, 2009

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Over (Under)</u>
Revenues:				
State allotments	\$ 223,932,914	\$ 233,098,063	\$ 232,368,131	\$ (729,932)
Charges for services	5,277,821	5,574,815	5,187,197	(387,618)
Miscellaneous	75,065	75,065	36,175	(38,890)
	<u>229,285,800</u>	<u>238,747,943</u>	<u>237,591,503</u>	<u>(1,156,440)</u>
Expenditures:				
Confinement	195,683,763	203,718,742	194,449,430	(9,269,312)
Law enforcement	18,999,713	20,197,461	18,590,496	(1,606,965)
Parole	3,772,470	3,970,408	2,804,778	(1,165,630)
General support	10,829,854	10,861,332	8,602,253	(2,259,079)
	<u>229,285,800</u>	<u>238,747,943</u>	<u>224,446,957</u>	<u>(14,300,986)</u>
Excess of revenues over expenditures and other uses	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,144,546</u>	<u>\$ 13,144,546</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund

Statement of Net Assets

For the Fiscal Year Ended June 30, 2009

<u>Assets</u>	
Current Assets:	
Cash	\$ 1,662,723
Receivables, net of allowance for doubtful accounts	362,476
Internal balances	370,265
Inventories	319,227
Total current assets	<u>2,714,691</u>
Capital Assets, Net of Depreciation	<u>1,653,655</u>
Total assets	<u>4,368,346</u>

<u>Liabilities</u>	
Current Liabilities:	
Accrued wages and employee benefits	81,133
Vouchers payable	243,041
Deferred revenues	650,915
Accrued compensated absences	77,173
Due to agency fund	5,531
Total current liabilities	<u>1,057,793</u>
Noncurrent Liabilities:	
Post-retirement health care benefits payable	428,585
Accrued compensated absences	132,891
Total liabilities	<u>1,619,269</u>

<u>Net Assets</u>	
Invested in Capital Assets, Net of Related Debt	1,653,655
Unrestricted	<u>1,095,422</u>
Total net assets	<u>\$ 2,749,077</u>

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 Fiscal Year Ended June 30, 2009

Operating Revenues--	
Charges for Sales and Services	\$ 5,995,665
Total operating revenues	<u>5,995,665</u>
Operating Expenses:	
Cost of sales and services	5,801,539
Depreciation and amortization	<u>110,812</u>
Total operating expenses	<u>5,912,351</u>
Operating income	83,314
Non-Operating Income:	
Other expense	(70,030)
Interest expense	<u>(2,867)</u>
Total non-operating income	<u>(72,897)</u>
Change in net assets	10,417
Net Assets, July 1, 2008	<u>2,738,660</u>
Net Assets, June 30, 2009	<u><u>\$ 2,749,077</u></u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Proprietary Fund

Statement of Cash Flows

For the Fiscal Year Ended June 30, 2009

Cash Flows from Operating Activities:	
Receipts from customers	\$ 4,142,681
Receipts from interfund services provided	2,141,852
Payments to suppliers	(4,533,743)
Payments to employees	(956,857)
	<u>793,933</u>
Net cash provided by operating activities	
Cash Flows from Investing Activity:	
Change in valuation of cash held in state treasury	(86,108)
Interest received	16,078
	<u>(70,030)</u>
Net cash used for investment activities	
Cash Flows from Noncapital Financing Activity--	
Interest payments to vendors	(2,867)
Cash Flows from Capital and Related Financing Activity--	
Acquisition of capital assets	(68,739)
	652,297
Net increase in cash	
Cash at July 1, 2008	<u>1,010,426</u>
Cash at June 30, 2009	<u>\$ 1,662,723</u>
Reconciliation of Operating Income to Net Cash Flows provided by Operating Activities:	
Operating income	\$ 83,314
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	110,812
Change in assets and liabilities:	
Receivables	(56,114)
Inventories	214,049
Vouchers payable	(92,493)
Post-retirement health care benefits payable	209,134
Accrued wages and compensated absences	(8,440)
Deferred revenues	344,982
Due to other funds	(11,311)
	<u>(11,311)</u>
Net cash provided by operating activities	<u>\$ 793,933</u>

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Agency Fund

Statement of Assets and Liabilities

June 30, 2009

	<u>Assets</u>	<u>Agency Fund</u>
Cash		\$ 2,429,053
	<u>Liabilities</u>	
Due to Individuals		\$ 1,464,703
Due to Others		964,350
Total liabilities		\$ 2,429,053

See accompanying notes to the basic financial statements.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

1. Financial Reporting Entity

Effective July 1, 1990, Act 211, Session Laws of Hawaii (SLH) 1989, established the Department of Public Safety of the State of Hawaii (PSD). This Act transferred to the PSD the administration of the state correctional facilities and related services formerly administered by the State Department of Corrections. This Act also transferred to the PSD on July 1, 1990, all functions and powers to administer the Sheriffs' Office, formerly administered by the State Judiciary, and the Narcotics Enforcement Division, formerly administered by the State Department of the Attorney General.

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

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

a. Departmental Administration

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

b. Law Enforcement

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

c. Corrections

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

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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 stores' operations are reported in the general fund.

iii. Intake Service Centers Division

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

iv. Corrections Program Services Division

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

v. Health Care Division

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

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

1. Financial Reporting Entity (continued)

c. Corrections (continued)

vi. Correctional Industries Division

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

d. Crime Victim Compensation Commission (administratively attached to the PSD)

This commission assists victims of criminal acts by providing compensation to victims or survivors of deceased victims of certain crimes. Its operations are reported in the special revenue funds.

e. Hawaii Paroling Authority (administratively attached to the PSD)

This authority is a quasi-judicial body which establishes minimum terms of imprisonment, considers requests for parole and provides supervision for those granted parole. Its operations are reported in the general fund.

2. Significant Accounting Policies

a. Basis of Presentation

The government-wide financial statements report all assets, liabilities, and activities of the PSD as a whole. The fiduciary fund is excluded from the government-wide financial statements because the PSD cannot use those assets to finance its operations.

The financial transactions of the PSD are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, net assets, revenues, and expenditures.

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

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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.

c. Proprietary Fund Type

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

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

d. Fiduciary Fund Type

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

e. Government-Wide Financial Statements

The economic resources measurement focus and accrual basis of accounting is used for reporting the government-wide financial statements. With this measurement focus, all assets and liabilities associated with the operations of the PSD are included in the statement of net assets. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded when they are incurred.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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, except for long term compensated absences and workers compensation reserve, which are recognized as expenditures to the extent they have matured. General capital asset acquisitions are reported as expenditures in governmental funds.

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. Significant items subject to such estimates and assumptions include the liabilities for workers' compensation expense and the valuation allowance for receivables. Actual results could differ from those estimates.

i. Cash and Cash Equivalents

Cash and cash equivalents, for the purpose of the statement of cash flows, includes all cash and investments with original maturities of three months or less.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

2. Significant Accounting Policies (continued)

j. Receivables

Receivables in the general fund consist primarily of amounts due from individuals for whom salaries were overpaid by the PSD. Receivables in the enterprise fund consist primarily of amounts due from other state agencies for services provided to those agencies for a fee. The amounts reported as net receivables were established based on management's estimate of amounts collectible.

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

k. Inventories

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

l. Capital Assets

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

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

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements. Capital assets used in proprietary fund operations are accounted for on the same basis as in the government-wide financial statements.

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

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

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

2. Significant Accounting Policies (continued)

i. 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	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. Accrued Compensated Absences

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 restricted resources before unrestricted resources for expenses incurred.

p. Appropriations

Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

2. Significant Accounting Policies (continued)

q. Program Revenues

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

Charges for services - Charges for services include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided. Revenues in this category include fees charged for specific services, such as controlled substance registration fees, security service fees and state law and court imposed crime victim compensation fees. Payments from other governments that are exchange transactions are also reported as charges for services.

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

r. Intrafund and Interfund Transactions

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

s. Risk Management

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

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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 SLH. 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, 2009:

Excess of revenues over expenditures and other uses - actual on budgetary basis	\$ 13,144,546
Reserved for encumbrances at fiscal year-end	31,294,250
Reserved for receivables	104,165
Net change in unreserved liabilities	(2,261,760)
Expenditures for liquidation of prior fiscal year encumbrances	(28,291,245)
Net adjustment for commissary revenue accrual	<u>(13,672)</u>
Excess of revenues over expenditures and other uses - GAAP basis	<u>\$ 13,976,284</u>

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 (HRS) authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State,

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

4. Cash and Cash Equivalents (continued)

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, 2009, the carrying amount of total bank deposits including time certificates of deposit was approximately \$1,321,000 and the corresponding bank balances were approximately \$1,685,000. The PSD and the State deposits were exposed to custodial credit risk.

During 2009, the PSD reported a valuation adjustment of approximately \$210,000 for its State Treasury Investment Pool balances. The valuation adjustment relates primarily to the State of Hawaii auction rate securities.

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, 2009:

	General Fund	Enterprise Fund
Salary overpayments	\$ 163,965	\$ -
Accounts receivable	-	461,075
	163,965	461,075
Less: allowance for doubtful accounts	(59,800)	(98,599)
Receivables, net	\$ 104,165	\$ 362,476

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

6. Capital Assets

	Balance <u>June 30, 2008</u>	Adjustments	Additions	Reductions/ Transfers	Balance <u>June 30, 2009</u>
Governmental activities:					
Nondepreciable assets:					
Land	\$ 107,570	\$ -	\$ -	\$ -	\$ 107,570
Construction in progress	-	501,073	127,313	-	628,386
Total nondepreciable assets	<u>107,570</u>	<u>501,073</u>	<u>127,313</u>	<u>-</u>	<u>735,956</u>
Depreciable assets:					
Building and improvements	181,829,771	(6,322,092)	198,040	-	175,705,719
Furniture and equipment	7,183,556	(136,700)	2,308,048	29,231	9,384,135
Vehicles	4,874,902	-	480,388	(243,352)	5,111,938
Land improvements	<u>2,467,090</u>	<u>5,136,843</u>	<u>-</u>	<u>-</u>	<u>7,603,933</u>
Total depreciable assets	<u>196,355,319</u>	<u>(1,321,949)</u>	<u>2,986,476</u>	<u>(214,121)</u>	<u>197,805,725</u>
Less accumulated depreciation:					
Building and improvements	107,495,334	(283,329)	5,571,378	-	112,783,383
Furniture and equipment	4,641,345	338,355	740,769	(31,373)	5,689,096
Vehicles	4,150,475	-	352,218	(310,093)	4,192,600
Land improvements	<u>734,376</u>	<u>513,684</u>	<u>506,929</u>	<u>-</u>	<u>1,754,989</u>
Total accumulated depreciation	<u>117,021,530</u>	<u>568,710</u>	<u>7,171,294</u>	<u>(341,466)</u>	<u>124,420,068</u>
Governmental activities - depreciable assets, net	<u>79,333,789</u>	<u>(1,890,659)</u>	<u>(4,184,818)</u>	<u>127,345</u>	<u>73,385,657</u>
Governmental activities - capital assets, net	<u>\$ 79,441,359</u>	<u>\$ (1,389,586)</u>	<u>\$ (4,057,505)</u>	<u>\$ 127,345</u>	<u>\$ 74,121,613</u>

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

6. Capital Assets (continued)

	Balance <u>June 30, 2008</u>	Additions	Reductions	Balance <u>June 30, 2009</u>
Business-type activities:				
Building and improvements	\$ 2,579,000	\$ -	\$ -	\$ 2,579,000
Equipment	868,608	68,739	(589)	936,758
Equipment under capital lease	<u>675,585</u>	<u>-</u>	<u>-</u>	<u>675,585</u>
Total capital assets	<u>4,123,193</u>	<u>68,739</u>	<u>(589)</u>	<u>4,191,343</u>
Less accumulated depreciation:				
Building and improvements	1,031,600	64,475	-	1,096,075
Equipment	720,280	46,337	(589)	766,028
Equipment under capital lease	<u>675,585</u>	<u>-</u>	<u>-</u>	<u>675,585</u>
Total accumulated depreciation	<u>2,427,465</u>	<u>110,812</u>	<u>(589)</u>	<u>2,537,688</u>
Business-type activities - capital assets, net	<u>\$ 1,695,728</u>	<u>\$ (42,073)</u>	<u>\$ -</u>	<u>\$ 1,653,655</u>

Depreciation expense was charged to functions as follows:

Governmental activities:	
Confinement	\$ 6,556,531
Law enforcement	752,839
Crime victim compensation	6,231
General support	<u>424,403</u>
Total governmental activities depreciation	<u>\$ 7,740,004</u>
Business-type activities --	
Correctional Industries	<u>\$ 110,812</u>

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

7. Long-Term Liabilities

The long-term liability for governmental activities includes accrued compensated absences and the workers' compensation reserve. Long-term liability activity during the fiscal year ended June 30, 2009, was as follows:

	Balance June 30, 2008	Additions	Reductions	Balance June 30, 2009	Amount Due Within One Year
Governmental Activities:					
Accrued compensated absences	\$ 17,768,792	\$ 11,065,490	\$(10,335,680)	\$ 18,498,602	\$ 6,795,971
Workers' compensation reserve	4,142,845	282,437	(665,250)	3,760,032	626,672
Total governmental activities long- term liabilities	<u>\$ 21,911,637</u>	<u>\$ 11,347,927</u>	<u>\$(11,000,930)</u>	<u>\$ 22,258,634</u>	<u>\$ 7,422,643</u>

Long-term liability activity for business-type activities during the fiscal year ended June 30, 2009, was as follows:

	Balance June 30, 2008	Additions	Reductions	Balance June 30, 2009	Amount Due Within One Year
Business-Type Activities:					
Accrued compensated absences	\$ 215,698	\$ 113,789	\$ (119,423)	\$ 210,064	\$ 77,173
Post-retirement health care benefits payable	219,451	347,631	(138,497)	428,585	-
Total business type activities long- term liabilities	<u>\$ 435,149</u>	<u>\$ 461,420</u>	<u>\$ (257,920)</u>	<u>\$ 638,649</u>	<u>\$ 77,173</u>

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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 \$51,104,666 for the fiscal year ended June 30, 2009, have been reported as revenues and expenditures in the general fund of the PSD. Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the PSD's special revenue funds.

9. Fund Balance Deficits

The general fund had a deficit in the unreserved fund balance at June 30, 2009 of \$6,009,558. 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

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, 2009, were approximately as follows:

Fiscal Year Ending June 30,	
2010	\$ 240,000
2011	177,000
2012	117,000
2013	63,000
2014	16,000
	<u>16,000</u>
	<u>\$ 613,000</u>

Total rent expense for the fiscal year ended June 30, 2009, was approximately \$305,000.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

11. Retirement Benefits

a. Employees' Retirement System

All eligible employees of the State and counties are required by HRS Chapter 88, 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 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 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new 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 became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are 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. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the new hybrid plan.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

11. Retirement Benefits (continued)

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, 2009, 2008 and 2007 were approximately \$888,000, \$736,000, and \$686,000 respectively. The contribution rate for the fiscal year ended June 30, 2009 was 15%. For 2008 and 2007, the contribution rate was 13.75%.

c. Post-Retirement Health Care and Life Insurance Benefits

The PSD provides certain other postemployment benefits (OPEB) other than pensions to all qualified employees. Pursuant to Chapter 87A of the HRS, the PSD contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF). The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees and their dependents. The EUTF currently provides medical, dental, vision, and life insurance benefits. The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the EUTF at 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

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.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

11. Retirement Benefits (continued)

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

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.

Annual OPEB Cost and Net OPEB Obligation

It is the State's policy that measurement of the actuarial valuation and the annual required contribution (ARC) are made for the state as a whole and are not separately computed for the individual state departments and agencies. The State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution (ARC), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR) or in stand alone departmental financial statements. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

The following table shows the components of the annual OPEB cost that have been allocated to Correctional Industries by the State.

Balance at June 30, 2008	\$ 219,451
Additions	347,631
Deletions	<u>(138,497)</u>
Balance at June 30, 2009	<u>\$ 428,585</u>

The State's CAFR includes the required footnote disclosure and required supplementary information on the State's post-retirement health care and life insurance benefit plans.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

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 \$1 million per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$100 million for windstorm, \$40 million for boiler and machinery and \$50 million for terrorism. The annual aggregate limit for property loss is \$40 million for flood and earthquake. The limit per occurrence of general liability losses is \$10 million. For certain general liability claims, the annual aggregate limit is \$10 million. The State also has an insurance policy to cover crime risk with a deductible of \$500,000 per occurrence and a \$10 million annual aggregate limit.

The State is self-insured for workers' compensation. Accordingly, the PSD is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims include the effects of specific incremental claim adjustment expenses, salvage and subrogation, and other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. The workers' compensation reserve amounted to \$3,760,032 at June 30, 2009.

Department of Public Safety, State of Hawaii

Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2009

13 Commitments and Contingencies

a. 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 are not convertible to pay upon termination of employment. As a result, no liability for sick pay is recorded in the accompanying financial statements. 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, 2009, amounted to approximately \$26,020,000.

b. Claims

The PSD estimates the amount of potential exposure with respect to claims, in accordance with SFAS 5. The PSD is party to pending proceedings subject to arbitration covering three general areas. There are currently four cases involving wrongful discharges, six cases involving suspensions, and six cases involving class grievances. It is not always possible to predict the outcome of arbitration, as it is subject to many uncertainties. Additionally, it is not always possible for management to make a meaningful estimate of the potential loss or range of loss associated with such arbitration.

SUPPLEMENTARY INFORMATION

Department of Public Safety, State of Hawaii

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2009

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹
U.S Department of Justice			
Prison Re-entry Initiative	16.202	07-RE-CX-0022	\$ 144,385
Sex Offender Treatment Program	16.203	2006-WP-BX-0019	90,588
Pass-through State Department of the Attorney General Crime Victim Compensation	16.576	05-VX-GX-0024 06-VC-GX-0033 07-VC-GX-0025	109,705 168,000 31,380 <hr/> 309,085
Electronic Prescription Monitoring Program	16.580	07-PM-VX-0002 07-PM-BX-0022	76,158 59,297 <hr/> 135,455
Residential Substance Abuse Treatment for State Prisoners (RSAT)	16.593	05-RT-1	42,672
State Forensic Drug Analysis	16.742	06-DN-02 07-CD-01	32,986 12,974 <hr/> 45,960
Statewide Victim Automated Information and Notification	16.575	05-VA-6 06-VA-6	94,785 132,990 <hr/> 227,775
Paperless Nursing Assessment	16.738	07-JD-08	3,028
Kauai COPS Grant	16.710	20060/862	53,168
Violent Offender Incarceration and Truth in Sentencing Incentive Grants	16.586	96-CV-VX-0015	3,394,273
Total U.S. Department of Justice			<hr/> \$ 4,446,389

Department of Public Safety, State of Hawaii

Schedule of Expenditures of Federal Awards

For the Fiscal Year Ended June 30, 2009

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures¹</u>
U.S. Department of Defense			
Pass-through Hawaii Army National Guard-- Master Cooperative Agreement	N/A	DAHA50-07-H1003	\$ 6,734
		DAHA50-08-H1003	15,129
Total U.S. Department of Defense			<u>21,863</u>
U.S. Department of Education			
Grants to States for Incarcerated Youth Offenders	84.331	Q331A070012	31,083
		Q331A080012	33,607
			<u>64,690</u>
Pass-through State Department of Education-- Title I Program for Neglected and Delinquent Children	84.013	S013A030011	26,807
		S013A070011A	37,253
			<u>64,060</u>
Pass-through University of Hawaii-- Vocational Education - Basic Grants to States	84.048	V048A40011	59,516
Total U.S. Department of Education			<u>188,266</u>
Department of Homeland Security			
Pass-through Department of Defense - State of Hawaii Homeland Security Grant	97.067	2005-GE-T5-0334	196,682
		2006-GE-T6-0033	42,641
		2007-GE-T7-0013	437,678
Total Department of Homeland Security			<u>677,001</u>
Total Federal Expenditures			<u>\$ 5,333,519</u>

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

PART II

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**



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

To Auditor
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, 2009, and have issued our report thereon dated March 29, 2010. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the PSD's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the PSD's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential, will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over financial reporting described in the accompanying Schedule of Findings and Questioned Costs as items 09-01 through 09-03 to be significant deficiencies.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 09-01 through 09-03 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the PSD's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and which are described in the accompanying Schedule of Findings and Questioned Costs as items 09-04 and 09-05.

The PSD's responses to the findings identified in our audit are described in the Response by Affected Agency section. We did not audit the PSD's response and, accordingly, we express no opinion on it.

In addition, we noted other matters involving compliance and other matters that we have reported to the management of PSD in a separate letter dated March 29, 2010.

This report is intended solely for the information and use of management, federal awarding agency 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 29, 2010

PART III

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

Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

To Auditor
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 year ended June 30, 2009. 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 09-04 in the accompanying Schedule of Findings and Questioned Costs, the PSD did not comply with requirements regarding equipment maintenance and reporting that are applicable to its Homeland Security Grant Program. Additionally, as described in item 09-05, the PSD did not comply with requirements regarding sub-recipient monitoring that are applicable to the Prisoner Reentry Initiative grant. Compliance with such requirements is necessary, in our opinion, for the PSD to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the PSD complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2009.

Internal Control Over Compliance

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

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, we consider item 09-04 to be a material weaknesses.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. The significant deficiency in internal control over compliance described above is also considered to be a material weakness.

The PSD's responses to the findings identified in our audit are described in the Response by Affected Agency section. We did not audit the PSD's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities 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 29, 2010

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, 2009

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditors’ report issued: Unqualified

Internal control over financial reporting:

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

Noncompliance material to financial statements noted? yes ___ no

Federal Awards

Internal control over major programs:

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

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:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
16.202	Prisoner Re-entry Initiative
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants
97.067	Homeland Security Grant

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

Auditee qualified as low-risk auditee? ___ yes no

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings

Finding No.: 09-01

Criteria: The PSD has a fiduciary duty to maintain current and accurate inmate trust account balances.

Condition, cause, and context: We noted the following conditions regarding the inmate trust accounts for the fiscal year ended June 30, 2009:

- 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, 2009.
- 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.

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.

This finding has 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 finding and even the establishment of a working group to address the many problems each facility encounters with reconciling the inmate trust accounts.

Effect: The total cash balance of inmate accounts exceeded the adjusted bank balances reported to the State of Hawaii by approximately \$25,000 as of June 30, 2009. 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.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings (continued)

Recommendation: 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:

- Restructure and centralize the process
- Standardize reconciliations
- Performance of reconciliations
- 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.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings (continued)

Performance of Reconciliations

The performance of accurate and timely reconciliations for the facilities is a key part of the process. The PSD 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.

Monitoring and 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 PSD should write-off or escheat, as applicable, the unreconciled difference. The PSD 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 PSD consider hiring an outside consultant for further assistance.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings (continued)

Finding No.: 09-02

Criteria: 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.

Condition, cause, and context: The following conditions were noted during our review of leave records for the fiscal year ended June 30, 2009:

- In ten instances, the excel spreadsheet which supports the accrued vacation balance on the financial statements did not contain the correct pay rates.
- In eight instances, the excel spreadsheet which supports the accrued vacation balance on the financial statements and represent data from the DPS-7 reports contained key-punching errors.
- In eleven instances, the DPS-7 report which is used to track an individual employee's accrued vacation, contained mathematical errors.
- The PSD has implemented a control to prevent the overpayment of salaries. The control is that the time and attendance clerk will utilize the sign-in and sign-out sheets as a record of the overtime worked by each employee rather than wait for the employee to turn in their respective timesheets. We noted that during 2009, Halawa Correctional Facility (HCF) and Womens Community Correctional Center (WCCC) have not implemented this control due to staff shortages.

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, 2009, the audit of four programs had been completed. There has been no training provided on the maintenance procedures to properly complete the leave records.

Effect: The salary overpayment receivable balance as of June 30, 2009, was approximately \$164,000 representing a 8% decrease from \$178,000 as of June 30, 2008. 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.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2009

Section II – Financial Statement Findings (continued)

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.

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.
- Require HCF and WCCC to comply with preventive control to continue minimizing risks related to untimely submitted timesheets.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings (continued)

Finding No.: 09-03

Criteria: Capital assets should be reported to the State in a timely manner. Capital assets that are in the possession, custody, control, or use by the PSD should be recorded on the State's Annual Inventory Report of Property.

Condition, cause, and context: During our review of the capital asset records of the PSD, we noted the following:

- Capital asset transactions were not reported to the State in a timely manner.
- Although reflected on the department's financials statements, since 1985, building and building improvement costs amounting to approximately \$24.7 million, net of depreciation, were not recorded on the State's Annual Inventory Report of Property as of June 30, 2009. Most of the costs were for the construction of capital assets for which the PSD was not the expending agency.

Effect: Approximately \$593,000 in capital assets actually acquired in prior fiscal years were recorded as current fiscal year additions. Accumulated depreciation per the state inventory is understated by approximately \$1.3 million due primarily to assets recorded with inaccurate acquisition years.

Recommendation:

The PSD should record all acquired capital assets in its possession, custody, control, or use, including completed capital projects paid by another state department, and remove disposed assets from the state property records, as appropriate in a timely manner. Each program should take inventory of capital assets and inform the fiscal office of any discrepancies.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section III – Federal Award Findings and Questioned Costs

Finding No.: 09-04

CFDA No.: 97.067

Program: Homeland Security Grant Program

Federal Agency: Department of Homeland Security

Award Period: July 1, 2008 – June 30, 2009

Criteria: 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.

Condition, cause, and context: To streamline the purchasing process, Civil Defense implemented a central electronic purchasing system called Fisher Safety (Fisher). Although Fisher is no longer used for new contracts, in the current year, there were transactions through Fisher for contracts initiated in prior years. 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 of approximately \$383,000 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.

Effect: 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.

Questioned Costs: None

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.

Department of Public Safety, State of Hawaii

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section III – Federal Award Findings and Questioned Costs (continued)

Finding No.: 09-05

CFDA No.: 16.202

Program: Prisoner Re-entry Initiative

Federal Agency: U.S. Department of Justice

Award Period: July 1, 2008 – June 30, 2009

Criteria: In accordance with the provisions of its grant agreement, the Company is required to monitor the expenditures of the sub-recipient of the federal grant monies.

Condition, cause, and context: On a quarterly basis, sub-recipients are required to submit documentation of expenditures for reimbursement to the PSD. Additionally, the PSD performs a yearly site-visit audit.

During our audit we noted that the PSD discovered potentially questionable costs during the yearly site-visit audit. Although the cost were ultimately determined to be allowable, we noted that the PSD should have detected the potentially unallowable costs earlier.

Effect: Failure to use Federal funding on allowable costs results in noncompliance and could jeopardize the program's funding.

Questioned Costs: None

Recommendation: We recommend that the PSD make sure all approvers clearly understand the expectations set forth in performing the control over monitoring a sub-recipients expenditures and provide training to the approvers to ensure he/she is capable of performing an adequate review.

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, 2008 dated March 13, 2009.

Recommendations

Status

Section II – Financial Statement Findings

08-01 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. 09-01.

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.

Recommendations

Status

08-02 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.
- To ensure that each program is completing the leave information accurately and correctly, training should be provided to all personnel with this responsibility.

Not accomplished. See 09-02.

08-03 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, as appropriate in a timely manner. Each program should take inventory of capital assets and inform the fiscal office of any discrepancies.

Not accomplished. See 09-03.

08-04 Financial Statement Oversight

The PSD should institute appropriate internal controls and provide adequate oversight of financial reporting, including a detailed review of the financial statements and notes.

Finding resolved.

Recommendations

Status

Section III – Federal Award Findings and Questioned Costs

08-05 Tracking Equipment Purchases

The PSD should establish controls that require the Sheriff Division to submit a reporting package that would allow the PSD fiscal office to record the equipment and purchases into the general ledger in a timely manner.

Not accomplished. See 09-04.

PART VI
RESPONSE OF THE AFFECTED AGENCY

LINDA LINGLE
GOVERNOR



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

CLAYTON A. FRANK
DIRECTOR

DAVID F. FESTERLING
Deputy Director
Administration

TOMMY JOHNSON
Deputy Director
Corrections

JAMES L. PROPOTNICK
Deputy Director
Law Enforcement

No. 2010-566

March 24, 2010

Mr. Wilcox W.K. Choy, Partner
KMH LLP
1003 Bishop Street
Suite 2400
Honolulu, HI 96814

SUBJECT: State Department of Public Safety's Response to the Financial Audit Findings for the Fiscal Year Ended June 30, 2009, Part IV – Schedule of Findings and Questioned Costs

Dear Mr. Choy:

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

09-01 Improve Controls Over Inmate Agency Fund Accounts

While PSD agrees with the auditor's recommendation, the action recommended by the auditors will require additional manpower and funding. The economic condition of the State currently restricts the efforts in addressing this problem.

09-02 Strengthen Controls Over Compensated Leaves of Absence

PSD Fiscal will continue to maintain collection and continue working with the Department of the Attorney General in the collections of overpayment accounts.

The Fiscal Office has implemented extending the individual payroll information to the programs. This will help in posting the most current employee wages on the DPS 7 form. Programs will also submit prior year DPS form 7 earlier to the Fiscal Office. This will allow the Fiscal Office to review the information and check for mathematical errors.

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09-03 Properly Account for Capital Assets

The Department of Accounting and General Services currently sends capital assets reconciliation documents each quarter to ensure that the assets have been properly recorded in the State inventory. This will eliminate the non-recording of capital assets.

09-04 Tracking Equipment Purchases

PSD's Sheriff Division has assigned a staff to coordinate and record all equipment purchases made using the Homeland Security Funds.

09-05 Monitor Expenditures of Sub-Recipient of Federal Grant Monies

PSD agrees with the auditor and each program administrator controlling Federal Grant Monies will be instructed to perform the grant expectations in the monitoring of sub-recipient grant funds. The Fiscal Office will be responsible for ensuring that administrators are trained in the monitoring of grant expenditures.

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

Sincerely,



Clayton A. Frank
Director