

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

Fiscal Year Ended June 30, 2002

March 26, 2003

Mr. James Propotnick
Interim Director
Department of Public Safety
State of Hawaii

Dear Mr. Propotnick:

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, 2002. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the PSD's basic financial statements as of and for the fiscal year ended June 30, 2002, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

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

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the PSD for the fiscal year ended June 30, 2002.

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, 2002, and our opinion on the basic financial statements.
- Part II - Our report on compliance and on internal control over financial reporting.
- Part III - Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - The summary schedule of prior audit findings.
- Part VI - Response of the affected agency.

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

Sincerely,



Ron T. Shiigi
Principal

**DEPARTMENT OF PUBLIC SAFETY
STATE OF HAWAII**

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PART I
FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

To the Director
Department of Public Safety
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department of Public Safety of the State of Hawaii (PSD), as of and for the fiscal year ended June 30, 2002, which collectively comprise the PSD's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the PSD's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

As discussed in Note A, the financial statements of the PSD are intended to present the financial position and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the PSD. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

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

PSD, as of June 30, 2002, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note B, the PSD has implemented a new financial reporting model, as required by the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments - Omnibus*, as of July 1, 2001.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2003, on our consideration of the PSD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

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

Nishihama & Kishida, CPAs, Inc.

Honolulu, Hawaii
February 28, 2003

**Department of Public Safety
State of Hawaii**

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

The Management's Discussion and Analysis (MD&A) offers readers of the PSD's basic financial statements a narrative overview and analysis of the PSD's financial activities for the fiscal year ended June 30, 2002. We encourage readers to consider the information presented here in conjunction with the basic financial statements and notes to the basic financial statements.

The implementation of the new financial reporting requirements under GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, makes the PSD's financial report for the fiscal year ended June 30, 2002, different than those of previous fiscal years. New features include this MD&A, the government-wide Statement of Net Assets, the government-wide Statement of Activities, the concept of major fund reporting, and the reporting of long-term debt liabilities in the governmental activities. These concepts are explained throughout this discussion and analysis. Fund and account definitions as well as accounting treatment are further explained in Note B, *Significant Accounting Policies*, of the notes to the basic financial statements.

FINANCIAL HIGHLIGHTS

- Total assets of the PSD exceeded its total liabilities at June 30, 2002 by approximately \$100 million. Net assets invested in capital assets accounted for nearly all of this amount.
- During the fiscal year ended June 30, 2002, the PSD incurred approximately \$178 million of expenses of which approximately \$166 million was funded by general fund revenues.
- Approximately \$147 million of governmental funds were expended for incarceration and related inmate programs.

OVERVIEW OF THE FINANCIAL STATEMENTS

This MD&A serves as an introduction to the PSD's basic financial statements. The basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements.

**Department of Public Safety
State of Hawaii**

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

Government-wide Financial Statements

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

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

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

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

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

Fund Financial Statements

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

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

**Department of Public Safety
State of Hawaii**

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

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

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

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

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

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

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

FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS

The following table presents a condensed government-wide Statement of Net Assets of the PSD as of June 30, 2002. Since this is the initial year of preparing financial statements in accordance with the new GASB reporting standards, there is no

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

comparative data available. In future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

Condensed Statement of Net Assets

	Governmental Activities	Business-type Activities	Total
	<u> </u>	<u> </u>	<u> </u>
Current and other assets	\$ 19,702,903	\$ 975,151	\$ 20,678,054
Capital assets	<u>102,592,312</u>	<u>2,425,748</u>	<u>105,018,060</u>
Total assets	<u>\$ 122,295,215</u>	<u>\$ 3,400,899</u>	<u>\$ 125,696,114</u>
Long-term debt outstanding	\$ 8,383,896	\$ 283,452	\$ 8,667,348
Other liabilities	<u>16,222,649</u>	<u>689,207</u>	<u>16,911,856</u>
Total liabilities	<u>\$ 24,606,545</u>	<u>\$ 972,659</u>	<u>\$ 25,579,204</u>
Net assets			
Invested in capital assets, net of related debt	\$ 102,592,312	\$ 2,164,940	\$ 104,757,252
Restricted	2,036,642	--	2,036,642
Unrestricted (deficit)	<u>(6,940,284)</u>	<u>263,300</u>	<u>(6,676,984)</u>
Total net assets	<u>\$ 97,688,670</u>	<u>\$ 2,428,240</u>	<u>\$ 100,116,910</u>

The PSD's combined net assets amounted to \$100 million as of June 30, 2002. Governmental net assets accounted for 98% of total net assets that was comprised primarily of buildings and improvements of correctional facilities.

The deficit in unrestricted net assets for governmental activities was approximately \$7 million as of June 30, 2002. This deficit in unrestricted net assets is primarily the result of liabilities for programs incurred as of June 30, 2002, for which state allotted appropriations were not yet available. The largest liability as of June 30, 2002 is for compensated absences totaling \$13 million and are not funded by state allotted appropriations until employees use the earned leave or are paid out upon termination. Therefore, there are no assets currently available to the PSD to pay for the compensated absence liability as of June 30, 2002.

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

Condensed Changes in Net Assets

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
REVENUES			
Program revenues	\$ 5,345,924	\$ 4,656,833	\$ 10,002,757
General revenues	<u>166,115,525</u>	<u>16,089</u>	<u>166,131,614</u>
Total revenues	<u>171,461,449</u>	<u>4,672,922</u>	<u>176,134,371</u>
EXPENSES			
Confinement	146,591,578	--	146,591,578
Law enforcement	14,177,076	--	14,177,076
Parole	2,463,584	--	2,463,584
Crime victim compensation	1,464,243	--	1,464,243
General support	8,554,061	--	8,554,061
Correctional industries	<u>--</u>	<u>5,219,370</u>	<u>5,219,370</u>
Total expenses	<u>173,250,542</u>	<u>5,219,370</u>	<u>178,469,912</u>
Deficiency before transfers and lapsed appropriations	(1,789,093)	(546,448)	(2,335,541)
Transfers out	(58,651)	--	(58,651)
Lapsed appropriations	<u>(2,725,297)</u>	<u>--</u>	<u>(2,725,297)</u>
Change in net assets	<u>\$ (4,573,041)</u>	<u>\$ (546,448)</u>	<u>\$ (5,119,489)</u>

Total net assets decreased by approximately \$5 million during the fiscal year ended June 30, 2002 as shown above.

Total revenues for PSD were \$176 million for the fiscal year ended June 30, 2002. Governmental activities provided \$171 million (97%) and business-type activities added approximately \$5 million (3%).

Expenses for the fiscal year ended June 30, 2002, totaled approximately \$178 million. Governmental activities accounted for \$173 million, with the largest program expenses for the incarceration of law offenders that accounted for 85% of total expenses for governmental activities. Approximately \$27 million was incurred for the housing and care of inmates at out-of-state correctional facilities.

**Department of Public Safety
State of Hawaii**

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

FINANCIAL ANALYSIS OF THE FUND FINANCIAL STATEMENTS

As noted earlier, 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

PSD's major fund is the general fund, which accounted for approximately \$16 million or 80% of total governmental fund assets as of June 30, 2002, and \$168 million or 98% of total governmental fund revenues for the fiscal year ended June 30, 2002. The general fund revenues were comprised primarily of state allotted appropriations.

Proprietary Fund

The Correctional Industries is PSD's only enterprise fund. As of June 30, 2002, Correctional Industries reported \$2.4 million in net assets of which \$2.1 million was accounted for by investment in capital assets, net of related debt.

With recent state mandates to reduce spending, Correctional Industries experienced decreased revenues from its major customer base and a net loss for the fiscal year ended June 30, 2002.

BUDGETARY ANALYSIS

As shown below, the general fund's original budget was restricted by approximately \$1.4 million for the fiscal year ended June 30, 2002. In November 2001, the Council on Revenues confirmed the severity of the State's economic downturn by significantly lowering its revenue projections for the State through the fiscal biennium 2001-03. Based on those projections, it was determined that spending needed to be curtailed.

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

General Fund Budgetary Comparison

	Budget		Actual on Budgetary Basis	Favorable (Unfavorable) Variance
	Original	Final		
Confinement	\$ 127,274,690	\$ 126,350,806	\$ 125,230,988	\$ 1,119,818
Law enforcement	14,716,977	14,604,722	12,092,994	2,511,728
Parole	2,227,980	2,234,980	2,234,909	71
General support	9,540,198	9,141,571	7,824,162	1,317,409
Total expenditures	<u>153,759,845</u>	<u>152,332,079</u>	<u>147,383,053</u>	<u>4,949,026</u>
Transfers to special revenue funds	<u>450,000</u>	<u>450,000</u>	<u>450,000</u>	<u>--</u>
Total expenditures and transfers	<u>\$ 154,209,845</u>	<u>\$ 152,782,079</u>	<u>\$ 147,833,053</u>	<u>\$ 4,949,026</u>

The amount for the total final budget of \$152,782,079 reflects an expenditure ceiling. Generally, expenditure ceilings are formulated based on anticipated program needs. Optimally, expenditure ceilings should be close or equal to actual expenditures. However, actual expenditures are limited to the availability of funds. Therefore, the PSD's limited to spending either the expenditure ceiling or the cash balance, whichever amount is lower. For the fiscal year ended June 30, 2002, the \$4,949,026 variance between the final budget and actual expenditures on a budgetary basis is attributed to a combination of the following factors:

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

**Department of Public Safety
State of Hawaii**

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

CAPITAL ASSETS

As of June 30, 2002, the PSD had approximately \$105 million invested in capital assets. Capital assets for governmental activities accounted for 98% of total capital assets. Building and improvements for correctional facilities totaling approximately \$100 million, net of accumulated depreciation, accounted for 94% of total capital assets for governmental activities.

There was approximately \$7 million or a 6% decrease in capital assets, net of depreciation, from the end of the last fiscal year. This decrease is primarily a result of annual depreciation totaling approximately \$6 million.

Capital Assets, Net of Depreciation

	Governmental Activities		Business-type Activities		Total	
	2002	2001	2002	2001	2002	2001
Land	\$ 107	\$ 107	\$ --	\$ --	\$ 107	\$ 107
Buildings and improvements	100,852	106,484	1,934	1,999	102,786	108,483
Furniture, equipment and vehicles	<u>1,633</u>	<u>1,788</u>	<u>492</u>	<u>622</u>	<u>2,125</u>	<u>2,410</u>
Total	\$ <u>102,592</u>	\$ <u>108,379</u>	\$ <u>2,426</u>	\$ <u>2,621</u>	\$ <u>105,018</u>	\$ <u>111,000</u>

ECONOMIC FACTORS

As discussed earlier in the budgetary analysis section, the Council on Revenues confirmed in November 2001, the severity of the State's economic downturn by significantly lowering its revenue projections for the State through the fiscal biennium 2001-03. Based on those projections, it was determined that spending needed to be curtailed. As a result, the PSD's budget for the fiscal year ended June 30, 2003, was reduced by about \$2.9 million.

REQUEST FOR INFORMATION

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

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

**Department of Public Safety
State of Hawaii
STATEMENT OF NET ASSETS
June 30, 2002**

	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	\$ 17,907,246	\$ 175,056	\$ 18,082,302
Receivables	799,558	456,421	1,255,979
Due from State of Hawaii	941,761	--	941,761
Internal balances	(26,758)	26,758	--
Due from other funds	81,096	--	81,096
Inventories	--	316,916	316,916
Total current assets	19,702,903	975,151	20,678,054
Capital assets			
Non-depreciable	107,570	--	107,570
Depreciable, net	102,484,742	2,425,748	104,910,490
Total assets	\$ 122,295,215	\$ 3,400,899	\$ 125,696,114
LIABILITIES			
Accrued wages and employee benefits payable	\$ 5,558,339	\$ 87,654	\$ 5,645,993
Vouchers payable	5,635,238	221,177	5,856,415
Deferred revenues	215,395	174,523	389,918
Capital lease obligations	--	135,308	135,308
Accrued compensated absences	4,715,942	58,421	4,774,363
Due to other funds	97,735	12,124	109,859
Total current liabilities	16,222,649	689,207	16,911,856
Capital lease obligations	--	125,500	125,500
Accrued compensated absences	8,383,896	157,952	8,541,848
Total liabilities	24,606,545	972,659	25,579,204
NET ASSETS			
Invested in capital assets, net of related debt	102,592,312	2,164,940	104,757,252
Restricted for public safety programs	2,036,642	--	2,036,642
Unrestricted (deficit)	(6,940,284)	263,300	(6,676,984)
Total net assets	\$ 97,688,670	\$ 2,428,240	\$ 100,116,910

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2002**

Functions/Programs	Expenses	Program Revenues		Net (Expense) Revenue and Changes in Net Assets		Total
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental activities:						
Confinement	\$ 146,591,578	\$ 213,613	\$ 631,794	\$ (145,746,171)	\$ -	\$ (145,746,171)
Law enforcement	14,177,076	3,216,433	115,700	(10,844,943)	-	(10,844,943)
Parole	2,463,584	-	-	(2,463,584)	-	(2,463,584)
Crime victim compensation	1,464,243	802,662	365,722	(295,859)	-	(295,859)
General support	8,554,061	-	-	(8,554,061)	-	(8,554,061)
Total governmental activities	<u>173,250,542</u>	<u>4,232,708</u>	<u>1,113,216</u>	<u>(167,904,618)</u>	<u>-</u>	<u>(167,904,618)</u>
Business-type activities:						
Correctional industries	<u>5,219,370</u>	<u>4,656,833</u>	<u>-</u>	<u>-</u>	<u>(562,537)</u>	<u>(562,537)</u>
Total business-type activities	<u>5,219,370</u>	<u>4,656,833</u>	<u>-</u>	<u>-</u>	<u>(562,537)</u>	<u>(562,537)</u>
Total	\$ <u>178,469,912</u>	\$ <u>8,889,541</u>	\$ <u>1,113,216</u>	\$ <u>(167,904,618)</u>	\$ <u>(562,537)</u>	\$ <u>(168,467,155)</u>
General revenues:						
State allotments				146,682,747	-	146,682,747
State-provided payroll fringe benefits				18,540,597	-	18,540,597
Grants not restricted to specific programs				780,320	-	780,320
Unrestricted investment earnings				66,669	16,089	82,758
Miscellaneous				45,192	-	45,192
Lapsed appropriations				(2,725,297)	-	(2,725,297)
Transfers				(58,651)	-	(58,651)
Total general revenues and transfers				<u>163,331,577</u>	<u>16,089</u>	<u>163,347,666</u>
Changes in net assets				(4,573,041)	(546,448)	(5,119,489)
Net assets at July 1, 2001				<u>102,261,711</u>	<u>2,974,688</u>	<u>105,236,399</u>
Net assets at June 30, 2002				<u>\$ 97,688,670</u>	<u>\$ 2,428,240</u>	<u>\$ 100,116,910</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2002**

	<u>General</u>	<u>Capital Projects</u>	<u>Other Funds</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents	\$ 13,695,284	\$ 250	\$ 4,211,712	\$ 17,907,246
Receivables	799,558	--	--	799,558
Due from State of Hawaii	941,761	--	--	941,761
Due from other funds	<u>71,119</u>	<u>--</u>	<u>9,977</u>	<u>81,096</u>
Total assets	<u>\$ 15,507,722</u>	<u>\$ 250</u>	<u>\$ 4,221,689</u>	<u>\$ 19,729,661</u>
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Accrued wages and employee benefits payable	\$ 5,524,759	\$ --	\$ 33,581	\$ 5,558,340
Vouchers payable	5,615,780	--	19,458	5,635,238
Deferred revenues	--	250	215,144	215,394
Due to other funds	<u>123,135</u>	<u>--</u>	<u>1,358</u>	<u>124,493</u>
Total liabilities	<u>11,263,674</u>	<u>250</u>	<u>269,541</u>	<u>11,533,465</u>
FUND BALANCES				
Reserved for:				
Encumbrances	6,546,297	--	349,685	6,895,982
Receivables	870,677	--	--	870,677
Unreserved	<u>(3,172,926)</u>	<u>--</u>	<u>3,602,463</u>	<u>429,537</u>
Total fund balances	<u>4,244,048</u>	<u>--</u>	<u>3,952,148</u>	<u>8,196,196</u>
Total liabilities and fund balances	<u>\$ 15,507,722</u>	<u>\$ 250</u>	<u>\$ 4,221,689</u>	<u>\$ 19,729,661</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, 2002**

Total fund balances - governmental funds		\$ 8,196,196
 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.		
Governmental capital assets	\$ 179,925,129	
Less accumulated depreciation	<u>(77,332,817)</u>	102,592,312
 Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds.		
		<u>(13,099,838)</u>
 Net assets of governmental activities		 \$ <u>97,688,670</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
Fiscal Year Ended June 30, 2002**

	<u>General</u>	<u>Capital Projects</u>	<u>Other Funds</u>	<u>Total</u>
REVENUES				
State allotted appropriations	\$ 146,682,747	\$ --	\$ --	\$ 146,682,747
State-provided payroll fringe benefits	18,540,597	--	--	18,540,597
Operating grants and contributions	--	--	1,893,536	1,893,536
Charges for services	2,908,068	--	1,324,640	4,232,708
Unrestricted investment earnings	--	--	66,669	66,669
Miscellaneous	<u>45,192</u>	<u>--</u>	<u>--</u>	<u>45,192</u>
	<u>168,176,604</u>	<u>--</u>	<u>3,284,845</u>	<u>171,461,449</u>
EXPENDITURES				
Confinement	140,151,052	--	792,452	140,943,504
Law enforcement	13,626,534	--	407,634	14,034,168
Parole	2,413,353	--	--	2,413,353
Crime victim compensation	--	--	1,458,738	1,458,738
General support	<u>8,449,201</u>	<u>--</u>	<u>--</u>	<u>8,449,201</u>
	<u>164,640,140</u>	<u>--</u>	<u>2,658,824</u>	<u>167,298,964</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>3,536,464</u>	<u>--</u>	<u>626,021</u>	<u>4,162,485</u>
OTHER FINANCING SOURCES (USES)				
Transfers in	--	--	450,000	450,000
Transfers out	<u>(507,000)</u>	<u>--</u>	<u>(1,651)</u>	<u>(508,651)</u>
	<u>(507,000)</u>	<u>--</u>	<u>448,349</u>	<u>(58,651)</u>
EXCESS OF REVENUES OVER EXPENDITURES AND OTHER USES	3,029,464	--	1,074,370	4,103,834
OTHER CHANGES IN FUND BALANCES				
Lapsed appropriations	<u>2,428,037</u>	<u>297,260</u>	<u>--</u>	<u>2,725,297</u>
NET CHANGE IN FUND BALANCES	601,427	(297,260)	1,074,370	1,378,537
FUND BALANCES AT JULY 1, 2001	<u>3,642,621</u>	<u>297,260</u>	<u>2,877,778</u>	<u>6,817,659</u>
FUND BALANCES AT JUNE 30, 2002	<u>\$ 4,244,048</u>	<u>\$ --</u>	<u>\$ 3,952,148</u>	<u>\$ 8,196,196</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
RECONCILIATION OF THE CHANGE IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2002**

Net change in fund balances - total governmental funds		\$ 1,378,537
 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	\$ 383,671	
Less current year depreciation	<u>(6,168,467)</u>	(5,784,796)
 Loss on the disposition of capital assets reported in the statement of activities does not require the use of current financial resources and therefore is not reported as an expenditure in governmental funds.		
		(2,000)
 Change in long-term compensated absences reported in the statement of activities does not require the use of current financial resources and therefore is not reported as an expenditure in governmental funds.		
		<u>(164,782)</u>
 Change in net assets of governmental activities		 \$ <u>(4,573,041)</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF NET ASSETS
PROPRIETARY FUND
June 30, 2002**

ASSETS

Current assets		
Cash	\$	175,056
Receivables, net of allowance for doubtful accounts		456,421
Due from other funds		26,758
Inventories		<u>316,916</u>
Total current assets		975,151
Capital assets, net of depreciation		<u>2,425,748</u>
Total assets	\$	<u><u>3,400,899</u></u>

LIABILITIES

Current liabilities		
Accrued wages and employee benefits	\$	87,654
Vouchers payable		221,177
Due to other funds		12,124
Deferred revenues		174,523
Capital lease obligations		135,308
Accrued compensated absences		<u>58,421</u>
Total current liabilities		<u>689,207</u>
Noncurrent liabilities		
Capital lease obligations		125,500
Accrued compensated absences		<u>157,952</u>
		<u>283,452</u>
Total liabilities		<u>972,659</u>

NET ASSETS

Invested in capital assets, net of related debt		2,164,940
Unrestricted		<u>263,300</u>
Total net assets	\$	<u><u>2,428,240</u></u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND
Fiscal Year Ended June 30, 2002**

	<u>Enterprise Fund</u>
OPERATING REVENUES	
Charges for sales and services	\$ 4,671,333
Less provision for uncollectible accounts	<u>(14,500)</u>
	<u>4,656,833</u>
OPERATING EXPENSES	
Cost of sales and services	4,944,578
Depreciation and amortization	<u>248,859</u>
	<u>5,193,437</u>
OPERATING LOSS	<u>(536,604)</u>
NON-OPERATING INCOME (EXPENSE)	
Interest income	16,089
Interest expense	<u>(25,933)</u>
	<u>(9,844)</u>
NET LOSS	(546,448)
NET ASSETS AT JULY 1, 2001	<u>2,974,688</u>
NET ASSETS AT JUNE 30, 2002	\$ <u><u>2,428,240</u></u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF CASH FLOWS
PROPRIETARY FUND
Fiscal Year Ended June 30, 2002**

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 4,667,401
Receipts from interfund services provided	283,251
Payments to suppliers	(3,211,994)
Payments to employees	<u>(1,806,885)</u>
Net cash used in operating activities	<u>(68,227)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest received on investments	<u>16,089</u>
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CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Purchases of capital assets	(9,623)
Principal payments on capital lease obligations	(135,727)
Interest paid on capital lease obligations	<u>(25,933)</u>
Net cash used by capital and related financing activities	<u>(171,283)</u>

NET DECREASE IN CASH (223,421)

Cash at July 1, 2001 398,477

Cash at June 30, 2002 \$ 175,056

Department of Public Safety
State of Hawaii
STATEMENT OF CASH FLOWS (Continued)
PROPRIETARY FUND
Fiscal Year Ended June 30, 2002

**RECONCILIATION OF OPERATING INCOME TO NET CASH
USED IN OPERATING ACTIVITIES**

Operating loss	\$ (536,604)
Adjustment to reconcile operating income to net cash used in operating activities:	
Depreciation	248,859
Provision for uncollectible accounts	14,500
Change in assets and liabilities	
(Increase) decrease in:	
Receivables, net	392,570
Due from other funds	24,475
Inventories	214,992
Increase (decrease) in:	
Vouchers payable	(304,256)
Accrued wages and employee benefits payable	5,548
Accrued compensated absences	15,155
Due to other funds	(5,740)
Deferred revenues	<u>(137,726)</u>
Net cash used in operating activities	\$ <u><u>(68,227)</u></u>

**SUPPLEMENTAL SCHEDULE OF NONCASH CAPITAL AND
FINANCING ACTIVITIES**

Acquisition of equipment under capital leases	\$ <u><u>43,754</u></u>
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See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL - GENERAL FUND
Fiscal Year Ended June 30, 2002**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Favorable (Unfavorable) Variance</u>
Revenues				
State allotments	\$ 148,110,513	\$ 146,682,747	\$ 146,682,747	\$ --
Charges for services	6,024,267	6,024,267	2,908,068	(3,116,199)
Miscellaneous	<u>75,065</u>	<u>75,065</u>	<u>52,657</u>	<u>(22,408)</u>
	<u>154,209,845</u>	<u>152,782,079</u>	<u>149,643,472</u>	<u>(3,138,607)</u>
Expenditures				
Confinement	127,274,690	126,350,806	125,230,988	1,119,818
Law enforcement	14,716,977	14,604,722	12,092,994	2,511,728
Parole	2,227,980	2,234,980	2,234,909	71
Crime victim compensation	--	--	--	--
General support	<u>9,540,198</u>	<u>9,141,571</u>	<u>7,824,162</u>	<u>1,317,409</u>
	<u>153,759,845</u>	<u>152,332,079</u>	<u>147,383,053</u>	<u>4,949,026</u>
Excess of revenues over expenditures	450,000	450,000	2,260,419	1,810,419
Other financing uses				
Transfers out	<u>450,000</u>	<u>450,000</u>	<u>(507,000)</u>	<u>(57,000)</u>
EXCESS OF REVENUES OVER EXPENDITURES AND OTHER USES	\$ <u> --</u>	\$ <u> --</u>	\$ <u> 1,753,419</u>	\$ <u> 1,753,419</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
STATEMENT OF ASSETS AND LIABILITIES
AGENCY FUND
Fiscal Year Ended June 30, 2002**

ASSETS		
Cash		\$ 4,518,281
Due from others		<u>109,859</u>
 Total assets		 \$ <u>4,628,140</u>
LIABILITIES		
Vouchers payable		\$ 43,921
Due to other funds		81,096
Due to individuals		1,040,017
Due to others		<u>3,463,106</u>
 Total liabilities		 \$ <u>4,628,140</u>

See accompanying notes to the basic financial statements.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE A - FINANCIAL REPORTING ENTITY

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

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

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

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

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

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

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

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

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE A - FINANCIAL REPORTING ENTITY (Continued)

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

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

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

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

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

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

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

As of July 1, 2001, the PSD adopted the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for Local and State Government: Omnibus*. These statements require significant changes in financial statement presentation and disclosures. Certain significant changes include the following:

- For the first time the financial statements include a Management's Discussion and Analysis section providing an analysis of the PSD's overall financial position and results of operations.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- The basic financial statements include the statement of net assets and statement of activities, which include the economic effect of assets and liabilities previously reported as the general fixed asset account group and the general long-term debt account group.
- (1) ***Basis of Presentation*** - The government-wide financial statements report all assets, liabilities, and activities of the PSD as a whole. The fiduciary funds are excluded from the government-wide financial statements because the PSD cannot use those assets to finance its operations.

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

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

Governmental Fund Types

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

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

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

Proprietary Fund Type

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

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Fiduciary Fund Type

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

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

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

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

Proprietary and Agency Funds - All proprietary and agency funds are accounted for on a flow of economic resources measurement focus and accrual basis of accounting.

(3) ***Use of Estimates*** - The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(4) ***Cash and Cash Equivalents*** - Cash and cash equivalents, for the purpose of the statement of cash flows, includes all cash and investments with original maturities of three months or less.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (5) **Receivables** - Receivables in the general fund consist primarily of amounts due from individuals for whom salaries were overpaid by the PSD. Receivables in the enterprise fund consist primarily of amounts due from other state agencies for services provided to those agencies for a fee. The amounts reported as net receivables were established based on management's estimate of amounts collectible.
- (6) **Inventories** - Inventory of goods, materials and supplies is valued at cost (first-in, first-out method). Inventory in the enterprise fund consists primarily of printing, construction, sewing, and computer supplies to be used in the Correctional Industries Program.
- (7) **Capital Assets** - The accounting treatment over capital assets depends on whether the assets are used in governmental fund or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

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

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

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

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

The State has adopted the following capitalization policy:

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

Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (8) ***Due to Individuals*** - Due to individuals represents assets held by the PSD primarily in an agency capacity for the inmate population.
- (9) ***Accumulated Vacation*** - Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.
- (10) ***Restricted Net Assets*** - Net assets are restricted when constraints placed on net assets are imposed by grantors, contributors, or laws and regulations of authorizing governments. When both restricted and unrestricted net assets are available, the PSD generally applies unrestricted resources before restricted resources for expenses incurred.
- (11) ***Appropriations*** - Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.
- (12) ***Program Revenues*** - Program revenues derive directly from the programs of 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.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (13) ***Intrafund and Interfund Transactions*** - Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the basic financial statements.
- (14) ***Risk Management*** - The PSD is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

NOTE C - BUDGETING AND BUDGETARY CONTROL

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedule - General Fund are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations such as those related to the special revenue funds.

For purposes of budgeting, the PSD's budgetary fund structure and accounting principles differ from those utilized to present the governmental fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The PSD's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase order and contract obligations, (2) the recognition of certain receivables, and (3) special revenue fund operating grant accruals and deferrals. These differences represent a departure from GAAP. The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the general fund for the fiscal year ended June 30, 2002.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

	<u>Amount</u>
Excess of revenues over expenditures and other uses - actual on budgetary basis	\$ 1,753,419
Reserved for encumbrances at fiscal year-end	6,546,297
Reserved for receivables	870,677
Expenditures for liquidation of prior fiscal year encumbrances	(5,783,538)
Net change in unreserved liabilities	(278,806)
Net adjustment for commissary revenue accrual	(78,585)
Excess of revenues over expenditures and other uses - GAAP basis	<u>\$ 3,029,464</u>

NOTE D - CASH AND CASH EQUIVALENTS

The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Hawaii Revised Statutes authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with state statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

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, 2002, the carrying amount of total bank deposits including time certificates of deposit was approximately \$1,055,000 and the corresponding bank balances which are represented were approximately \$1,116,000.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE E - RECEIVABLES

Receivables of the PSD, net of an allowance for doubtful accounts, consisted of the following at June 30, 2002:

	<u>General Fund</u>	<u>Enterprise Fund</u>
Salary overpayments	\$1,325,558	\$ --
Accounts receivable	<u> --</u>	<u>506,321</u>
	1,325,558	506,321
Less allowance for doubtful accounts	<u> 526,000</u>	<u> 49,900</u>
Receivables, net	<u>\$ 799,558</u>	<u>\$ 456,421</u>

NOTE F - CAPITAL ASSETS

The changes in capital assets were as follows:

	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2002</u>
Governmental activities:				
Nondepreciable assets				
Land	\$ 107,570	\$ --	\$ --	\$ 107,570
Depreciable assets				
Building and improvements	172,084,272	--	--	172,084,272
Furniture and equipment	3,921,274	328,054	27,921	4,221,407
Vehicles	<u>3,497,924</u>	<u>55,617</u>	<u>41,661</u>	<u>3,511,880</u>
Total at historical cost	<u>179,611,040</u>	<u>383,671</u>	<u>69,582</u>	<u>179,925,129</u>
Less accumulated depreciation for:				
Building and improvements	65,601,223	5,631,287	--	71,232,510
Furniture and equipment	2,860,587	243,973	25,921	3,078,639
Vehicles	<u>2,770,122</u>	<u>293,207</u>	<u>41,661</u>	<u>3,021,668</u>
Total accumulated depreciation	<u>71,231,932</u>	<u>6,168,467</u>	<u>67,582</u>	<u>77,332,817</u>
Governmental activities capital assets, net	<u>\$ 108,379,108</u>	<u>\$ (5,784,796)</u>	<u>\$ 2,000</u>	<u>\$ 102,592,312</u>

Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002

NOTE F - CAPITAL ASSETS (Continued)

	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2002</u>
Business-type activities:				
Building and improvements	\$ 2,579,000	\$ --	\$ --	\$ 2,579,000
Equipment	2,093,814	9,623	--	2,103,437
Equipment under capital lease	606,004	43,754	--	649,758
Total at historical cost	<u>5,278,818</u>	<u>53,377</u>	<u>--</u>	<u>5,332,195</u>
Less accumulated depreciation for:				
Building and improvements	580,275	64,475	--	644,750
Equipment	1,848,750	70,125	--	1,918,875
Equipment under capital lease	228,563	114,259	--	342,822
Total accumulated depreciation	<u>2,657,588</u>	<u>248,859</u>	<u>--</u>	<u>2,906,447</u>
Business-type activities capital assets, net	\$ <u>2,621,230</u>	\$ <u>(195,482)</u>	\$ <u>--</u>	\$ <u>2,425,748</u>

Depreciation expense was charged to functions as follows:

	<u>Amount</u>
Governmental activities:	
Confinement	\$ 5,808,428
Law enforcement	112,245
Parole	1,290
Crime victim compensation	2,714
General support	<u>243,790</u>
Total governmental activities depreciation	6,168,467
Business-type activities:	
Correctional industries	<u>248,859</u>
Total depreciation expense	\$ <u>6,417,326</u>

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE G - LONG-TERM LIABILITIES

The only long-term liability for governmental activities is for accrued compensated absences. Long-term liability activity during the fiscal year ended June 30, 2002, was as follows:

	<u>Amount</u>
Balance at July 1, 2001	\$ 12,935,057
Additions	7,467,671
Reductions	<u>(7,302,890)</u>
Balance at June 30, 2002	\$ <u>13,099,838</u>

The amount of governmental activities compensated absences liability due within one year is \$4,715,942. The compensated absences liability has been paid primarily by the general fund in the past.

Long-term liability activity for business-type activities during the fiscal year ended June 30, 2002, was as follows:

	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2002</u>	<u>Amount Due Within One Year</u>
Capital lease obligations	\$ 352,781	\$ 43,754	\$ 135,727	\$ 260,808	\$ 135,308
Accrued compensated absences	<u>201,218</u>	<u>94,291</u>	<u>79,136</u>	<u>216,373</u>	<u>58,421</u>
Total business-type activities long-term liabilities	\$ <u>553,999</u>	\$ <u>138,045</u>	\$ <u>214,863</u>	\$ <u>477,181</u>	\$ <u>193,729</u>

NOTE H - NON-IMPOSED EMPLOYEE FRINGE BENEFITS

Payroll fringe benefit costs of the PSD's employees funded by state appropriations (general fund) are assumed by the State and are not charged to PSD's operating funds. These costs, totaling approximately \$18,541,000 for the fiscal year ended June 30, 2002, have been reported as revenues and expenditures in the general fund of the PSD.

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

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE I - FUND BALANCE DEFICITS

The general fund had a deficit in the unreserved fund balance at June 30, 2002, of \$3,172,926. The deficit resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when the funds are measurable and available.

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

The agency fund is purely custodial (assets equal liabilities) and thus does not involve the measurement of results of operations. The changes in assets and liabilities of the agency fund for the fiscal year ended June 30, 2002, were as follows:

	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2002</u>
Assets				
Cash and other assets held in trust	\$ <u>2,148,478</u>	\$ <u>8,820,234</u>	\$ <u>6,340,572</u>	\$ <u>4,628,140</u>
Liabilities				
Due to individuals and others	\$ <u>2,148,478</u>	\$ <u>8,820,234</u>	\$ <u>6,340,572</u>	\$ <u>4,628,140</u>

NOTE K - LEASE COMMITMENTS

(1) **Capital Leases** - The PSD's Correctional Industries Program has long-term equipment leases expiring through October 2006, that are accounted for as capital leases in the enterprise fund. These leased equipment are amortized using the straight-line method over the estimated useful lives of the equipment. The amortization is included in depreciation and amortization expense of the enterprise fund and amounted to approximately \$114,000 for the fiscal year ended June 30, 2002.

Interest expense of \$25,933 is included as a direct function expense of the Correctional Industries Program on the statement of activities for the fiscal year ended June 30, 2002.

At June 30, 2002, the future minimum lease payments together with the present value of net minimum lease payments (obligations under capital leases) were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2003	\$ 150,844
2004	101,064
2005	18,782
2006	10,443
2007	<u>3,481</u>
Total minimum lease payments	284,614
Less amounts representing interest at 7.27% - 10.47%	<u>23,806</u>
Present value of minimum lease payments	\$ <u>260,808</u>

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE K - LEASE COMMITMENTS (Continued)

- (2) **Operating Leases** - The PSD leases office facilities from third party lessors as well as equipment on a long-term basis that are reported in the general and enterprise funds. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2002, were as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2003	\$ 258,000
2004	244,000
2005	200,000
2006	119,000
2007	18,000
Thereafter	<u>1,000</u>
	<u>\$ 840,000</u>

Total rent expense for the fiscal year ended June 30, 2002, was approximately \$318,000.

NOTE L - RETIREMENT BENEFITS

Employees' Retirement System

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

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the PSD hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the PSD is required to contribute to both options at an actuarially determined rate. No contributions were required or made by the PSD for the fiscal year ended June 30, 2002. Contributions by the PSD for the fiscal years ended June 30, 2001 and 2000, were approximately \$71,000, and \$164,000, respectively. The contribution rate was 5.78% from July 1, 2000 to November 15, 2000, and nil for the remainder of the fiscal year ended June 30, 2001. The contribution rate for the fiscal year ended June 30, 2000 was 5.83%.

**Department of Public Safety
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2002**

NOTE L - RETIREMENT BENEFITS (Continued)

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired state employees. Contributions are financed on a pay-as-you-go basis. The PSD's special revenue fund share of the post-retirement health care and life insurance benefits expense for the fiscal year ended June 30, 2002, was approximately \$245,000.

Deferred Compensation Plan

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

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

NOTE M - RISK MANAGEMENT

The PSD is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally retains the first \$250,000 per occurrence of property losses and the first \$2 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 \$300 million (\$50 million for earthquake and flood) and the annual aggregate for general liability losses per occurrence is \$23 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$40 million per occurrence with no annual aggregate limit. The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs includes the accumulation of estimates for losses and claims reported prior to fiscal year-end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the 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
June 30, 2002**

NOTE N - COMMITMENTS AND CONTINGENCIES

Accumulated Sick Leave

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2002, amounted to approximately \$18,510,000.

SUPPLEMENTARY INFORMATION

**Department of Public Safety
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2002**

<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 Justice			
State Criminal Alien Assistance Program	16.606	--	\$ <u>780,320</u>
Methamphetamine Initiative Grant	N/A ²	--	<u>14,703</u>
Federal Equitable Sharing Program	N/A ²	--	<u>86,909</u>
Pass-through State Department of the Attorney General			
Crime Victim Compensation	16.576	99-VC-1 00-VC-1 01-VC-1	33,539 306,692 <u>18,784</u> <u>359,015</u>
Byrne Formula Grant Program	16.579	98-DB-27 99-DB-24 99-DB-26 00-DB-04 00-DB-03 01-DB-07 01-DB-16	155,322 4,854 14,140 76,901 30,660 39,654 <u>4,500</u> <u>326,031</u>
Residential Substance Abuse Treatment for State Prisoners (RSAT)	16.593	98-RT-1 99-RT-1	165,381 <u>56,968</u> <u>222,349</u>
Total U.S. Department of Justice			\$ <u>1,789,327</u>

**Department of Public Safety
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2002**

<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 Education			
Grants to States for Incarcerated Youth Offenders	84.331	V331A990008	\$ 7,861
Pass-through State Department of Education			
Title I Program for Neglected and Delinquent Children	84.013	S013A990011	40,681
Pass-through University of Hawaii			
Vocational Education - Basic Grants to States	84.048	V048A40011	<u>66,381</u>
Total U.S. Department of Education			<u>114,923</u>
U.S. Department of Defense			
Pass-through Hawaii Army National Guard			
Master Cooperative Agreement	N/A ²	DAHA50-01-H1003	11,762
		DAHA50-02-H1003	<u>37,670</u>
Total U.S. Department of Defense			<u>49,432</u>
U.S. Department of the Treasury			
Pass-through State Department of the Attorney General			
Federal Equitable Sharing Program	N/A ²	--	<u>716</u>
Total U.S. Department of the Treasury			<u>716</u>
TOTAL FEDERAL EXPENDITURES			\$ <u>1,954,398</u>

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

² Not applicable.

PART II

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

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

To the Director
Department of Public Safety
State of Hawaii

We have audited the basic financial statements of the Department of Public Safety of the State of Hawaii (PSD), as of and for the fiscal year ended June 30, 2002, and have issued our report thereon dated February 28, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the PSD's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the PSD's ability to record, process, summarize and report financial data consistent with the assertions of management in the basic financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 02-1 through 02-6.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider all of the reportable conditions described above to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to the management of the PSD in a separate letter dated February 28, 2003.

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

Nishihama & Kishida, CPAs, Inc.

Honolulu, Hawaii
February 28, 2003

PART III

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

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

To the Director
Department of Public Safety
State of Hawaii

Compliance

We have audited the compliance of the Department of Public Safety of the State of Hawaii (PSD) with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2002. The PSD's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the PSD's management. Our responsibility is to express an opinion on the PSD's compliance based on our audit.

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

As described in item 02-6 in the accompanying schedule of findings and questioned costs, the PSD did not comply with the reporting requirements that are applicable to the State Criminal Alien Assistance Program (CFDA No. 16.606).

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 fiscal year ended June 30, 2002.

Internal Control Over Compliance

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

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

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

Nishihama & Kishida, CPAs, Inc.

Honolulu, Hawaii
February 28, 2003

PART IV
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2002

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

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

Federal Awards

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

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

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

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
16.606	State Criminal Alien Assistance Program
16.579	Byrne Formula Grant Program
N/A	Federal Equitable Sharing Program

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

Auditee qualified as a low-risk auditee? yes no

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref.

No. Internal Control Findings

02-1 Improve Controls Over Inmate Agency Fund Accounts

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

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

We noted the following conditions regarding the inmate trust accounts as of June 30, 2002:

- Seven of the eight facilities did not perform reconciliations between the inmate trust account balance and the recorded cash balance. We were unable to reconcile the inmate trust account balance per the ITA system's printed trial balance to the reconciled cash balance as of June 30, 2002. The unreconciled difference totaled approximately \$179,000.
- Two facilities did not prepare bank reconciliations during the current fiscal year. The Women's Community Correctional Center did not perform monthly bank reconciliations since May 31, 1996.
- Kulani Correctional Facility did not submit their "Funds not Deposited to State Treasury" for the last quarter of the current fiscal year in a timely manner.
- The bank signature card for Kauai Community Correctional Center includes the signature of an employee who is no longer employed with the PSD.
- Inactive inmate accounts totaling approximately \$84,000 remained on the PSD's financial records.
- There was no segregation of duties related to the cash account maintained at Halawa Correctional Facility to account for funds of inactive inmate accounts. One employee is responsible for receipting, recording, depositing, disbursing, and reconciling the bank account.

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

**Ref.
No.**

Internal Control Findings (Continued)

02-1 Improve Controls over Inmate Agency Fund Accounts (Continued)

- Stale-dated checks of approximately \$6,100 over one-year old were not escheated to the State Treasury.

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

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

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

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

Recommendation

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

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

Ref.
No. Internal Control Findings (Continued)

02-2 Strengthen Controls Over Compensated Leaves of Absence

The following conditions were noted during our review of leave records as of June 30, 2002:

- The salary overpayment receivable balance as of June 30, 2002, was approximately \$1,326,000. Prior to January 1995, the PSD was able to garnish any overpaid wages from the employees' next paycheck. However, according to HRS Section 78-12, the PSD must conduct a hearing to recover these overpayments. The PSD submitted a list of overpayments to the State Department of the Attorney General (AG) and held the required hearings. Most of the salary overpayments occurred because of the timing requirements for processing payroll data under the State's payroll system. For employees hired effective July 1, 1998, paychecks are prepared after the payroll period rather than before the end of the payroll period to provide time to make any payroll adjustments to prevent salary overpayments. We noted that the occurrences of salary overpayments have stabilized from the fiscal year ended June 30, 2000.
- The Oahu Community Correctional Center (OCCC) used the incorrect pay rates to prepare the annual leave schedule. Errors at OCCC were attributed to the fact that employee leave schedules prepared and submitted to the PSD Fiscal Office were not reviewed for accuracy prior to submission.
- In three instances, the Form G-1, "Application for Leave of Absence," was not on file.
- In five instances, leave hours per the Form DPS-7, "Employee Leave Record" were not supported by Form G-1, "Application for Leave of Absence."
- In several instances, the Form G-1, "Application for Leave of Absence," was not properly completed, including three instances where the Form G-1, "Application for Leave of Absence," did not have the necessary authorizing signatures.
- In one instance, the Form DPS-7, "Employee Leave Record" was not mathematically accurate.
- There were several instances where the approval date on the Form G-1, "Application for Leave of Absence," was several days after the vacation period requested.

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

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

02-2 Strengthen Controls Over Compensated Leaves of Absence (Continued)

The PSD has been participating in a pilot project for a new statewide computerized time and attendance system, KRONOS. KRONOS was implemented at the OCCC in June 2001. In the future, compensated leaves of absence records will be generated from the KRONOS system, which should reduce the number of discrepancies in reported leave time taken.

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

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

02-3 Maintain Current and Accurate Financial Records for Correctional Industries

During our review of the accounting records at the Correctional Industries, we noted the following conditions as of June 30, 2002:

- There was an unreconciled difference in expenses of approximately \$260,000 between the Correctional Industries' internal general ledger and the financial reports printed from the Financial Accounting and Management Information System (FAMIS). The Correctional Industries was unable to explain the difference, which is primarily attributed to the fact that they do not reconcile their general ledger, in total, to FAMIS.
- Correctional Industries did not perform its annual physical inventory count on the last day of the fiscal year. Instead, they performed a cyclical inventory where portions of the inventory were counted over a period of days. The counts were not adjusted for inventory movements and transactions to determine the actual number of items on hand as of the statement of net assets date. In addition, the warehouse, where the majority of inventory is stored, remained open throughout the physical inventory count process. The combined impact of these conditions made it very difficult to obtain accurate inventory counts as of June 30, 2002.
- Total fixed assets reported on the State's *Annual Inventory Report of Property* was less than the amount recorded on the Correctional Industries' accounting records by approximately \$1,400,000 as of June 30, 2002. Discrepancies were caused in part because the Correctional Industries does not have procedures to ensure consistency in the recording of fixed assets into their general ledger software and the reporting of capital assets to the PSD Fiscal Office for submission to the State Department of Accounting and General Services (DAGS).

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

Ref.

No. Internal Control Findings (Continued)

02-3 Maintain Current and Accurate Financial Records for Correctional Industries (Continued)

Recommendation

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

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

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

02-4 Adhere to Established Policies and Procedures for Inmate Stores

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

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

Revised and effective November 5, 2002, paragraph 4.5 of PSD Policy No. COR.02.01 states in part, ". . . Facilities that operate an inmate store with contracted services shall transfer 100 percent of the fiscal year's net profit to the Administrator/Inmate Activity Fund. Expenditures shall be made in accordance with the Department Policy COR.02.05, Administrator/Inmate Activity Fund. This section is applicable to all prior fiscal years for any inmate store with contracted services for those years." We noted the following conditions:

- The HCF transferred only a portion of the net profits from inmate store sales to the Administrator/Inmate Activity Fund. The amounts owed to the Administrator/Inmate Activity Fund at June 30, 2002, was approximately \$35,000.
- The OCCC transferred 25% of net profits to the Administrator/Inmate Activity Fund in accordance with PSD Policy No. 493.02.01 which was effective prior to the revision of PSD Policy No. COR.02.01, and transferred the remaining 75% of net profits to the special revolving fund.

Recommendation

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

- All facilities must comply with established PSD policies and procedures pertaining to inmate stores.
- The HCF and OCCC should transfer net profits earned from commissary operations retroactively to the Administrator/Inmate Activity Fund.

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

Ref.
No. Internal Control Findings (Continued)

02-5 Properly Account for Capital Assets

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

- Capital asset transactions were not reported to the State in a timely manner. As a result, approximately \$556,000 in capital assets actually acquired prior to the fiscal year ended June 30, 2002, was recorded as current fiscal year additions.
- Building and building improvement costs amounting to approximately \$60 million were not recorded on the State's *Annual Inventory Report of Property* as of June 30, 2002. Much of the costs were for the construction of capital assets for which the PSD was not the expending agency.
- A demolished building with a recorded cost of approximately \$2.6 million was not removed from the State's property inventory records.

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

Recommendation

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

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

SECTION III - FEDERAL AWARD FINDINGS

<u>Ref. No.</u>	<u>Compliance and Internal Control Findings</u>	<u>Questioned Cost</u>
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02-6 Report Costs Properly

During the current fiscal year, the PSD received two payments from the State Criminal Alien Assistance Program (SCAAP) (CFDA No. 16.606) for the award years 2001 and 2002, for the cost of incarcerating illegal criminal aliens at state facilities. The award amounts are based on the pro rata share of total federal appropriations, which is allocated among applicants for the SCAAP based on the number of alien inmates claimed and allowable corrections officers' salaries. In reporting the amount of allowable corrections officers' salaries for each award, the following were noted:

- For award 2001-AP-BX-0938, the PSD used estimated adult corrections officers' salaries instead of actual costs.
- For award 2002-AP-BX-0139, the PSD included retroactive pay, which could potentially include unallowable benefits and overtime payments, as a part of corrections officers' salary costs. The PSD did not determine whether retroactive pay included unallowable benefits or overtime.
- For both awards, the PSD did not deduct the amount of the reimbursement received from the U.S. Marshal that was attributed to the corrections officers' salary costs.

The Bureau of Justice Assistance Fact Sheet - FY 2002 State Criminal Alien Assistance Program states in part, "Applicants may not include any records for inmates for whom any payments to cover costs of housing inmates are received from other jurisdictions or the Federal Government..." Also, "Annual SCAAP payment amounts are determined using actual inmate, cost, and facility data...."

SCAAP Frequently Asked Questions (FAQs) states in part, "Salary information provided on the SCAAP application SHOULD NOT include benefits or overtime."

Because the award amount is based on a percentage of the total claims for all applicants, the effect of the overstated costs on the PSD's award amount is unknown at this time.

Unknown

**Department of Public Safety
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2002**

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

02-6 **Report Costs Properly (Continued)**

Recommendation

The PSD should properly report the amount of allowable corrections officers' salaries. This includes using actual salary costs and properly deducting the amount of reimbursements received from the U.S. Marshal from the amount of corrections officers' salaries. In addition, the PSD should ensure that any retroactive payments reported do not include unallowable benefits and overtime payments. Because the award is not the usual dollar-for-dollar cost reimbursement, the PSD needs to work with the federal grantor as to the amount of questioned costs, if any.

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, 2001, dated November 19, 2001.

Recommendations	Status
SECTION II - FINANCIAL STATEMENT FINDINGS	
01-1 Improve Controls Over Inmate Agency Fund Accounts (pages 38 to 39)	
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. 02-1.
Internal controls over inmate trust account transactions should be strengthened. This includes adequate segregation of duties and timely reconciliations of inmate trust account balances to the bank balances. Management should consider having independent reviews performed by the PSD Audit and Compliance Office to ensure that internal controls are functioning properly and that departmental procedures are followed.	

01-2 Improve Controls Over Agency Funds Held at the Sheriff Division (pages 40 to 41)

The PSD should perform the following procedures prior to closing the agency funds held by the Sheriff Division (SD) by:

- Requiring each of the SD's offices to reconcile the subsidiary ledger to the reconciled cash balance. These reconciliations should be submitted to and reviewed by the PSD Fiscal Office along with the monthly bank reconciliations.
- Reminding the SD's offices to update authorized signature cards immediately. Signature plates of previously authorized signers should be destroyed.
- Escheating stale-dated checks and money due to individuals over one-year old to the State Treasury.

The SD ceased its legal document processing services on July 1, 2001. They are currently in the process of disbursing all funds to the appropriate individuals.

01-3 Strengthen Controls Over Compensated Leaves of Absence (pages 42 to 43)

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

- Continue collection efforts in the repayment of salary overpayments.
- Continue to work on using the KRONOS system to provide up-to-date and accurate compensated leaves of absence records.
- Require all employees to submit the completed Form G-1, "Application for Leave of Absence," with proper approval, prior to taking vacation or compensatory time-off. The completed Form G-1 for sick leave taken should be submitted immediately upon returning to work.

Partially accomplished. The number of salary overpayment occurrences have stabilized. In addition, PSD has been participating in a pilot project for a new statewide computerized time and attendance system, KRONOS. Compensated leaves of absence records will be generated from the KRONOS system. However, errors in the compensated leaves of absence records continued to occur during the fiscal year ended June 30, 2002. See Reference No. 02-2.

Recommendations

Status

01-4 Maintain Current and Accurate Financial Records for Correctional Industries (page 44)

Correctional Industries should maintain current and accurate financial records to facilitate proper analysis and management decisions that are critical to maintaining a self-supporting operation.

Partially accomplished. Account balances over 90 days have decreased from prior years and continuing efforts are being made to improve on collections. However, there continues to be errors in fixed asset records. See Reference No. 02-3.

01-5 Standardize Inmate Store Sale Activities (pages 45 to 46)

To improve controls over the commissary activities, the PSD should send written reminders to the facilities to ensure the following:

- All three facilities must standardize the way they account for inmate store sale activities. Specifically, they should ensure that 75% and 25% of inmate store sales be transferred to the special revolving fund and the Administrator/Inmate Activity Fund, respectively.
- The HCF should transfer the net profits earned from commissary operations from July 1, 1997 to June 30, 2001, to the special revolving fund and the Administrator/Inmate Activity Fund, respectively, using the aforementioned allocation percentages.

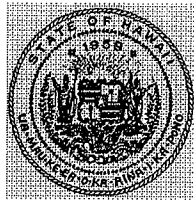
Partially accomplished. The PSD revised its policy for commissary operations. However not all facilities complied with the revised policy. See Reference No. 02-4.

In addition, the PSD should consider revising PSD Policy No. 493.02.01 to reflect the change in commissary operations.

Recommendations	Federal CFDA Number	Status
SECTION III - FEDERAL AWARD FINDINGS		
01-6 Report Costs Properly (page 47)	16.606	Not accomplished. See Reference No. 02-6.
<p>The PSD should report properly the amount of corrections officers' salaries by deducting the amount of reimbursements received from the U.S. Marshal from the amount of corrections officers' salaries. Because the award is not the usual dollar-for-dollar cost reimbursement, the PSD needs to work with the federal grantor as to the amount of questioned costs, if any.</p>		

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

JAMES L. PROPOTNICK
INTERIM DIRECTOR

CLAIRE Y. NAKAMURA
Deputy Director
Administration

FRANK J. LOPEZ
Deputy Director
Corrections

Deputy Director
Law Enforcement

No. _____

March 24, 2003

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

Dear Mr. Shiigi:

SUBJECT: State Department of Public Safety's Response to the Financial Audit Findings for the Fiscal Year Ended June 30, 2002

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

02-1 Improve Controls Over Inmate Agency Fund Accounts

- Through the Inmate Trust Accounting (ITA) software system, PSD can generate a list of inactive accounts by correctional facility. An account is considered inactive upon release of the inmate. The system was designed to capture such information to assist the facilities with the escheatment process to the State Department of Budget and Finance (B&F). Any account with a balance remains with the last facility.

The ITA system was also designed to reflect restitution collections as general reductions to cash balances in inmate accounts. Such collections are, however, reflected more specifically as restitution payments in manual ledgers. These collections are being transferred to the Crime Victims Compensation Commission (CVCC) with appropriate copies of inmate restitution records.

- The facilities continue working with the new ITA software, with a current focus on cleaning up inactive accounts that have accumulated over the years. To that end, a working group has been formed to discuss and resolve common problems encountered with the ITA software and with the inmate trust accounts in general. The working group will review procedures used by facilities that do successfully reconcile these accounts in an effort to discern why others are not able to do so. In some cases, additional staff must be hired to provide the dedicated attention needed to address longstanding difficulties

with the inmate trust accounts, given the high volume of small-dollar transactions, and transient nature of many short-term inmates/pre-trial detainees.

- Kauai Community Correctional Center (KCCC) reportedly updated its bank signature card in September 2002.
- Halawa Correctional Facility (HCF) established a new account specifically for escheating inactive account balances to DB&F. Except for the Women's Community Correctional Center (WCCC), other facilities have transferred all of their 12/31/99 balances to this account. Deposits are initiated by the ITA system, and disbursement checks require two signatures. All requests concerning this account are made independently of the employee with custodial responsibility, to ensure separation of duties. Based on the foregoing, HCF believes that proper internal controls exist. Ample documentation is available for review.

HCF further concurs with the audit recommendation that internal controls over inmate trust account transactions could be strengthened through the performance of independent reviews by the PSD Audit and Compliance Office. Such reviews should be incorporated into routine inspections of each facility to ensure compliance with official PSD policies and procedures.

- Facilities will assign a higher priority to clearing up stale-dated checks.

02-2 Strengthen Controls Over Compensated Leaves of Absence

- PSD continues its efforts to audit leave records and collect employee salary overpayments. The required overpayment hearings are conducted by departmental staff, thereby exacerbating chronic staffing shortfalls.
- As the audit recognized, PSD has been participating in a pilot project for a new Statewide computerized time and attendance system, KRONOS. The Time and Attendance Project has been stalled by software and interface problems. However, OCCC continues to dedicate staff to the project while the State Department of Accounting and General Services (DAGS) attempts to work with its Information and Communication Services Division (ICSD), KRONOS, and the State Department of Human Resources Development (DHRD) to resolve the software interface problems.

When this project is fully implemented, time and attendance records will be automatically generated when data is entered to generate employee payroll. *Accordingly, PSD should not be held solely accountable for systemic problems which are the functional responsibility of other entities beyond PSD's control.*

- The implementation of GASB 34 which requires reporting of beginning balances, credits earned, leave used, and ending balances has significantly reduced the number of arithmetic errors on the Form 7. The PSD Fiscal Office will continue to collect this data at the end of the fiscal year and perform random checks of the salary rate used in reporting leave balances.
- Staff and supervisors will be reminded to submit the Form G-1 on a more timely basis. Collective bargaining agreements permit employees to submit a Form G-1 for sickness within five working days upon returning to duty. Authorization for vacation leave is sometimes granted verbally on an emergency basis, thereby resulting in after-the-fact but immediate submittal of a Form G-1.
- Oahu Community Correctional Center (OCCC) will improve the process of amending the Form G-1 and Form 7, whereby the individual making any changes to one form will ensure that corresponding forms have also been amended in a consistent manner.

02-3 Maintain Current and Accurate Financial Records for Correctional Industries

- Beginning with FY 2003, PSD will close its internal financial statements at fiscal yearend and disallow any adjustments to the prior period. Further, Correctional Industries' (CI) internal software program (Peachtree retail accounting) ledgers will be reconciled with the State's Financial Accounting and Management Information System (FAMIS) reports. *We note that PSD must maintain its own shadow accounting system because FAMIS does not generate income statements or balance sheets applicable to retail-type operations such as the Correctional Industries program.*
- In preparation for conducting inventory at fiscal yearend, the CI warehouse will be closed on June 27 and June 30, 2003, in the case of FY 2003, to permit more thorough physical verification of inventory balances.
- Fixed assets will be reported by the CI Accounting Office as recommended in the audit. CI will attempt to clear old inventory on file as well as more consistently report equipment previously overlooked.

02-4 Adhere to Established Policies and Procedures for Inmate Stores

- PSD revised its PSD Policy No. 493.02.01 to require a transfer of net profits earned from commissary operations retroactively to the Administrator/Inmate Activity Fund. WCF, HCF, and OCCC will comply with the revised policy. Gross profits from store sales will be

Mr. Ronald T. Shiigi
Nishihama & Kishida, CPA's, Inc.
March 24, 2003
Page 4

deposited into the special revolving fund and, after related expenses have been deducted, the net profits will be deposited into the Administrator/Inmate Activity Fund.

- HCF is working to clear prior-years' (FY 2000 and FY 2001) transfers of net profits from the inmate store accounts and should complete the process by June 30, 2003.

02-5 Properly Account for Capital Asset Transactions

The Department will submit a DAGS (inventory) Form 17A to record any additions, deletions, or changes to capital assets in the State Inventory System. The Fiscal Office will monitor the timely submission of such forms by reviewing the DAGS CIP and Inventory Change reports.

02-6 Report Costs Properly

PSD will continue to work with the US Department of Justice, Office of Justice Programs, in meeting grant reporting requirements.

Should you have any questions on this matter, please call Ms. Claire Nakamura, Deputy Director for Administration (587-1251), or Mr. Clifford Asato, Fiscal Officer (587-2520). Thank you for the opportunity to comment.

Sincerely,


for JAMES L. PROPOTNICK
Interim Director

c: Deputy Director Claire Nakamura
Fiscal Officer Clifford Asato