

**FINANCIAL AUDIT OF THE
DEPARTMENT OF AGRICULTURE**

STATE OF HAWAII

**FOR THE
FISCAL YEAR ENDED JUNE 30, 2003**

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Ms. Sandra Lee Kunimoto
Chairperson, Board of Agriculture
Department of Agriculture
State of Hawaii

Dear Ms. Kunimoto:

This is our report on the financial and compliance audit of the Department of Agriculture of the State of Hawaii (Department) for the fiscal year ended June 30, 2003. Our audit was performed in accordance with the terms of our contract with the Department, and with the requirements of the Single Audit Act Amendments of 1996.

AUDIT OBJECTIVES

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Department's financial statements for the fiscal year ended June 30, 2003, and to comply with the audit requirements established under the Single Audit Act Amendments of 1996 in Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The specific objectives of the audit were:

- 1) To provide a basis for an opinion on the fairness of the presentation of the Department's financial statements.
- 2) To satisfy the audit requirements of OMB Circular A-133.
- 3) To determine whether expenditures have been made and all revenues and other receipts to which the Department 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, where applicable, the Federal government.
- 4) To evaluate the adequacy of the Department's system of internal accounting control in assuring that there is effective control over and proper accounting of revenues, expenditures, assets and liabilities.
- 5) To determine whether the Department has complied with the fiscal provisions of grant agreements and applicable Federal laws, regulations and circulars with regard to Federal grant activities.

AUDIT SCOPE

Our audit was performed in conformity with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and the provisions of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* as they pertain to financial and compliance audits. The scope of our audit included tests of the transactions and accounting records for the fiscal year ended June 30, 2003. In addition, we reviewed the existing systems and procedures of accounting, reporting and internal controls to provide us with a basis to report on whether the Department had complied with the material terms and conditions of Federal grant agreements.

Choo, Osada & Lee, CPAs, Inc.

Honolulu, Hawaii
February 20, 2004

INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS AND SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

To the Board of Agriculture
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Agriculture of the State of Hawaii (Department) as of and for the year ended June 30, 2003, as shown on pages 12 through 32. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

As discussed in Note 2, the financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003 and the changes in its financial position for the 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, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2003 and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis and other required supplementary information on pages 5 to 11 and 33 to 34 are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2004, on our consideration of the Department'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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the 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 financial statements of the Department. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

Choo, Osada & Lee, CPAs, Inc.

Honolulu, Hawaii
February 20, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Department of Agriculture of the State of Hawaii (Department)'s financial performance provides an overview of the Department's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the introduction on pages 1-2 and the Department's financial statements, which begin on page 12.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 12 and 13) provide information about the activities of the Department as a whole and present a longer-term view of the Department's finances. Fund financial statements start on page 14. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Department's operations in more detail than the government-wide statements by providing information about the Department's most significant funds. The remaining statements provide financial information about activities for which the Department acts solely as a trustee or agent for the benefit of those outside of the government.

Reporting the Department as a Whole

Our analysis of the Department as a whole begins on page 7. One of the most important questions asked about the Department's finances is, "Is the Department as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the Department as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Department's *net assets* and changes in them. You can think of the Department's net assets – the difference between assets and liabilities – as one way to measure the Department's financial health, or *financial position*. Over time, *increases or decreases* in the Department's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in legislation affecting the Department's animal quarantine program and the conditions of the Department's agricultural parks and irrigation and drainage systems, to assess the *overall health* of the Department.

We have reported the Department governmental activities in the Statement of Net Assets and the Statement of Activities. All of the Department's basic services are reported here, including the animal industry, agricultural loan, quality assurance, agricultural development, agricultural resource management and plant industry divisions, aquaculture development program and general administration. General fund appropriations, fees, agricultural loan interest, and state and federal grants finance most of these activities. The Department is not considered to have business-type activities and component units.

MANAGEMENT'S DISCUSSION AND ANALYSIS - continued

Reporting the Department's Most Significant Funds

- Our analysis of the Department's major funds begins on page 9. The fund financial statements begin on page 14 and provide detailed information about the most significant funds – not the Department as a whole. Generally, the Department's funds are required to be established by State law. However, the Department establishes many other funds to show that it is meeting legal responsibilities for using certain taxes, grants, and other money (like grants received from the U.S. Department of Agriculture). The Department's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term* view of the Department's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Department's programs. We describe the relationship (or differences) between *activities* (reported in the Statement of Net Assets and the Statement of Activities) and governmental *funds* on the Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds to the Statement of Activities on page 16.

The Department as Trustee

The Department is the trustee, or *fiduciary*, for private-purpose trust and agency funds. All of the Department's fiduciary activities are reported in a separate statement of fiduciary net assets on page 17. A statement of changes in fiduciary net assets is also included on page 18 for the Department's private-purpose trust funds. We exclude these activities from the Department's other financial statements because the Department cannot use these assets to finance its operations. The Department is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

MANAGEMENT'S DISCUSSION AND ANALYSIS - continued**THE DEPARTMENT AS A WHOLE**

The Department's condensed financial information of its governmental activities for the year ended June 30, 2003 and 2002 are provided in Tables 1 and 2 below.

Table 1
Net Assets
(in Millions)

	<u>2003</u>	<u>2002</u>
Current and other assets	\$ 32.9	37.2
Loans receivable	21.6	19.9
Capital assets	<u>53.2</u>	<u>42.7</u>
Total assets	\$ <u>107.7</u>	<u>99.8</u>
Long-term liabilities	\$ 3.7	3.2
Other liabilities	<u>2.9</u>	<u>4.3</u>
Total liabilities	<u>6.6</u>	<u>7.5</u>
Net assets (deficit)		
Invested in capital assets	53.2	42.7
Restricted	50.2	50.5
Unrestricted	(2.3)	(.9)
Total net assets	<u>101.1</u>	<u>92.3</u>
Total liabilities and net assets	\$ <u>107.7</u>	<u>99.8</u>

Table 2
Changes in Net Assets
(in Millions)

	<u>2003</u>	<u>2002</u>
Revenue		
Program revenues		
Charges for services	\$ 7.5	7.3
Operating grants and contributions	3.8	2.7
Capital grants and contributions	8.6	9.1
General revenues		
State allotted appropriations	10.4	12.6
Intergovernmental revenues	1.6	1.0
Transfers	<u>1.9</u>	<u>-</u>
Total revenues	<u>33.8</u>	<u>32.7</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS – continued

Table 2 - continued
Changes in Net Assets
(in Millions)

	<u>2003</u>	<u>2002</u>
Program expenses		
Productivity improvement and management assistance	\$ 9.8	9.3
Product development and marketing	2.9	3.1
General support for agriculture	5.9	5.0
Agricultural water development and irrigation services	2.0	2.2
Pollution control	2.0	1.5
Protection of the consumer	0.6	0.6
Aquaculture development	0.5	0.5
Agriculture loans	<u>1.3</u>	<u>.9</u>
Total expenses	<u>25.0</u>	<u>23.1</u>
 Increase in net assets	 \$ <u>8.8</u>	 <u>9.6</u>

Net assets of the Department's governmental activities increased by 9.5% (\$101.1 million compared to \$92.3 million). Unrestricted net assets – the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements - changed from a \$900,000 deficit to a \$2,300,000 deficit at the end of the year. The current year's deficit in unrestricted governmental net assets arose primarily because the Department was not allowed to include in past budgets amounts needed to pay for unused accrued employee vacation. The Department will need to cover these amounts in future years' budgets as they become due. The June 30, 2002 deficit also included similar amounts for accrued employee vacation, but it was partially offset by higher levels of encumbered funds that had not been released at the end of the year. Net assets invested in capital assets increased primarily due to construction in progress related to irrigation and drainage system capital projects.

The Department's total revenues increased by 3% (\$1.1 million), primarily due to increased federal funding and transfers, although this was partially offset by a decrease in allotted appropriations for Hawaii agricultural research and development. Total expenses increased by \$1.9 million, primarily due to increased spending on the federal program to promote specialty crops.

Governmental Activities

State allotted appropriations decreased by \$2.2 million while grants and contracts from the federal government increased by \$1.1 million; charges for services remained constant.

The cost of services for productivity improvement and management assistance increased by \$500,000 primarily due to expenses related to new grants from the Federal government for the detection of the brown tree snake and other pests.

MANAGEMENT'S DISCUSSION AND ANALYSIS – continued

The cost of services for the general support for agriculture increased by \$900,000 primarily due to expenses related to a new grant from the Federal government to promote agriculture specialty crops.

Table 3 presents the cost of each of the Department's five largest programs as well as each program's *net* cost (total cost less revenues generated by the activities). The net cost shows the financial burden that was placed on Hawaii's taxpayers by each of these functions.

Table 3
Governmental Activities
(in Millions)

	<u>Total Cost of Services</u>		<u>Net Cost of Services</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Productivity improvement and management assistance	\$ 9.8	9.3	5.7	5.4
Product development and marketing	2.9	3.1	2.7	2.8
General support for agriculture	5.9	5.0	3.4	4.1
Agricultural water development and irrigation services	2.0	2.2	(8.2)	(9.3)
Pollution control	2.0	1.5	.7	.6
All others	<u>2.4</u>	<u>2.0</u>	<u>.9</u>	<u>.3</u>
Totals	\$ <u>25.0</u>	<u>23.1</u>	<u>5.2</u>	<u>3.9</u>

THE DEPARTMENT'S FUNDS

The Department's governmental funds (as presented in the balance sheet on page 14) reported a *combined* fund balance of \$29.3 million, a decrease of \$3.1 million. In addition, these other changes in fund balances should be noted:

- The Department received \$8.7 million of State allotted appropriations and federal grants and spent \$4.7 million this year on irrigation and drainage system capital projects, increasing the fund balance in that capital projects fund by the same amount. The Department anticipates that these funds will be expended in the near future to complete the projects. Although such capital expenditures reduce available fund balances, they create new assets for the Department as reported in the Statement of Net Assets and as discussed in Note 2 to the financial statements.
- During the current year, \$7.35 million was identified by the 2003 Legislature for transfer out of various Department special funds to the State general fund as a source of revenue to meet anticipated budget shortfalls and balance the State's budget.

MANAGEMENT'S DISCUSSION AND ANALYSIS – continued

General Fund Budgetary Highlights

The Department's general fund budget was revised to raise spending ceilings due to collective bargaining increases. With the change in Governor in December 2002 and expenditures expected to exceed projected general fund revenues, a 5% general fund restriction was imposed on the Department's FY 03 discretionary appropriation and all vacant positions were frozen unless Governor approved filling. This freeze on filling vacant positions slowed down the personnel hiring and expenditures. With the commencement of the war with Iraq, which was anticipated to further economic decline, additional spending restrictions were imposed through a spending moratorium on certain discretionary non-payroll funds. Other revisions included appropriation transfers within Department programs to fund payments on accrued vacation pay primarily for personnel in appointed positions whose term of employment expired due to the change of Governor. The Department was forced to use cost savings arising primarily from personnel vacancies in other programs to fund the transfers because the 2002 Legislature deleted the funds budgeted to cover the accrued vacation pay for appointed employees.

With this adjustment, the actual charges to appropriations (expenditures) were \$934,000 below the final budget amounts, or 7.3% of total budgeted expenditures.

The Department's General Fund balance of \$.6 million reported on pages 15 differs from the General Fund's *budgetary* fund balance of \$-0- reported in the budgetary comparison schedule on page 33. This is principally because the *budgetary* fund balance includes \$.9 million of encumbrances reported as expenditures for budgetary purposes.

CAPITAL ASSETS

At the end of June 30, 2003, the Department had \$53 million invested in a broad range of capital assets, including land, agricultural parks, buildings, equipment and motor vehicles (See Table 4 below.) This amount represents a net increase (including additions and deductions) of \$10.4 million over last year.

Table 4
Capital Assets at Year-end
(Net of Depreciation, in Millions)

	<u>2003</u>	<u>2002</u>
Land	\$ 22.5	21.9
Buildings	14.2	7.8
Land improvements	3.9	3.9
Furniture and equipment	.8	.5
Motor vehicles	.4	.3
Construction in progress	<u>11.4</u>	<u>8.2</u>
Total	\$ <u>53.2</u>	<u>42.6</u>

This year's major additions included \$3.9 million for construction of irrigation and drainage infrastructure, paid for with the proceeds from general obligation bonds and federal grants.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The continuing uncertain economic climate prompted the Governor to carry-over the Department's current year's general fund restrictions as permanent reductions to the next fiscal biennium 2004-2005 budget and continue the freeze on filling vacant positions. Although economic indicators suggest a strengthening of the economy and projected revenue growth in the future, impending collective bargaining negotiations, current and possible future strikes, and the Legislature's desire to fund critical needs and demands of the community may result in further budget reductions and/or restrictions. An additional \$1.4 million has been identified by the 2003 Legislature for transfer out of various Department special funds to the State general fund in FY 04.

CONTACTING THE DEPARTMENT'S FINANCIAL MANAGEMENT

This financial report is designed to provide users of our report with a general overview of the Department's finances and to show the Department's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Department's Administrative Services Office at 1428 South King Street, Honolulu, Hawaii.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF NET ASSETS
JUNE 30, 2003**

	<u>Governmental Activities</u>
ASSETS	
Cash and cash equivalents	\$ 32,166,984
Receivables, net	624,332
Prepaid expenses	47,569
Loans receivable, net	21,595,829
Capital assets	
Land, improvements, and construction in progress	33,926,489
Other capital assets, net of depreciation	<u>19,271,914</u>
Total assets	\$ <u>107,633,117</u>
LIABILITIES	
Accounts payable and accrued liabilities	\$ 2,124,150
Due to State General Fund	9,750
Due to agency fund	3,712
Deferred revenues	772,162
Long-term liabilities	
Due within one year	1,420,021
Due in more than one year	<u>2,235,362</u>
Total liabilities	<u>6,565,157</u>
NET ASSETS (DEFICIT)	
Invested in capital assets	53,198,403
Restricted for:	
Capital projects	14,479,190
Agricultural loan program	30,228,970
Other purposes	5,480,870
Unrestricted	(<u>2,319,473</u>)
Total net assets	<u>101,067,960</u>
Total liabilities and net assets	\$ <u>107,633,117</u>

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003**

Functions/Programs	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges For Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Governmental Activities</u>
Governmental activities					
Productivity improvement and management assistance	\$ 9,799,002	3,509,744	614,494	-	(5,674,764)
Product development and marketing	2,908,989	195,186	52,406	-	(2,661,397)
General support for agriculture	5,927,545	916,613	1,615,944	-	(3,394,988)
Agricultural water development and irrigation services	2,057,961	1,175,225	445,081	8,674,274	8,236,619
Pollution control	1,997,834	636,795	705,702	-	(655,337)
Protection of the consumer	582,481	-	-	-	(582,481)
Aquaculture development	542,705	431	40,801	-	(501,473)
Agriculture loans	<u>1,285,713</u>	<u>1,111,066</u>	<u>364,667</u>	<u>-</u>	<u>190,020</u>
	\$ <u>25,102,230</u>	<u>7,545,060</u>	<u>3,839,095</u>	<u>8,674,274</u>	<u>(5,043,801)</u>
General revenues					
State allotted appropriations					10,387,070
Intergovernmental revenues					1,594,221
Transfers					<u>1,946,545</u>
					<u>13,927,836</u>
Change in net assets					8,884,035
Net assets – beginning					<u>92,183,925</u>
Net assets – ending					\$ <u>101,067,960</u>

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
BALANCE SHEET – GOVERNMENTAL FUNDS
JUNE 30, 2003**

	<u>General</u>	<u>Financial Assistance For Agriculture</u>	<u>Promote Agriculture Specialty Crops</u>	<u>Irrigation and Drainage System Capital Projects</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS						
Cash and cash equivalents	\$ 1,570,650	8,801,418	559,159	14,799,138	6,436,619	32,166,984
Prepaid expenses	<u>47,569</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>47,569</u>
Total assets	\$ <u>1,618,219</u>	<u>8,801,418</u>	<u>559,159</u>	<u>14,799,138</u>	<u>6,436,619</u>	<u>32,214,553</u>
LIABILITIES AND FUND EQUITY						
Liabilities						
Vouchers payable	\$ 602,866	-	66,000	319,948	504,094	1,492,908
Accrued payroll	417,993	23,837	-	-	189,412	631,242
Due to State General Fund	9,750	-	-	-	-	9,750
Due to agency fund	-	3,713	-	-	-	3,713
Deferred revenues	<u>-</u>	<u>-</u>	<u>493,159</u>	<u>-</u>	<u>279,002</u>	<u>772,161</u>
Total liabilities	<u>1,030,609</u>	<u>27,550</u>	<u>559,159</u>	<u>319,948</u>	<u>972,508</u>	<u>2,909,774</u>
Fund balances (deficit)						
Reserved for encumbrances	903,669	2,106,000	-	3,872,200	591,645	7,473,514
Reserved for continuing appropriations	-	6,667,868	-	10,606,990	4,872,466	22,147,324
Unreserved	(316,059)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	(316,059)
Total fund balances	<u>587,610</u>	<u>8,773,868</u>	<u>-</u>	<u>14,479,190</u>	<u>5,464,111</u>	<u>29,304,779</u>
Total liabilities and fund balances	\$ <u>1,618,219</u>	<u>8,801,418</u>	<u>559,159</u>	<u>14,799,138</u>	<u>6,436,619</u>	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds						53,198,403
Receivables in the statement of activities that do not provide current financial resources are not reported as receivables in the funds						624,332
Agricultural loans not available to pay for current-period expenditures and therefore are deferred in the funds						21,595,829
Some liabilities, such as compensated absences, are not due and payable in the current period and therefore are not reported in the funds						(3,655,383)
Net assets of governmental activities						\$ <u>101,067,960</u>

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES - GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2003**

	General	Financial Assistance For Agriculture	Promote Agriculture Specialty Crops	Irrigation and Drainage System Capital Projects	Other Governmental Funds	Total Governmental Funds
Revenues						
State allotted appropriations	\$ 11,557,450	-	-	6,690,000	-	18,247,450
Intergovernmental	1,594,221	-	1,169,042	1,984,275	2,085,446	6,832,984
Interest on agricultural loans	-	1,423,422	-	-	-	1,423,422
Agricultural loan repayments	-	2,399,226	-	-	-	2,399,226
Charges for services	-	-	-	-	6,275,681	6,275,681
Investment earnings	-	364,667	-	-	219,940	584,607
Total revenues	<u>13,151,671</u>	<u>4,187,315</u>	<u>1,169,042</u>	<u>8,674,275</u>	<u>8,581,067</u>	<u>35,763,370</u>
Expenditures						
Current						
Productivity improvement and management assistance	5,580,955	-	-	-	3,813,430	9,394,385
Product development and marketing	2,615,253	-	-	-	254,313	2,869,566
General support for agriculture	2,359,118	-	1,169,042	-	1,526,397	5,054,557
Agricultural water development and irrigation services	352,617	-	-	-	1,978,537	2,331,154
Pollution control	714,232	-	-	-	1,275,186	1,989,418
Protection of the consumer	764,251	-	-	-	-	764,251
Aquaculture development	487,550	-	-	-	40,247	527,797
Agricultural loans	-	5,504,034	-	-	-	5,504,034
Capital outlay	-	-	-	3,947,680	-	3,947,680
Total expenditures	<u>12,873,976</u>	<u>5,504,034</u>	<u>1,169,042</u>	<u>3,947,680</u>	<u>8,888,110</u>	<u>32,382,842</u>
Excess of revenues over (under) expenditures	<u>277,695</u>	<u>(1,316,719)</u>	<u>-</u>	<u>4,726,595</u>	<u>(307,043)</u>	<u>3,380,528</u>
Other financing sources						
Lapsed appropriations	(1,019,155)	-	-	(151,225)	-	(1,170,380)
Operating transfers in	-	-	-	2,000,000	330,958	2,330,958
Operating transfers out	(330,958)	(5,800,000)	-	-	(1,550,000)	(7,680,958)
	<u>(1,350,113)</u>	<u>(5,800,000)</u>	<u>-</u>	<u>1,848,775</u>	<u>(1,219,042)</u>	<u>(6,520,380)</u>
Excess of revenues and other sources over (under) expenditures and other uses	<u>(1,072,418)</u>	<u>(7,116,719)</u>	<u>-</u>	<u>6,575,370</u>	<u>(1,526,085)</u>	<u>(3,139,852)</u>
Fund balances at July 1, 2002	<u>1,660,028</u>	<u>15,890,587</u>	<u>-</u>	<u>7,903,820</u>	<u>6,990,196</u>	<u>32,444,631</u>
Fund balances at June 30, 2003	<u>\$ 587,610</u>	<u>8,773,868</u>	<u>-</u>	<u>14,479,190</u>	<u>5,464,111</u>	<u>29,304,779</u>

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003**

Net change in fund balances – total governmental funds	\$ (3,139,852)
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	10,547,162
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds	151,201
Issuance of agricultural loans are expenditures and repayment of agricultural loans are revenues in the governmental funds, but are reported as an increase or decrease of loans receivable in the statement of net assets	1,682,038
Some expenses reported in the statement of activities, such as compensated absences, do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds	(<u>356,514</u>)
Change in net assets of governmental activities	\$ <u><u>8,884,035</u></u>

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2003**

	Private- Purpose <u>Trusts</u>	<u>Agency</u>
ASSETS		
Cash and cash equivalents	\$ 23,416	45,133
Loans receivable, net	-	217,911
Due to special funds	<u>-</u>	<u>3,713</u>
Total assets	\$ <u>23,416</u>	<u>266,757</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Vouchers payable	\$ -	37,431
Accrued payroll, workers compensation and vacation payable	29,827	
Due to others		7,702
Due to State General Fund	<u>-</u>	<u>221,624</u>
Total liabilities	<u>29,827</u>	<u>266,757</u>
Net assets (deficit)	(<u>6,411</u>)	<u>-</u>
	\$ <u>23,416</u>	<u>266,757</u>

The accompanying notes are an integral part of these financial statements.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
JUNE 30, 2003

	Private- Purpose <u>Trusts</u>
Revenues	
Other revenues	\$ 419,485
Expenditures	
Expendable trust funds	<u>451,726</u>
Excess of revenues over (under) expenditures	(32,241)
Net assets at July 1, 2002	<u>25,830</u>
Net assets (deficit) at June 30, 2003	\$ (<u>6,411</u>)

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2003**

NOTE 1 - NATURE OF ORGANIZATION

The mission of the Department of Agriculture of the State of Hawaii (Department) is to stimulate growth in agriculture with programs that provide the foundation for agricultural enterprises to build successful businesses. The Department administers and oversees programs that include plant quarantine, control of plant diseases and pests, livestock disease control, animal quarantine, agricultural park, aquaculture development, irrigation system, inspection and grading of commodities, monitoring the production and processing of milk, measurement standards, collection and dissemination of agricultural statistics and import and export statistics, granting agricultural loans, and market development and promotion of Hawaiian grown products.

The Board of Agriculture (Board) is responsible for the direction of the Department's activities. The ten member Board is appointed by the Governor with the consent of the Senate to serve four year terms and may be appointed to an additional term.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity

The Department's financial statements reflect only its activities. The State Comptroller maintains the central accounts for all State funds and publishes a comprehensive annual financial report for the State which includes the Department's financial activities.

The Department's financial statements include the activities of the Agribusiness Development Corporation, a separate public instrumentality affiliated with the Department for administrative purposes.

Basis of presentation

The Department complies with generally accepted accounting principles (GAAP). GAAP includes all relevant Governmental Accounting Standards Board (GASB) pronouncements.

Government-wide financial statements

The statement of net assets and the statement of activities display information about the reporting government as a whole. They include all funds of the reporting entity except for fiduciary funds.

Fund financial statements

Fund financial statements of the Department are organized on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Governmental funds

Governmental funds are those through which the acquisition, use and balances of the Department's expendable financial resources and the related liabilities are accounted for. The measurement focus is on the flow of current financial resources. The following are the Department's governmental fund types:

General fund - The general fund is the general operating fund of the Department and is always classified as a major fund. It is used to account for all financial activities except those required to be accounted for in another fund. The general fund presented is a part of the State's general fund and is limited only to those appropriations and obligations of the Department.

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

Capital projects funds - Capital projects funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary funds

Trust and agency funds - Trust and agency funds are used to account for assets held by the Department in a trustee or agency capacity. These include expendable trust funds which account for cash collected and expended by the Department as trustee and agency funds which account for the cash collected and expended by the Department in a custodial capacity.

Major funds

The following are the activities of the major funds accounted for in the fund financial statements:

General - See above for description.

Special revenue funds -

Financial assistance for agriculture - Accounts for revenues and expenditures of providing agricultural loans in the State of Hawaii.

Promote Agriculture Specialty Crops - Accounts for revenues and expenditures of promoting agriculture specialty crops of the State of Hawaii.

Capital projects funds -

Irrigation and drainage system - Accounts for resources restricted for the acquisition or construction of irrigation and drainage systems.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Basis of accounting

The government-wide financial statements of the Department are presented on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

The fund financial statements, which include governmental funds, expendable trust funds, and agency funds, are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when susceptible to accrual, i.e., both measurable and available, usually when the appropriations are allotted. Expenditures are generally recognized when the related liability is incurred, except for accumulated unpaid vacation and workers compensation benefits, which are recognized as an expenditure when payable from expendable available resources.

In applying the susceptible to accrual concept to federal grant revenues, the legal and contractual requirements of the numerous individual programs are used as guidance. Under most of the Department's federal programs, moneys must be expended for a specific purpose or project; therefore, revenue is recognized to the extent that expenditures are recognized.

Cash and cash equivalents

Cash and cash equivalents reported in the balance sheet includes cash in the State Treasury and cash in a Hawaii-based bank.

The State of Hawaii maintains a cash pool that is available for all funds. Each fund type's portion of this pool is displayed on the balance sheet within cash and cash equivalents. Those funds are pooled with funds from other State of Hawaii agencies and departments and deposited in approved financial institutions by the Director of Finance. Deposits not covered by federal deposit insurance are fully collateralized by government securities held in the name of the State of Hawaii by third party custodians.

Hawaii Revised Statutes (HRS) authorize the Director of Finance to invest any moneys of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State, 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.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Fixed assets

Fixed assets (primarily land, buildings, improvements, furniture and equipment) on the government-wide financial statements are accounted for as capital assets. All fixed assets are recorded at historical cost, or estimated historical cost if actual is unavailable. Depreciation on all exhaustible fixed assets is recorded as an allocated expense in the statement of activities and accumulated depreciation reflected in the statement of net assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	30 years
Land improvements	15 years
Furniture and equipment	7 years
Motor vehicles	5 years

The Department began to report and depreciate new infrastructure assets effective for the year ended June 30, 2002. Infrastructure assets include irrigation and drainage systems, etc. Prior to July 2002, neither their historical cost nor related depreciation has historically been reported in the financial statements. The Department has elected to utilize the infrastructure transition option in the implementation of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-For State and Local Governments* in the current year and plans to implement the retroactive infrastructure provisions in the fiscal year ending June 30, 2004.

Fixed assets on the fund financial statements are recorded as capital outlay expenditures of the governmental fund upon acquisition.

Compensated absences

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end, and is convertible to pay upon termination of employment. The liability for these compensated absences is recorded as long-term liabilities in the government-wide financials statements. The current portion of this liability is estimated based on historical trends. In fund financial statements, the amounts expected to be liquidated with expendable available financial resources are accrued in the respective funds.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

Fund balances

Reserved amounts in fund balances represent amounts that are not appropriable for expenditure or legally segregated for a specific future use. Portions of the fund balances are reserved for the following:

- Encumbrances for outstanding commitments which generally are liquidated in the subsequent fiscal year.
- Loans receivable which are not currently available for expenditure at the balance sheet date.
- Expendable trust fund balances which are restricted to the purpose of the account.
- Continuing appropriations for unencumbered allotment balances representing amounts that have been released and made available for encumbrance or expenditure and are legally segregated for a specific future use.

Appropriations

Appropriations represent an authorization granted by the State legislature permitting 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, except for allotted appropriations related to capital improvement projects.

Employee benefit expenditures

Employee benefit expenditures related to the Department's employees are paid by another state agency and are not reflected in the financial statements unless reimbursed under Federal contracts.

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 financial statements.

NOTE 3 - BUDGETING AND BUDGETARY CONTROL

The budget of the Department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected as budgeted revenues are those estimates as compiled by the Department. Budgeted expenditures are derived primarily from a biennial general appropriations act as amended by any supplemental or other specific appropriations acts.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 3 - BUDGETING AND BUDGETARY CONTROL - continued

The Department follows these procedures in establishing the budgetary data reflected in the financial statements:

The Budget - Not less than 30 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendations of the Governor for each succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress, and an estimate for the succeeding biennium.

Legislative Review - The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analyses of programs and finances as will assist in determining the State's program and financial plan and budget.

Program Execution - Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

All expenditures of these appropriated funds are made pursuant to the appropriation in the biennial budget as amended by subsequent supplemental appropriations. The final legally adopted budget represents the original appropriations, supplemental appropriations, transfers and other legally authorized legislative and executive changes.

Budgetary control is maintained at the appropriation line item as established in the appropriation acts. The Governor is authorized to transfer appropriations within a State agency; however, transfers of appropriations between State agencies generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the Department.

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

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003

NOTE 3 - BUDGETING AND BUDGETARY CONTROL - continued

Budgets adopted by the State Legislature for the general and major special revenue funds are presented in the budgetary comparison schedule. The Department's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to the encumbrances of purchase order and contract obligations as expenditures for budgetary purposes. These differences represent departures from generally accepted accounting principles (GAAP). A reconciliation between non-GAAP budgetary actual and GAAP actual is as follows:

	<u>General Fund</u>	<u>Financial Assistance For Agriculture</u>	<u>Promote Agriculture Specialty Crops</u>
Excess of revenues and other sources over (under) expenditures and other uses – actual on budgetary basis	\$ 934,123	(6,917,621)	1,093,702
Reserved for encumbrances at fiscal year-end	903,669	2,106,000	-
Revenue and expenditure accruals for the year not recognized for budgetary purposes, net of prior year accruals	457,255	12,291	(1,093,702)
Lapsed appropriations	(1,019,155)	-	-
Expenditures for prior fiscal years' encumbrances	(2,348,310)	(2,317,389)	<u>-</u>
Excess of revenues and other sources over (under) expenditures and other uses - GAAP basis	\$ (1,072,418)	(7,116,719)	<u><u>-</u></u>

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 3 - BUDGETING AND BUDGETARY CONTROL - continued

Funds for the Department appropriated from the State's general revenues for the fiscal year ended June 30, 2003, were authorized under the following appropriations:

Act 177, Session Laws of Hawaii (SLH) of 2002 for the operating budget of the Department:	
Productivity improvement and management assistance	\$ 5,004,454
Product development and marketing	2,488,693
General support for agriculture	2,084,026
Agricultural water development and irrigation services	261,684
Pollution control	620,478
Protection of the consumer	623,970
Aquaculture development	435,145
Act 197, SLH of 2002, for pineapple research	<u>39,000</u>
Budget total	\$ <u>11,557,450</u>

NOTE 4 - CASH AND CASH EQUIVALENTS

Information relating to insurance and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

At June 30, 2003, the carrying amount of the Department's cash and cash equivalents, which approximates the bank balance, was \$32,166,984.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003

NOTE 5 - LOANS RECEIVABLE

At June 30, 2003, loans receivable consisted of the following:

	<u>Special Revenue</u>	<u>Agency</u>
Hawaii Agriculture Loan Program	\$ 20,987,517	-
Hawaii Aquaculture Loan Program	1,100,578	-
Hawaii Agricultural Products Loan Program	77,517	-
Independent Sugar Growers Loan Program	-	168,556
Emergency Loan Program		49,355
Accrued interest	<u>580,217</u>	<u>-</u>
	22,745,829	217,911
Less allowance for doubtful receivables	<u>1,150,000</u>	<u>-</u>
	<u>\$ 21,595,829</u>	<u>217,911</u>

The Department grants credit in the form of loans to farmers, all of whom are located in the State of Hawaii. The loans are collateralized by real estate, equipment, crops and other assets of the borrower.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003

NOTE 6 - CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	Balance <u>July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	Balance <u>June 30, 2003</u>
Governmental activities				
Capital assets not being depreciated				
Land	\$ 21,954,327	601,000	-	22,555,327
Construction in progress	<u>8,190,525</u>	<u>3,947,680</u>	<u>767,043</u>	<u>11,371,162</u>
Total capital assets not being depreciated	<u>30,144,852</u>	<u>4,548,680</u>	<u>767,043</u>	<u>33,926,489</u>
Other capital assets				
Buildings	13,911,023	7,035,675	475,000	20,471,698
Land improvements	19,035,163	767,043	-	19,802,206
Furniture and equipment	3,653,788	594,859	465,843	3,782,804
Motor vehicles	<u>2,386,853</u>	<u>286,375</u>	<u>263,159</u>	<u>2,410,069</u>
Total other capital assets at historical cost	<u>38,986,827</u>	<u>8,683,952</u>	<u>1,204,002</u>	<u>46,466,777</u>
Less accumulated depreciation				
Buildings	6,139,581	574,019	475,000	6,238,600
Land improvements	15,123,679	794,880	-	15,918,559
Furniture and equipment	3,109,157	111,970	220,077	3,001,050
Motor vehicles	<u>2,108,023</u>	<u>181,850</u>	<u>253,219</u>	<u>2,036,654</u>
Total accumulated depreciation	<u>26,480,440</u>	<u>1,662,719</u>	<u>948,296</u>	<u>27,194,863</u>
Governmental activities capital assets, net	\$ <u>42,651,239</u>	<u>11,569,913</u>	<u>1,022,749</u>	<u>53,198,403</u>

Depreciation expense for the year ended June 30, 2003 was charged to governmental activities as follows:

Productivity improvement and management assistance	\$ 496,455
Product development and marketing	50,084
General support for agriculture	116,485
Agricultural water development and irrigation services	889,697
Pollution control	18,983
Protection of the consumer	16,693
Aquaculture development	1,950
Agricultural loans	<u>37,905</u>
	\$ <u>1,628,252</u>

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 7 - LEASES

The Department, as lessor, has noncancelable lease agreements for parcels of land at agricultural parks located throughout the State of Hawaii. The lease agreements have minimum and, where applicable, additional rent based on a percentage of revenues and terms of up to 55 years. Minimum future lease revenue for fiscal years after June 30, 2003 is as follows:

2004	\$ 388,000
2005	365,000
2006	365,000
2007	365,000
2008	365,000
Thereafter	<u>10,172,000</u>
	<u>\$ 12,020,000</u>

Rental income from leases at the agricultural parks for the year ended June 30, 2003 amounted to \$354,095, including \$30,542 for additional rent based on a percentage of revenues.

NOTE 8 - LONG-TERM LIABILITIES

Long term liability activity for the year ended June 30, 2003, was as follows:

	<u>Balance July 1, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2003</u>
Governmental activities				
Compensated absences	<u>\$ 3,298,869</u>	<u>356,514</u>	<u>-</u>	<u>3,655,383</u>

Compensated absences liabilities will be liquidated primarily by the general fund. In the past, approximately 80% has been paid by the general fund and the remainder by various other governmental funds.

NOTE 9 - RETIREMENT PLAN

Substantially all eligible employees of the Department are 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, disability and survivor benefits for State employees, teachers, professors, county employees, police officers, firefighters, judges and elected officials. All contributions, benefits, and eligibility requirements are governed by Chapter 88 of the Hawaii Revised Statutes.

DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003

NOTE 10- RETIREMENT PLAN - continued

Measurement of assets and actuarial valuations are prepared for the entire ERS and are not separately computed for individual participating employers such as the Department. The ERS issues a publicly available report that includes financial statements and required supplementary information for the ERS. That report may be obtained by writing to Employees' Retirement System of the State of Hawaii, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813 or by calling 1-808-586-1735.

Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are excluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service for the contributory and noncontributory options, respectively. Most members of the contributory plan are required to contribute 7.8% of their salary.

Required employer contributions to the ERS are based on actuarially determined rates that should provide sufficient resources to pay member pension benefits when due. The funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contribution is comprised of the "normal cost" plus the level annual payment required to amortize the unfunded actuarial accrued liability over the remaining period to June 30, 2016. The employer normal cost is the level percentage of payroll contribution required to pay all benefits. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer unfunded accrued liability.

For the years ended June 30, 2003, 2002, and 2001, the actuarially determined contribution requirements for the ERS were as follows:

<u>For year ended June 30,</u>	
2003	\$190,586,000
2002	167,458,900
2001	8,132,000

The contribution requirements are prepared for the entire ERS and are not separately computed for individual participating employers such as the Department. The Department's general fund share of the retirement system expense for the year ended June 30, 2003, was included as an item to be expended by the Department of Budget and Finance and is not reflected in the Department's general fund financial statements. No contributions were expended from Special Revenue and Expendable Trust Funds for the year ended June 30, 2003.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 11- 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 based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The Department's general fund share of expense for post-retirement benefits for the fiscal year ended June 30, 2003 has not been separately computed and is not reflected in the Department's general fund financial statements.

NOTE 12 - ACCUMULATED SICK LEAVE

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a State employee who retires or leaves government service in good standing with sixty days or more of unused sick leave shall be entitled to additional service credit in the Employee's Retirement System. Accumulated sick leave at June 30, 2003 was approximately \$10,635,000.

NOTE 13 - DEFERRED COMPENSATION PLAN

The State established a deferred compensation plan pursuant to Internal Revenue Code Section 457 which enables State employees to defer a portion of their compensation. The State of Hawaii, Department of Human Resources Development, has the fiduciary responsibility for administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employees or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the general creditors of the State in an amount equal to the fair market value of the deferred account for each participant. The assets of the plan and the deferred compensation payable are recorded in the State of Hawaii's Employee Benefits Agency Fund.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTES TO FINANCIAL STATEMENTS - continued
JUNE 30, 2003**

NOTE 14 - COMMITMENTS AND CONTINGENCIES

The Department is involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's general fund.

The State maintains certain insurance coverages to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State follows GASB Statement No. 10, "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" which establishes accounting and financial reporting standards for risk financing and insurance related activities of state governmental entities and requires the recordation of a risk liability for financing and insurance related losses, including those incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. Previously, these losses were recorded on a pay-as-you-go basis. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2003, the State recorded an estimated loss for workers' compensation, automobile and general liability claims in the statement of net assets as the losses will be not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's general fund. The Department's share of workers' compensation losses are appropriated annually in the general fund. Workers compensation expenditures for the year ended June 30, 2003 were \$7,554.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
(BUDGET AND ACTUAL) - GENERAL FUND
YEAR ENDED JUNE 30, 2003**

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	Budgetary Basis	Final Budget Positive (Negative)
Budgetary fund balance at July 1, 2002	\$ -	-	-	-
Revenues				
State allotted appropriations	11,557,450	11,557,450	11,557,450	-
Intergovernmental	-	<u>1,594,221</u>	<u>1,594,221</u>	-
	<u>11,557,450</u>	<u>13,151,671</u>	<u>13,151,671</u>	-
Expenditures				
Productivity improvement and management assistance	5,004,454	5,743,720	5,390,622	353,098
Product development and marketing	2,488,693	2,847,008	2,612,338	234,670
General support for agriculture	1,932,468	2,216,509	1,989,363	227,146
Agricultural water development and irrigation services	121,284	121,284	110,504	10,780
Pollution control	620,478	718,458	716,439	2,019
Protection of the consumer	623,970	705,868	633,786	72,082
Aquaculture development	<u>435,145</u>	<u>467,866</u>	<u>433,538</u>	<u>34,328</u>
	<u>11,226,492</u>	<u>12,820,713</u>	<u>11,886,590</u>	<u>934,123</u>
Excess of revenues over expenditures	330,958	330,958	1,265,081	934,123
Other financing sources				
Operating transfers in (out)	(330,958)	(330,958)	(330,958)	-
Excess of revenues and other sources over expenditures and other uses	-	-	934,123	934,123
Lapsed appropriations	-	-	(934,123)	(934,123)
Budgetary fund balance at June 30, 2003	\$ -	-	-	-

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
(BUDGET AND ACTUAL) – MAJOR SPECIAL REVENUE FUNDS
YEAR ENDED JUNE 30, 2003**

	<u>Budgeted Amounts</u>		<u>Actual Amounts</u>	<u>Variance with</u>
	<u>Original</u>	<u>Final</u>	<u>Budgetary</u>	<u>Final Budget</u>
			<u>Basis</u>	<u>Postive (Negative)</u>
Financial Assistance for Agriculture				
Revenues				
Charges for services and investment income	\$ 15,880,954	15,950,954	4,191,028	(11,759,926)
Expenditures				
Agricultural loans	<u>15,880,954</u>	<u>15,950,954</u>	<u>5,308,649</u>	<u>10,642,305</u>
Excess of revenues and other sources over (under)				
expenditures	-	-	(1,117,621)	(1,117,621)
Other financing sources				
Operating transfers in (out)	(5,800,000)	(5,800,000)	(5,800,000)	-
Excess of revenues and other sources over (under)				
expenditures and other uses	\$ (5,800,000)	(5,800,000)	(6,917,621)	(1,117,621)
 Promote Agriculture Specialty Crops				
Revenues				
Charges for services and investment income	\$ 1,652,862	1,652,862	9,339	(1,640,661)
Expenditures				
Productivity improvement and management				
assistance	<u>1,652,862</u>	<u>1,652,862</u>	<u>1,103,042</u>	<u>546,958</u>
Excess of revenues and other sources over (under)				
expenditures and other uses	\$ <u>-</u>	<u>-</u>	(1,093,703)	(1,093,703)

The accompanying notes are an integral part of these financial statements.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2003**

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Expenditures</u>
<u>Department of Agriculture (USDA)</u>			
Cooperative National Plant Pest Survey and Detection	10.025	02-8511-0009-CA	\$ 15,565
Homeland Security for Pest Detection Activity		02-8510-0586-CA	118,232
Homeland Security for Animal Disease Emergency Response Preparedness		215-9715-943	57,067
Hawaii Brown Tree Snake Detector Program		02-73-15-5388-GR	<u>135,452</u>
			<u>326,316</u>
Upcountry Maui Watershed	10.904	69-9251-9-454	58,377
		68-9251-1-524	55,035
		68-9251-2-591	19,954
Lower Hamakua Watershed, Hawaii		65-9251-1-512	11,160
		65-9251-1-514	102,768
		69-9251-1-516	85,278
		68-9251-1-549	5,333
		69-9251-1-562	523,865
		69-9251-1-563	322,359
		69-9251-1-564	329,101
		69-9251-1-565	546,055
		68-9251-1-583	26,768
		65-9251-1-584	<u>173,630</u>
			<u>2,259,683</u> *
Meat Grading and Certification Service	10.162	12-25-A-3850	172
Shell Egg Surveillance		12-25-A-3310	<u>14,343</u>
			<u>14,515</u>
Cooperative Pesticide Recordkeeping	10.163	12-25-A-4053	<u>5,893</u>
An Agricultural Market Information System for Small Farm Decision-Making in Hawaii	10.156	12-25-G-0303	<u>16,353</u>
Cooperative Forest Health Prevention and Suppression	10.664	00-DG-11052000-146	<u>2,911</u>
Exploration for Biological Control of Melon Fly In Indo-Malayan Region	10.001	58-5320-1-530	<u>16,285</u>

* Denotes a major program.

The accompanying note is an integral part of this schedule.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS - continued
YEAR ENDED JUNE 30, 2003**

<u>Federal Grantor/Pass-through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Grant Number</u>	<u>Expenditures</u>	
<u>Department of Agriculture (USDA) - continued</u>				
Promote Specialty Crops	Not Available	Public Law No. 107-25, Section 7	\$ <u>1,103,042</u>	*
Passed through the State Department of Land and Natural Resources and Oceanic Institute Disease Management for Hawaiian Aquaculture	10.950	97-38500-4042	<u>39,737</u>	
Total Department of Agriculture			<u>3,784,735</u>	
<u>Environmental Protection Agency (EPA)</u>				
Consolidated Pesticide Compliance Monitoring and Program Cooperative Agreements	66.700	E-009159-02-0 X-989512-01-0 E-009419-02-0	326,010 125,000 <u>31,025</u>	
Total Environmental Protection Agency			<u>482,035</u>	*
<u>Department of Interior</u>				
Research and Development for the Brown Tree Snake	15.875	2001/2002 Interior Appropriations Act	<u>126,987</u>	
Hawaii Water Resources Study	15.504	02-FG-30-0029	<u>71,500</u>	
Total Department of Interior			<u>198,487</u>	
<u>Department of Commerce</u>				
Voluntary Inspection Services for Fish and Fishery Products	Not available	45ABNMA0B1070	<u>6,222</u>	
Total Department of Commerce			<u>6,222</u>	
<u>Department of Defense</u>				
Operation and Maintenance Work at the Nohili And Kawaiele Pump Stations	Not available	N62742-01-C-3515	<u>902,687</u>	
Total Department of Defense			<u>902,687</u>	
			\$ <u>5,374,166</u>	

* Denotes a major program.

The accompanying note is an integral part of this schedule.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
NOTE TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2003**

BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A - 133, *Audits of States, Local Governments, and Non-Profit Organizations*.

CHOO, OSADA & LEE, CPAs, INC.

CERTIFIED PUBLIC ACCOUNTANTS

3536 HARDING AVENUE
SUITE 605
HONOLULU, HAWAII 96816

TELEPHONE (808) 734-1921

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

To the Board of Agriculture
State of Hawaii

We have audited the financial statements of the Department of Agriculture of the State of Hawaii (Department), as of and for the year ended June 30, 2003, and have issued our report thereon dated February 20, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Department's 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 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 Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting 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 misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Agriculture, management, others within the organization and 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.

Choo, Osada & Lee, CPAs, Inc.

Honolulu, Hawaii
February 20, 2004

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

To the Board of Agriculture
State of Hawaii

Compliance

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

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003. However, the results of our auditing procedures disclosed an instance of noncompliance that is required to be reported under OMB Circular A-133 which is described in the accompanying schedule of findings and questioned costs as item 03-1.

Internal Control Over Compliance

The management of the Department 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 Department'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 the Board of Agriculture, management, others within the organization and 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.

Choo, Osada & Lee, CPAs, Inc.

Honolulu, Hawaii
February 20, 2004

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2003**

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: unqualified

Internal control over financial reporting:

Material weaknesses identified? _____yes X no

Reportable conditions identified
not considered to be material weaknesses? _____yes X none reported

Noncompliance material to financial statements noted? _____yes X no

Federal Awards

Internal control over major programs:

Material weaknesses identified? _____yes X no

Reportable conditions identified
not considered to be material weaknesses? _____yes X none reported

Type of auditor's report issued on compliance for
major programs: unqualified

Any audit findings disclosed that are required to be
reported in accordance with Circular A-133,
Section .510(a)? X yes _____no

Identification of major programs:

CFDA Number

Name of Federal Program or Cluster

Not available

Department of Agriculture

Promote agriculture, with priority being given to
specialty crops

66.700

Environmental Protection Agency

Consolidated Pesticide Enforcement Cooperative
Agreements

10.904

Department of Agriculture

Watershed Protection and Flood Protection

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
SCHEDULE OF FINDINGS AND QUESTIONED COSTS - continued
YEAR ENDED JUNE 30, 2003**

Section I - Summary of Auditor's Results - continued

Dollar threshold used to distinguish between
Type A and Type B programs:

\$ 300,000

Auditee qualified as low-risk auditee?

_____yes X no

Section II - Financial Statement Findings

No matters were reported.

Section III - Federal Award Findings and Questioned Costs

**Finding No. 03-1 UPCOUNTRY MAUI WATERSHED; DRAINAGE, WAIMANALO IRRIGATION SYSTEM;
LOWER HAMAKUA WATERSHED, HAWAII. CFDA: 10.904; AND PROMOTE AGRICULTURE, WITH
PRIORITY BEING GIVEN TO SPECIALTY CROPS. CFDA: NONE**

Condition

According to Office of Management and Budget Circular A-133, Part 3(I), "Contractors receiving individual awards of \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred." Suspension and debarment certifications from contractors receiving Federal monies in excess of \$100,000 were not obtained.

Recommendation

We recommend that the Department obtain suspension and debarment certifications from all contractors submitting bids for contracts exceeding \$100,000.

**DEPARTMENT OF AGRICULTURE
STATE OF HAWAII
SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2003**

Section I - Findings Related To Federal Programs

Finding 02-1 for the year ended June 30, 2002 has been repeated and has been reported to management as finding 03-1 for the year ended June 30, 2003.

Finding 02-2 for the year ended June 30, 2002 has been corrected and thus will not be repeated for the year ended June 30, 2003.

LINDA LINGLE
Governor



SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DIANE LEY
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 South King Street
Honolulu, Hawaii 96814-2512
Phone: (808) 973-9600 Fax: (808) 973-9613

March 19, 2004

Choo, Osada & Lee, CPAs, Inc.
3536 Harding Avenue, Suite 605
Honolulu, HI 96816

Gentlemen:

Thank you for the opportunity to review and provide comments on the draft report of the Financial and Compliance Audit of the Department of Agriculture for the fiscal year ended June 30, 2003.

We commend the Choo, Osada & Lee staff for the cooperative and professional manner in which they conducted themselves during this audit.

Please feel free to call Elaine Abe of my staff at 973-9606 if there are any questions, or if additional information is needed.

Sincerely,

A handwritten signature in black ink, appearing to read "Sandra Lee Kunimoto", is written over a horizontal line.

Sandra Lee Kunimoto
Chairperson, Board of Agriculture

Enclosure

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2003**

Section III – Federal Award Findings and Questioned Costs

Finding No. 03-01 UPCOUNTRY MAUI WATERSHED; DRAINAGE, WAIMANALO IRRIGATION SYSTEM; LOWER HAMAKUA WATERSHED, HAWAII. CFDA: 10.904; AND PROMOTE AGRICULTURE, WITH PRIORITY GIVEN TO SPECIALTY CROPS. CFDA: NONE.

Condition:

According to Office of Management and Budget Circular A-133, Part 3(I), "Contractors receiving individual awards of \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred." Suspension and debarment certifications from contractors receiving Federal monies in excess of \$100,000 were not obtained.

Recommendation:

We recommend that the Department obtain suspension and debarment certifications from all contractors submitting bids for contracts exceeding \$100,000.

Response:

Upcountry Maui Watershed: On March 2, 2004, notification was given to Agricultural Resource Management Division staff and the Engineering Division of the Department of Land and Natural Resources (our contract manager), that all department contracts involving federal funds require suspension and debarment certifications by the contractor. A sample form was included. Henceforth, the Agricultural Resource Management Division will verify that all contractors submitting bid proposals on federally funded projects have submitted a signed certification.

Specialty Crops: All USDA Specialty Crop Fund contractors with funds exceeding \$100,000 will be requested to sign the certifications. Deadline to submit the signed certifications will be April 30, 2004. Contractors submitting proposals on all federal funded projects will be required to submit the signed certification regardless of the dollar amount. Submittal of signed suspension and debarment certifications by contractors will be a condition for receiving an award.

Finally, a memo will be disseminated to all department programs reminding them of the requirement of the Office of Management and Budget Circular A-133, Part 3(I), "Contractors receiving individual awards of \$100,000 or more and all subrecipients must certify that the organization and its principals are not suspended or debarred."