



**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Basic Financial Statements and Single Audit Reports

June 30, 2007

(With Independent Auditors' Report Thereon)

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Table of Contents

	Page
I. Introduction	
Audit Objectives	1
Scope of Audit	1
Organization of Report	2
II. Basic Financial Statements	
Independent Auditors' Report	3
Management's Discussion and Analysis	5
Department-Wide Financial Statements:	
Statement of Net Assets	12
Statement of Activities	13
Fund Financial Statements:	
Balance Sheet – Governmental Funds	14
Reconciliation of Governmental Funds Balance Sheet to the Statement of Net Assets	15
Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds	16
Reconciliation of Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities	17
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – General Fund and Federal Fund	18
Statement of Net Assets – Proprietary Funds	19
Statement of Revenues, Expenses, and Changes in Fund Net Assets – Proprietary Funds	20
Statement of Cash Flows – Proprietary Funds	21
Statement of Fiduciary Net Assets – Fiduciary Funds	22
Notes to Basic Financial Statements	23
III. Supplementary Information	
Combining Balance Sheet – Nonmajor Governmental Funds	38
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Nonmajor Governmental Funds	39

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Table of Contents

	Page
IV. Compliance and Internal Control over Financial Reporting	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	40
V. Compliance and Internal Control over Federal Awards	
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133	42
Schedule of Expenditures of Federal Awards	44
Notes to Schedule of Expenditures of Federal Awards	51
Schedule of Findings and Questioned Costs	53

SECTION I

Introduction



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

June 17, 2008

The Director
Department of Labor and Industrial Relations
State of Hawaii:

We have completed our audit of the basic financial statements of the Department of Labor and Industrial Relations, State of Hawaii (the Department), as of and for the year ended June 30, 2007. We have also audited the Department's compliance with requirements applicable to its major federal financial assistance programs. We submit herein our reports on compliance and on internal control over financial reporting and over federal awards, a schedule of expenditures of federal awards, and a schedule of findings and questioned costs.

The objectives and scope of our audit were as follows:

Audit Objectives

1. To provide opinions on the fair presentation of the Department's basic financial statements and the schedule of expenditures of federal awards as of and for the year ended June 30, 2007, in accordance with U.S. generally accepted accounting principles.
2. To consider the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the Department's compliance with laws, regulations, contracts, and grants that could have a direct and material effect on the determination of financial statement amounts.
4. To consider 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.
5. To provide an opinion on the Department's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.

Scope of Audit

We performed an audit of the Department's basic financial statements and schedule of expenditures of federal awards as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, the standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the provisions of U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The Director
Department of Labor and Industrial Relations
State of Hawaii
June 17, 2008
Page 2

Organization of Report

Our report is organized into five sections as follows:

1. Section I, entitled "Introduction" describes the objectives and scope of our audit and the organization and contents of this report.
2. Section II, entitled "Basic Financial Statements" contains the Department's basic financial statements and footnotes for the year ended June 30, 2007, and our report thereon. It also contains management's discussion and analysis on the Department's financial activities for the year ended June 30, 2007.
3. Section III, entitled "Supplementary Information" contains the combining financial statements for the Department's nonmajor governmental funds.
4. Section IV, entitled "Compliance and Internal Control over Financial Reporting" contains our report on the Department's internal control over financial reporting and compliance and other matters based upon our audit of the Department's basic financial statements.
5. Section V, entitled "Compliance and Internal Control over Federal Awards" contains our report on the Department's compliance and internal control over federal awards in accordance with OMB Circular A-133, a schedule of expenditures of federal awards, and a schedule of findings and questioned costs.

We would like to take this opportunity to express our appreciation to the personnel of the Department of Labor and Industrial Relations, State of Hawaii for the cooperation and assistance extended to us during our audit. We will be pleased to discuss any questions that you or your associates may have regarding our recommendations.

Very truly yours,

KPMG LLP

SECTION II

Basic Financial Statements



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

The Director
Department of Labor and Industrial Relations
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 Labor and Industrial Relations, State of Hawaii (the Department), as of and for the year ended June 30, 2007, which collectively comprise the Department's basic financial statements as listed in the table of contents. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in note 1 to basic financial statements, the financial statements of the Department are intended to present the financial position and the changes in financial position, and, where applicable, cash flows thereof 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 are 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, 2007, and the changes in its financial position, and, where applicable, its cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department as of June 30, 2007, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund and federal fund for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 17, 2008 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 5 through 11 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the 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. The combining nonmajor fund financial statements and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

June 17, 2008

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

As management of the Department of Labor and Industrial Relations, State of Hawaii (the Department), we offer readers of the Department's basic financial statements this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2007.

Financial Highlights

- The assets of the Department exceeded its liabilities at June 30, 2007 by \$614.4 million (net assets).
- Of the total net assets at June 30, 2007, the amount of \$605.9 million or 98.6% was unrestricted and may be used by the Department for its operations and activities in achieving its goal to ensure and increase the economic security, physical and economic well-being, and productivity of Hawaii's workers.
- At June 30, 2007, the Department reported governmental fund balances of \$21.4 million, an increase of \$2.3 million or 11.9% from the prior fiscal year.

Overview of the Basic Financial Statements

This discussion and analysis are intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements are comprised of three components: (1) department-wide financial statements, (2) fund financial statements, and (3) notes to basic financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Department-Wide Financial Statements

The department-wide financial statements are designed to provide readers with a broad overview of the Department's finances, in a manner similar to a private sector business.

The statement of net assets presents information on all of the Department's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The statement of activities presents information showing how the Department's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected tax revenue and unused vacation leave).

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 Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The funds of the Department can be divided into three categories: (1) governmental funds, (2) proprietary funds, and (3) fiduciary funds.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

Governmental Funds

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

Because the focus of governmental funds is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities in the department-wide financial statements. The department-wide statement of net assets and statement of activities can be found on pages 12 and 13 of this report, respectively.

Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the general fund, federal fund, and the aggregate nonmajor governmental funds. The governmental funds balance sheet and statement of revenues, expenditures, and changes in fund balances can be found on pages 14 and 16 of this report, respectively.

The Department adopts an annual appropriated budget for its general fund and federal fund. A budgetary comparison statement has been provided for these funds to demonstrate compliance with this budget. The budgetary comparison statement for the general fund and federal fund can be found on page 18 of this report.

Proprietary Funds

Proprietary funds are used to show activities that operate more like those of commercial enterprises. They are known as enterprise funds because they charge fees for services provided to outsiders. They are used to report the same functions presented as business-type activities in the department-wide financial statements. The Department uses enterprise funds to account for the operations of the unemployment compensation fund and the disability compensation fund.

The proprietary funds financial statements provide the same type of information as the business-type activities in the department-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the unemployment compensation fund and disability compensation fund, both of which are considered to be major funds of the Department.

The proprietary funds financial statements can be found on pages 19 – 21 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the State of Hawaii. Fiduciary funds are not reflected in the department-wide financial statements because the resources of those funds are not available to support the Department's own programs. The accounting use for fiduciary funds is much like that used for proprietary funds.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

The fiduciary funds financial statements can be found on page 22 of this report.

Notes to Basic Financial Statements

The notes to basic financial statements provide additional information that is essential to a full understanding of the data provided in the department-wide and fund financial statements.

Department-Wide Financial Analysis

The following is a financial analysis on the governmental and business-type activities of the Department. Net assets are a useful indicator of a government's financial position. For the Department, total assets exceeded liabilities by \$614.4 million, and increased \$42.6 million or 7.4% over the course of this fiscal year's operations.

The following table was derived from the department-wide statement of net assets.

Summary Schedule of Net Assets

June 30, 2007 and 2006

Assets	2007			2006		
	Governmental activities	Business-type activities	Total	Governmental activities	Business-type activities	Total
Cash	\$ 22,932,139	567,586,264	590,518,403	20,067,221	512,972,533	533,039,754
Unemployment taxes receivable	—	28,244,020	28,244,020	—	40,234,107	40,234,107
Capital assets, net	8,211,055	286,188	8,497,243	8,122,248	—	8,122,248
Other assets	5,203,066	735,086	5,938,152	4,709,555	1,494,571	6,204,126
Total assets	36,346,260	596,851,558	633,197,818	32,899,024	554,701,211	587,600,235
Liabilities						
Vouchers payable	3,207,171	6,420,214	9,627,385	1,999,527	4,322,652	6,322,179
Accrued expenses and other	3,548,217	11,602	3,559,819	3,665,263	—	3,665,263
Long-term obligation – accrued vacation	5,614,715	—	5,614,715	5,771,015	—	5,771,015
Total liabilities	12,370,103	6,431,816	18,801,919	11,435,805	4,322,652	15,758,457
Net Assets						
Invested in capital assets	8,211,055	286,188	8,497,243	8,122,248	—	8,122,248
Unrestricted	15,765,102	590,133,554	605,898,656	13,340,971	550,378,559	563,719,530
Total net assets	\$ 23,976,157	590,419,742	614,395,899	21,463,219	550,378,559	571,841,778

Analysis of Net Assets

Total assets increased by \$45.6 million or 7.8% from the prior fiscal year, primarily due to a \$42.2 million or 7.6% increase in total assets of the business-type activities. The \$59.8 million or 12.1% increase in cash held in Federal Treasury offset by a \$12.0 million or 29.8% decrease in unemployment taxes receivable. The increase in cash held in Federal Treasury is primarily attributable to employer contributions for unemployment benefits.

Total liabilities increased by \$3.0 million or 19.3% from the prior fiscal year, due primarily to a \$3.3 million or 52.3% increase in vouchers payable reported for the governmental and business-type activities.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

The Department's unrestricted net assets increased to \$605.9 million at June 30, 2007 from \$563.7 million at June 30, 2006, an increase of \$42.2 million or 7.5%. Unrestricted net assets of the business-type activities increased by \$39.8 million or 7.2%. A substantial portion of the unrestricted net assets consists of cash amounts held by the Department as business-type activities in the statement of net assets. Cash held in Federal Treasury, to be used for benefits to unemployed workers, and cash in State Treasury, to be used for workers injured on the job, aggregated to \$567.6 million and \$513.0 million at June 30, 2007 and 2006, respectively.

At June 30, 2007, the Department is able to report positive balances of net assets for governmental and business-type activities of \$24.0 million and \$590.4 million, respectively.

Changes in Net Assets

The following financial information was derived from the department-wide statement of activities and reflects how the Department's net assets changed during the fiscal year.

Summary Schedule of Changes in Net Assets

Fiscal years ended June 30, 2007 and 2006

	2007			2006		
	Governmental activities	Business-type activities	Total	Governmental activities	Business-type activities	Total
Revenues:						
Program revenues:						
Charges for services	\$ 3,738,478	148,310,263	152,048,741	3,682,431	176,423,234	180,105,665
Operating grants and contributions	37,669,121	—	37,669,121	42,917,169	—	42,917,169
General revenues:						
State appropriations, net	26,437,261	—	26,437,261	22,465,209	—	22,465,209
Interest income	508,773	25,983,919	26,492,692	434,051	22,195,946	22,629,997
Transfers, net	647,990	(625,823)	22,167	—	—	—
Total revenues	69,001,623	173,668,359	242,669,982	69,498,860	198,619,180	268,118,040
Expenses:						
Assistance in work-related difficulties	20,113,332	133,627,176	153,740,508	20,871,542	121,942,384	142,813,926
Full opportunity to work	22,807,086	—	22,807,086	23,098,403	—	23,098,403
Program support	19,041,350	—	19,041,350	18,893,295	—	18,893,295
Other	4,526,917	—	4,526,917	4,316,667	—	4,316,667
Total expenses	66,488,685	133,627,176	200,115,861	67,179,907	121,942,384	189,122,291
Change in net assets	2,512,938	40,041,183	42,554,121	2,318,953	76,676,796	78,995,749
Net assets, beginning of year	21,463,219	550,378,559	571,841,778	19,144,266	473,701,763	492,846,029
Net assets, end of year	\$ 23,976,157	590,419,742	614,395,899	21,463,219	550,378,559	571,841,778

Analysis of Changes in Net Assets

The Department's net assets increased by \$42.6 million or 7.4% during the fiscal year ended June 30, 2007. Net assets of the governmental and business-type activities increased by \$2.5 million and \$40.0 million, respectively. Revenues decreased by \$25.4 million or 9.5% from the prior fiscal year. Revenues from business-type activities decreased by \$25.0 million, due primarily to an \$28.1 million or 15.9% decrease in charges for services as a result of the decreased employer contributions. In fiscal year 2007, the labor force grew by 1.2% while

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

employment rose 1.5%. Approximately 62.7% of the Department's total revenues came from charges for services (as compared to 67.2% for 2006), while 15.5% resulted from operating grants and contributions (including federal aid). The largest expenses were for assistance in work-related difficulties (unemployment and workers' compensation benefits).

Total expenses increased by \$11.0 million or 5.8% from the prior fiscal year. Total expenses of the business-type activities increased by \$11.7 million or 9.6%, due to an increase in assistance in work-related difficulties as a result of an increase of 3.2% in the average number of weeks of unemployment benefits paid and an increase of 6.1% in the average weekly unemployment benefit rate.

Financial Analysis of the State's Individual Funds

As noted earlier, the Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the Department's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, the unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Department's governmental funds reported combined ending fund balances of \$21.4 million, an increase of \$2.3 million or 11.9% from the prior fiscal year.

The general fund and federal fund are the Department's primary operating funds. At the end of the current fiscal year, the fund balances of the Department's general fund and federal fund were \$4.0 million and \$818,000, respectively, which reflect an increase of \$2.4 million in the general fund and a decrease of \$596,000 in the federal fund.

Proprietary Funds

The Department maintains enterprise funds for unemployment compensation and disability compensation benefits. As of the end of the current fiscal year, the Department's enterprise funds reported combined ending fund net assets of \$590.4 million, an increase of \$40.0 million or 7.3% from the prior year.

At the end of the current fiscal year, the unemployment compensation fund net assets increased by \$44.5 million or 8.4% from the prior year and the disability compensation fund net assets decreased by \$4.5 million or 23.6% over the prior fiscal year's fund balances.

Fiduciary Funds

The Department maintains an agency fund for the funds held in bank accounts as security deposits for temporary disability insurance, unemployment compensation, and back wages due to employees.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

General Fund Budgetary Highlights

Actual general fund revenues were less than the final budget of \$22.4 million by \$560,000, and actual general fund expenditures were less than the final budget of \$22.4 million by \$560,000. The effect of the above resulted in no variance between the final budget and actual results on a budgetary basis in fiscal year 2007.

Federal Fund Budgetary Highlights

Actual federal fund revenues were more than the original and final budget of \$37.8 million by \$2.7 million, and actual federal fund expenditures were less than the original and final budget of \$54.2 million by \$1.7 million. These differences are primarily attributable to budgeted amounts being based on a higher anticipated unemployment rate of 3.0%. The effect of the above resulted in a favorable variance between the original and final budget and actual results on a budgetary basis of \$4.4 million in fiscal year 2007.

Capital Assets

The Department's investment in capital assets as of June 30, 2007 and 2006 for its governmental and business-type activities totaled \$8.5 million and \$8.1 million, respectively, (net of accumulated depreciation of \$17.0 million and \$16.1 million at June 30, 2007 and 2006, respectively). This investment in capital assets includes buildings, furniture and equipment, and vehicles.

Additional information on the Department's capital assets can be found in note 5 to basic financial statements.

Economic Factors and Next Year's Budget

In fiscal year 2007, both Hawaii's civilian labor force and employment increased over fiscal year 2006. The labor force grew by 1.2%, while employment rose by 1.5%. During fiscal year 2007, an average of 634,750 people were employed statewide, an increase of 2.0 over fiscal year 2006. The unemployment rate in fiscal year 2007 was 2.4%, down from 2.6% in fiscal year 2006.

The number of wage and salary jobs was up 2.1% for fiscal year 2007 compared to fiscal year 2006. Jobs are up most notably in construction; trade, transportation, and utilities; leisure and hospitality; and educational and health services, each with an increase of at least 1,800 jobs.

Unemployment remains low with the statewide seasonally adjusted unemployment rate of 2.5% for the past six months. One year ago, Hawaii's seasonally adjusted unemployment rate was 2.6%, while the seasonally adjusted national unemployment rate was 4.6%.

In September 2006, the Council on Revenues estimated that the State's general fund tax growth rate would be 6.0% in fiscal year 2007, 6.0% in fiscal year 2008, and 4.1% in fiscal year 2009. Since the current condition of Hawaii's economy is good, the Governor has not imposed any restriction on general fund discretionary expenditures of all Executive Branch departments and agencies for fiscal year 2007. However, consultant and personal services contracts greater than \$25,000 and the filling of nonessential positions continue to require the approval of the Governor, and other expenditure controls implemented in fiscal year 2007 continue to be in force.

Updates to revenue projections issued by the Council on Revenues will impact the Governor's policy on budget formulation and, accordingly, the Department's future budget.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Management's Discussion and Analysis

Year ended June 30, 2007

Requests for Information

Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director, Department of Labor and Industrial Relations, 830 Punchbowl Street, Room 321, Honolulu, Hawaii 96813. General information about the Department can be found at the State's Web site, <http://www.hawaii.gov/labor>.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Net Assets

June 30, 2007

Assets	Governmental activities	Business-type activities	Total
Petty cash and imprest funds	\$ 42,934	—	42,934
Cash in State Treasury	22,889,205	15,419,103	38,308,308
Cash held in Federal Treasury	—	552,167,161	552,167,161
Unemployment taxes receivable	—	28,244,020	28,244,020
Advances to subrecipients and others	1,285,046	—	1,285,046
Due from Federal Government and other	3,608,234	37,184	3,645,418
Internal balances	178,530	(178,530)	—
Inventory	35,718	—	35,718
Prepaid expenses	95,538	876,432	971,970
Capital assets, net	8,211,055	286,188	8,497,243
Total assets	36,346,260	596,851,558	633,197,818
Liabilities			
Liabilities:			
Vouchers payable	3,207,171	6,420,214	9,627,385
Accrued payroll and benefits	1,722,818	11,602	1,734,420
Due to State General Fund	42,934	—	42,934
Due to individuals and others	1,782,465	—	1,782,465
Long-term obligation – accrued vacation:			
Due within one year	1,019,771	—	1,019,771
Due in more than one year	4,594,944	—	4,594,944
Total liabilities	12,370,103	6,431,816	18,801,919
Net Assets			
Invested in capital assets	8,211,055	286,188	8,497,243
Unrestricted	15,765,102	590,133,554	605,898,656
Total net assets	\$ 23,976,157	590,419,742	614,395,899

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Activities
Year ended June 30, 2007

	<u>Program revenues</u>			<u>Net (expense) revenue and changes in net assets</u>		
	<u>Program expenses</u>	<u>Operating grants and contributions</u>	<u>Charges for services</u>	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Functions/programs:						
Governmental activities:						
Program support	\$ 19,041,350	8,006,282	—	(11,035,068)	—	(11,035,068)
Full opportunity to work	22,807,086	18,333,469	3,076,049	(1,397,568)	—	(1,397,568)
Fair and just employment practices	3,869,159	352,141	—	(3,517,018)	—	(3,517,018)
Labor-management relations	657,758	—	—	(657,758)	—	(657,758)
Assistance in work-related difficulties	19,769,959	10,977,229	661,502	(8,131,228)	—	(8,131,228)
Nonwork connected disability	35,042	—	910	(34,132)	—	(34,132)
Premium supplementation	308,331	—	17	(308,314)	—	(308,314)
Total governmental activities	<u>66,488,685</u>	<u>37,669,121</u>	<u>3,738,478</u>	<u>(25,081,086)</u>	<u>—</u>	<u>(25,081,086)</u>
Business-type activities:						
Unemployment compensation	114,952,938	—	134,916,646	—	19,963,708	19,963,708
Disability compensation	18,674,238	—	13,393,617	—	(5,280,621)	(5,280,621)
Total business-type activities	<u>133,627,176</u>	<u>—</u>	<u>148,310,263</u>	<u>—</u>	<u>14,683,087</u>	<u>14,683,087</u>
	<u>\$ 200,115,861</u>	<u>37,669,121</u>	<u>152,048,741</u>	<u>(25,081,086)</u>	<u>14,683,087</u>	<u>(10,397,999)</u>
General revenues:						
State appropriations, net				26,437,261	—	26,437,261
Interest income				508,773	25,983,919	26,492,692
Transfers in (out)				647,990	(625,823)	22,167
Net general revenues				<u>27,594,024</u>	<u>25,358,096</u>	<u>52,952,120</u>
Change in net assets				2,512,938	40,041,183	42,554,121
Net assets:						
Beginning of year				<u>21,463,219</u>	<u>550,378,559</u>	<u>571,841,778</u>
End of year				<u>\$ 23,976,157</u>	<u>590,419,742</u>	<u>614,395,899</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Balance Sheet – Governmental Funds

June 30, 2007

Assets	General Fund	Federal Fund	Nonmajor Governmental Funds	Total
Petty cash and imprest funds	\$ 5,399	37,535	—	42,934
Cash in State Treasury	5,477,922	966,785	16,444,498	22,889,205
Advances to subrecipients and others	—	1,285,046	—	1,285,046
Due from Federal Government and other	67,393	3,540,841	—	3,608,234
Due from enterprise funds	—	—	178,530	178,530
Inventory	—	35,718	—	35,718
Prepaid expenses	13,563	81,975	—	95,538
Total assets	<u>\$ 5,564,277</u>	<u>5,947,900</u>	<u>16,623,028</u>	<u>28,135,205</u>
Liabilities and Fund Balances				
Liabilities:				
Vouchers payable	\$ 902,561	2,250,304	54,306	3,207,171
Accrued payroll and benefits	653,106	1,059,387	10,325	1,722,818
Due to State General Fund	5,399	37,535	—	42,934
Due to individuals and others	—	1,782,465	—	1,782,465
Total liabilities	<u>1,561,066</u>	<u>5,129,691</u>	<u>64,631</u>	<u>6,755,388</u>
Fund balances:				
Unreserved	2,209,224	782,491	—	2,991,715
Reserved for encumbrances	1,793,987	—	—	1,793,987
Reserved for inventory	—	35,718	—	35,718
Reserved for unemployment insurance administration	—	—	1,906,576	1,906,576
Reserved for employment and training	—	—	2,341,054	2,341,054
Reserved for occupational safety and health training and assistance	—	—	306,720	306,720
Reserved for nonwork-related disability	—	—	8,916,341	8,916,341
Reserved for healthcare insurance premium supplementation	—	—	3,087,706	3,087,706
Total fund balances	<u>4,003,211</u>	<u>818,209</u>	<u>16,558,397</u>	<u>21,379,817</u>
Total liabilities and fund balances	<u>\$ 5,564,277</u>	<u>5,947,900</u>	<u>16,623,028</u>	<u>28,135,205</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Reconciliation of Governmental Funds Balance Sheet to the
Statement of Net Assets

June 30, 2007

Total fund balances – governmental funds	\$ 21,379,817
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the fund financial statements: These assets consist of:	
Capital assets	25,211,902
Accumulated depreciation	<u>(17,000,847)</u>
Total capital assets	<u>8,211,055</u>
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the fund financial statements	<u>(5,614,715)</u>
Net assets of governmental activities	<u><u>\$ 23,976,157</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
Year ended June 30, 2007

	<u>General Fund</u>	<u>Federal Fund</u>	<u>Nonmajor Governmental Funds</u>	<u>Total</u>
Revenues:				
State allotted appropriations:				
Full opportunity to work	\$ 2,515,876	—	—	2,515,876
Fair and just employment practices	2,594,946	—	—	2,594,946
Labor-management relations	435,994	—	—	435,994
Assistance in work related difficulties	5,363,620	—	—	5,363,620
Overall program support	10,914,671	—	—	10,914,671
Total State allotted appropriations	21,825,107	—	—	21,825,107
Nonimposed employee fringe benefits	4,864,023	—	—	4,864,023
Total general revenues	26,689,130	—	—	26,689,130
Program revenues:				
Operating grants and contributions	—	37,669,121	—	37,669,121
Employment and training assessments	—	—	2,923,787	2,923,787
Other assessments	—	—	814,691	814,691
Total program revenues	—	37,669,121	3,738,478	41,407,599
Interest income	—	—	508,773	508,773
Total revenues	26,689,130	37,669,121	4,247,251	68,605,502
Expenditures:				
Full opportunity to work	3,035,329	16,372,324	3,163,867	22,571,520
Fair and just employment practices	3,415,261	411,451	—	3,826,712
Labor-management relations	644,242	—	—	644,242
Assistance in work-related difficulties	7,044,639	12,134,930	665,352	19,844,921
Overall program support	9,831,321	9,052,609	—	18,883,930
Capital outlays	20,328	942,139	—	962,467
Total expenditures	23,991,120	38,913,453	3,829,219	66,733,792
Excess (deficiency) of revenues over (under) expenditures	2,698,010	(1,244,332)	418,032	1,871,710
Other financing sources (uses):				
Lapsed appropriations related to previous years	(251,869)	—	—	(251,869)
Transfers in	—	647,990	—	647,990
Net change in fund balances	2,446,141	(596,342)	418,032	2,267,831
Fund balances:				
Beginning of year	1,557,070	1,414,551	16,140,365	19,111,986
End of year	\$ 4,003,211	818,209	16,558,397	21,379,817

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Reconciliation of Governmental Funds Statement of Revenues,
Expenditures, and Changes in Fund Balances to the Statement of Activities

Year ended June 30, 2007

Total net change in fund balances of governmental funds	\$ 2,267,831
Capital outlays are reported as expenditures in governmental funds; however, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these expenses are:	
Capital asset expenditures	962,467
Depreciation expense	<u>(873,660)</u>
Excess of depreciation expense over capital asset expenditures	<u>88,807</u>
The decrease in accrued vacation is reported in the statement of activities but does not require the use of current financial resources and is, therefore, not reported as an expenditure in governmental funds	
Change in net assets of governmental activities	<u>156,300</u>
	<u>\$ 2,512,938</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis) – General Fund and Federal Fund
Year ended June 30, 2007

	General Fund				Federal Fund		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Variance Favorable (Unfavorable)	Original and Final Budget	Actual (Budgetary Basis)	Variance Favorable (Unfavorable)
Revenues:							
State allotted appropriations	\$ 20,095,617	22,385,238	21,825,107	(560,131)	—	—	—
Operating grants and contributions	—	—	—	—	37,804,555	40,508,448	2,703,893
Total revenues	<u>20,095,617</u>	<u>22,385,238</u>	<u>21,825,107</u>	<u>(560,131)</u>	<u>37,804,555</u>	<u>40,508,448</u>	<u>2,703,893</u>
Expenditures:							
Full opportunity to work	2,391,505	2,515,876	2,515,876	—	29,724,265	29,006,359	717,906
Fair and just employment practices	2,455,493	2,594,946	2,594,946	—	442,380	405,280	37,100
Labor-management relations	421,716	435,994	435,994	—	—	—	—
Assistance in work-related difficulties	5,053,665	5,363,620	5,363,620	—	14,670,575	13,972,116	698,459
Overall program support	9,773,238	11,474,802	10,914,671	560,131	9,404,788	9,157,824	246,964
Total expenditures	<u>20,095,617</u>	<u>22,385,238</u>	<u>21,825,107</u>	<u>560,131</u>	<u>54,242,008</u>	<u>52,541,579</u>	<u>1,700,429</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ —</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(16,437,453)</u>	<u>(12,033,131)</u>	<u>4,404,322</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Net Assets – Proprietary Funds

June 30, 2007

Assets	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Cash and deposits:			
Cash in State Treasury	\$ (64,575)	15,483,678	15,419,103
Cash in Federal Treasury	552,167,161	—	552,167,161
	<u>552,102,586</u>	<u>15,483,678</u>	<u>567,586,264</u>
Unemployment taxes receivable	28,244,020	—	28,244,020
Prepaid expense	—	876,432	876,432
Due from State agencies	37,184	—	37,184
Capital assets	—	286,188	286,188
Total assets	<u>580,383,790</u>	<u>16,646,298</u>	<u>597,030,088</u>
Liabilities and Net Assets			
Liabilities:			
Vouchers payable	4,299,393	2,120,821	6,420,214
Due to special revenue funds	178,530	—	178,530
Accrued payroll	—	11,602	11,602
Total liabilities	<u>4,477,923</u>	<u>2,132,423</u>	<u>6,610,346</u>
Net assets – unrestricted	<u>\$ 575,905,867</u>	<u>14,513,875</u>	<u>590,419,742</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Revenues, Expenses, and Changes in Fund Net Assets – Proprietary Funds

Year ended June 30, 2007

	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Operating revenues:			
Employer contributions	\$ 127,521,618	—	127,521,618
Workers' compensation assessments	—	13,290,590	13,290,590
Intergovernmental contributions	7,395,028	—	7,395,028
Fines and penalties	—	14,255	14,255
Other	—	88,772	88,772
Total operating revenues	134,916,646	13,393,617	148,310,263
Operating expenses:			
Assistance in work-related difficulties	114,952,938	18,674,238	133,627,176
Operating income (loss)	19,963,708	(5,280,621)	14,683,087
Nonoperating revenues (expenses):			
Interest income	25,187,502	796,417	25,983,919
Other financing uses:			
Transfers out	(625,823)	—	(625,823)
Change in net assets	44,525,387	(4,484,204)	40,041,183
Net assets:			
Beginning of year	531,380,480	18,998,079	550,378,559
End of year	\$ 575,905,867	14,513,875	590,419,742

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Cash Flows – Proprietary Funds

Year ended June 30, 2007

	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Cash flows from operating activities:			
Cash received from contributions and assessments	\$ 146,906,733	13,393,617	160,300,350
Cash paid for work-related difficulties	(111,901,188)	(18,857,339)	(130,758,527)
Net cash provided by (used in) operating activities	35,005,545	(5,463,722)	29,541,823
Cash flows used in capital and related financing activities:			
Purchase of capital assets	—	(286,188)	(286,188)
Cash flows used in noncapital financing activities:			
Transfers out	(625,823)	—	(625,823)
Cash flows provided by investing activities:			
Interest from investments	25,187,502	796,417	25,983,919
Net increase (decrease) in cash and deposits	59,567,224	(4,953,493)	54,613,731
Cash and deposits:			
Beginning of year	492,535,362	20,437,171	512,972,533
End of year	\$ 552,102,586	15,483,678	567,586,264
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 19,963,708	(5,280,621)	14,683,087
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Decrease in assets:			
Receivables	11,990,087	—	11,990,087
Prepaid expense	—	117,136	117,136
Increase (decrease) in liabilities:			
Vouchers and other payables	2,409,401	(300,237)	2,109,164
Due to special revenue funds	118,323	—	118,323
Due to other State agencies	524,026	—	524,026
Net cash provided by (used in) operating activities	\$ 35,005,545	(5,463,722)	29,541,823

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Statement of Fiduciary Net Assets – Fiduciary Funds

June 30, 2007

Agency Funds					
Assets	Temporary Deposits	Temporary Disability Insurance	Unemployment compensation	Wage claim and other	Total
Cash in State Treasury	\$ 2,000	928	884,264	1,469,852	2,357,044
Investments	—	1,603,000	—	—	1,603,000
Total assets	\$ 2,000	1,603,928	884,264	1,469,852	3,960,044
Liabilities					
Due to individuals and others	\$ 2,000	1,603,928	884,264	1,469,852	3,960,044
Total liabilities	\$ 2,000	1,603,928	884,264	1,469,852	3,960,044

See accompanying notes to basic financial statements.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

(1) Organization and Financial Statement Presentation

(a) *Financial Reporting Entity*

The Department of Labor and Industrial Relations (the Department) is a department of the State of Hawaii (the State). The Department administers and oversees the operations of the State's employment service programs, unemployment insurance program, occupational safety and health program, workers' compensation program, temporary disability compensation program, and prepaid healthcare program. The Department also oversees employment and training services provided through federal and special funds.

The Director of Labor and Industrial Relations is responsible for the direction of the Department's activities. The Director is a cabinet level official appointed by the Governor with the consent of the Senate.

The Department's basic financial statements present the financial position and changes in financial position and cash flows of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State that are attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes comprehensive financial statements for the State annually, which include the Department's financial activities.

The accounting policies of the Department conform to U.S. generally accepted accounting principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financed reporting principles.

(b) *Department-Wide and Fund Financial Statements*

The department-wide financial statements, which are the statement of net assets and the statement of activities, report information of all of the nonfiduciary activities of the Department. For the most part, the effect of interfund activity has been removed from these department-wide financial statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include operating grants and contributions that are restricted to meeting the operational requirements of a particular function. State appropriations and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

The financial activities of the Department are recorded in individual funds, each of which is deemed to be a separate accounting entity. The Department uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the department-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

The financial activities of the Department that are reported in the accompanying fund financial statements have been classified into the following major and nonmajor governmental and proprietary funds. In addition, a description of the Department's fiduciary fund is as follows:

Governmental Fund Types

The Department reports the following major governmental funds:

General Fund

This fund is the Department's primary operating fund. It accounts for all financial activities of the Department, 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.

Federal Fund

This fund accounts for all programs related to employment and training services provided through federal funds.

The nonmajor governmental funds are comprised of the following:

Special Revenue Funds

These funds account for the financial resources obtained from specific revenue sources and used for restricted purposes.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

Proprietary Fund Type

Enterprise Funds

These funds are used to account for the contributions and assessments collected and benefits paid to qualified recipients for unemployment and disability compensation.

Unemployment Compensation Fund

This fund was created to provide temporary income to unemployed individuals as required by the federal Social Security and National Employment Acts. The fund's operations are financed through State unemployment insurance premiums (payroll taxes) assessed on employers and interest earnings.

Disability Compensation Fund

This fund was created to enhance the employability of persons with preexisting injuries, to reduce discrimination against persons with dependents, and require employers to pay compensation for employees' losses sustained while in their employment. The fund's operations are financed through levies on workers' compensation carriers and self-insured employers, interest earnings, reimbursements from defaulting employers, unpaid benefits in certain cases, and fines for noncompliance with workers' compensation law.

Fiduciary Fund Type

Agency Fund

This fund accounts for assets held by the Department in an agency capacity.

(2) Summary of Significant Accounting Policies

(a) *Basis of Accounting and Measurement Focus*

Department-Wide Financial Statements

The department-wide statement of net assets and statement of activities are accounted for on a flow of economic resources measurement focus and the accrual basis of accounting. With this measurement focus, all assets and all liabilities associated with the operation of these activities are included on the statement of net assets. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

Governmental Funds Financial Statements

The governmental funds financial statements are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included in the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The modified-accrual basis of accounting is used by the governmental fund types. Under the modified-accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year-end).

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 year-end to liquidate liabilities existing at the end of the fiscal year. The Department considers receivables collected within 60 days after year-end to be available and recognizes them as revenues of the current year.

Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenue when available, which is generally within 12 months of the end of the current fiscal year, and entitlement occurs. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred and funds are available.

Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgment are recorded only when payment is due.

Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of resources are recorded to reserve that portion of the applicable appropriation, is utilized in the governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will generally be honored during the subsequent fiscal year.

Proprietary and Fiduciary Funds Financial Statements

The financial statements of the proprietary and fiduciary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the department-wide financial statements described above.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Department has elected not to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

(b) *Inventory*

Inventory is valued at the lower of cost or market and consists of food commodities from the U.S. Department of Agriculture, Food and Nutrition Service Agency, under The Emergency Food Distribution Program. The cost is recorded as an expenditure when items are distributed rather than when purchased.

(c) *Capital Assets*

Capital assets are not capitalized in the governmental funds used to acquire or construct them. Instead, capital acquisition and construction are reflected as expenditures in governmental funds, and the related assets are reported in the department-wide statement of net assets. Capital assets acquired by purchase are recorded at cost. Donated capital assets are valued at the estimated fair market value on the date received. Maintenance, repairs, minor replacements, renewals, and betterments are charged to operations as incurred. Major replacements, renewals, and betterments are capitalized. Capital assets are defined as assets with an initial individual cost of \$5,000 or more and are depreciated on the straight-line method over the estimated useful lives of the respective assets (buildings – 30 years, furniture and equipment – 7 years, and vehicles – 5 years). Depreciation is recorded on capital assets on the department-wide statement of activities.

(d) *Accrued Vacation and Sick Leave*

Employees hired on or before July 1, 2001 earn vacation at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn vacation at rates ranging between 1 and 2 working days for each month of service, depending upon the employees' years of service and job classifications. Effective July 1, 2004, all employees earn vacation at the rate of one and three-quarters working days for each month of service. Each employee is allowed to accumulate a maximum of 90 days of vacation as of the end of the calendar year. All vacation pay is accrued when incurred in the department-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Sick leave is not convertible to pay upon termination of employment and is recorded as an expenditure when taken.

(e) *Net Assets and Fund Balances*

In the department-wide and proprietary funds financial statements, net assets are reported in two categories: net assets invested in capital assets and unrestricted net assets.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

(f) *Intrafund Transactions*

Transfers of financial resources within the same fund are eliminated.

(g) *Transfers*

During the fiscal year ended June 30, 2007, the Reed Act (the Act) was passed into law. The Act appropriates funds for services of the unemployment insurance and workforce development divisions. The Act allocates funding to the local workforce investment boards for employer outreach and services, labor force pool expansion, and capacity building. During the fiscal year ended June 30, 2007, \$625,823 of Reed Act funds held in the unemployment compensation trust fund were transferred to the federal fund for various projects.

(h) *Use of Estimates*

The preparation of basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenues, expenditures, and other financing sources and uses during the reporting period. Actual results could differ from those estimates.

(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 periodically during the fiscal year. Amounts reflected as budgeted revenues in the statement of revenues and expenditures – budget and actual (budgetary basis) – general and federal funds are those estimates as compiled by the Department. Budgeted expenditures are derived primarily from the General Appropriations Act of 2005 (Act 178, Session Laws of Hawaii (SLH) 2005), as amended by the Supplemental Appropriations Act of 2006, and from other authorizations contained in the State Constitution, the Hawaii Revised Statutes (HRS), and other specific appropriations acts in various SLH.

All expenditures of appropriated funds have been made pursuant to the appropriations in the fiscal 2005 – 2007 biennial budget. The general and special revenue funds have legally appropriated annual budgets. The final legally adopted budgets in the accompanying statement of revenues and expenditures – budget and actual (budgetary basis) – general and federal funds represent the original appropriations, transfers, and other legally authorized legislative and executive changes.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

The legal level of budgetary control is maintained at the appropriation line item level by department, program, and source of funds as established in the appropriations acts. The Governor is authorized to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the Department. During the fiscal year ended June 30, 2007, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, the general and federal funds' appropriations generally lapse at the end of the fiscal year for which the appropriations are made. The State Legislature specifies the lapse dates and any other contingencies, which may terminate the authorizations for other appropriations.

Budgets adopted by the State Legislature for the general and federal funds are presented in the accompanying statement of revenues and expenditures – budget and actual (budgetary basis) – general and federal funds. The Department's annual budget is prepared on the modified-accrual basis of accounting with several differences from the preparation of the statement of revenues, expenditures, and changes in fund balances (deficit), principally related to encumbrance of purchase orders and contract obligations and accrued revenues and expenditures, which represent departures from GAAP.

	General Fund	Federal Fund
Excess of expenditures over revenues – actual (budgetary basis)	\$ —	(12,033,131)
Reserve for encumbrances at fiscal year-end	1,793,987	—
Expenditures for liquidation of prior fiscal year encumbrances	(1,935,235)	(608,317)
Accrued revenues and expenditures not recognized for budgetary purposes – net of prior-year accruals	2,587,389	12,045,106
Net change in fund balances – actual (GAAP basis)	\$ 2,446,141	(596,342)

(4) Cash and Investments

(a) Cash in State Treasury

The State Director of Finance is responsible for the safekeeping of all moneys paid into the State Treasury. The State Director of Finance pools and invests any moneys of the State, which in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally insured savings and checking accounts, time certificates of deposits, and repurchase agreements with federally insured financial institutions.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

The State established a policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account. The Department records the pooled assets as cash in State Treasury.

For demand or checking accounts and time certificates of deposits, the State requires that the depository banks pledge collateral based on daily available bank balances. The use of daily available bank balances to determine collateral requirements results in the available balances being undercollateralized at times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

Credit Risk

The State's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating.

Custodial Risk

For an investment, custodial risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms, which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping certain types of securities to collateralize repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

Concentration of Credit Risk

The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

The carrying value of the Department's cash in State Treasury at June 30, 2007 was \$40,665,352 (\$22,889,205 for the governmental funds, \$15,419,103 for the proprietary funds, and \$2,357,044 for the fiduciary fund). Information relating to the cash in State Treasury is determined on a statewide basis and not for individual departments or divisions. Information regarding the carrying amount and corresponding bank balances of the cash (which includes the Department's cash in State Treasury) and collateralization of the cash balances is included in the comprehensive annual financial report of the State. The Department's share of the cash in State Treasury at June 30, 2007, as summarized in the table below, was 0.9%.

	<u>Fair value</u>	<u>Maturity (in years)</u>		
		<u>Less than 1</u>	<u>1 – 5</u>	<u>30</u>
(Amounts expressed in thousands)				
State Treasury:				
Cash and cash equivalents	\$ 2,464,152	2,464,152	—	—
Investments:				
Certificates of deposit	129,233	74,316	54,917	—
U.S. government securities	1,546,053	3,743	931,091	611,219
Repurchase agreements	386,917	276,435	110,482	—
Total investments	<u>2,062,203</u>	<u>354,494</u>	<u>1,096,490</u>	<u>611,219</u>
Total State Treasury	<u>\$ 4,526,355</u>	<u>2,818,646</u>	<u>1,096,490</u>	<u>611,219</u>

(b) Cash in Bank

The carrying value of the Department's cash in bank balance of \$42,934 for the governmental funds equals the bank balance and was uncollateralized at June 30, 2007.

(c) Cash Held in Federal Treasury

Unemployment compensation contributions received by the State Treasury are deposited with the Secretary of the Treasury of the United States to the credit of the State in the unemployment compensation fund, pursuant to Section 904 of the Social Security Act, as amended. Cash held in federal treasury amounted to \$552,167,161 at June 30, 2007.

(d) Investments

Investments in the fiduciary funds amounted to \$1,603,000 at June 30, 2007. Investment securities are held by the State and represent amounts deposited by self-insured employers in lieu of workers' compensation insurance, temporary disability insurance, and prepaid healthcare plan insurance.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

At June 30, 2007, investments consist of the following:

U.S. Treasury note, maturing January 15, 2008	\$	1,600,000
Certificate of deposit		3,000
	\$	1,603,000

(5) Capital Assets

The following is a summary of changes in capital assets:

	Balance, June 30, 2006	Additions	Retirements	Balance, June 30, 2007
Governmental activities:				
Buildings	\$ 20,614,785	97,332	—	20,712,117
Furniture and equipment	3,622,347	865,135	(12,097)	4,475,385
Vehicles	24,400	—	—	24,400
Total capital assets	24,261,532	962,467	(12,097)	25,211,902
Less accumulated depreciation for:				
Buildings	(13,041,043)	(660,498)	—	(13,701,541)
Furniture and equipment	(3,073,841)	(213,162)	12,097	(3,274,906)
Vehicles	(24,400)	—	—	(24,400)
Total accumulated depreciation	(16,139,284)	(873,660)	12,097	(17,000,847)
Governmental activities capital assets – net	\$ 8,122,248	88,807	—	8,211,055
Business-type activities:				
Furniture and equipment	\$ —	286,188	—	286,188

During the fiscal year ended June 30, 2007, depreciation expense of the governmental activities was charged to functions of the Department as follows:

Program support	\$	188,836
Full opportunity to work		276,204
Fair and just employment practices		56,514
Labor-management relations		15,861
Assistance in work-related difficulties		336,245
Total depreciation expense	\$	873,660

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

(6) Long-Term Obligation – Governmental Activities – Accrued Vacation

The changes to the accrued vacation liability during the fiscal year ended June 30, 2007 are as follows:

Balance at June 30, 2006	\$	5,771,015
Vacation earned		330,761
Vacation utilized		<u>(487,061)</u>
Balance at June 30, 2007		5,614,715
Less current portion		<u>(1,019,771)</u>
	\$	<u><u>4,594,944</u></u>

(7) Nonimposed Employee Fringe Benefits

Payroll fringe benefit costs of employees of the Department funded by state appropriations (general fund) are assumed by the State and are not charged to the Department’s operating funds. These costs, totaling \$4,864,023 for the fiscal year ended June 30, 2007, have been reported as revenues and expenditures within the Department’s general fund.

Payroll fringe benefit costs related to federally funded salaries are not assumed by the State and are recorded as expenditures in the federal fund and nonmajor governmental funds.

(8) Employee Benefits

(a) *Employees’ Retirement System*

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 benefits as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action. 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 precluded 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 under the contributory and noncontributory options, respectively. Both options provide a monthly retirement allowance based on the employee’s age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, Session Laws of Hawaii of 2004. Members are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Most of the new employees hired from July 1, 2006 were required to join the hybrid plan.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over a closed period ending June 30, 2029.

Measurement of assets and actuarial valuations are made for the entire ERS and are not separately computed for individual participating employers such as the Department. For the years ended June 30, 2007, 2006, and 2005, the Department made contributions of approximately \$4,144,000, \$3,286,000, and \$2,806,313, respectively, which were equal to its required contributions.

ERS issues a Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information that may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

(b) *Postretirement Healthcare and Life Insurance Benefits*

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain healthcare and life insurance benefits to all qualified employees upon retirement.

For employees hired before July 1, 1996, the State pays the entire monthly healthcare premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service.

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

There are currently approximately 37,000 state retirees receiving such benefits. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium. Contributions are financed by the Department on a pay-as-you-go

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

basis. For the fiscal year ended June 30, 2007, the Department's contribution for postretirement healthcare and life insurance benefits was approximately \$2,568,000.

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

On July 1, 2006, the EUTF adopted GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 43). GASB 43 establishes accounting and financial reporting standards for plans that provide other postemployment benefits (OPEB) other than pensions. GASB 43 requires a statement of plan net assets and a statement of changes in plan net assets for defined benefit OPEB plans that are administered as trusts or equivalent arrangements.

The reporting of active and retiree (including their respective beneficiaries) healthcare benefits provided through the same plan should separate those benefits for accounting purposes between active and retiree healthcare benefits. Accordingly, the EUTF reports the retiree healthcare benefits as OPEB in conformity with GASB 43 and the active employee healthcare benefits as risk financing in conformity with GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASB 10), as amended.

The EUTF administers postemployment healthcare benefits under an agent multiple-employer defined benefit plan as defined by GASB 43.

(c) *Accumulated Sick Leave*

Employees hired on or before July 1, 2001, earn sick leave credits at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn sick leave credits at the rate of one and one-quarter or one and three-quarters working days for each month of service depending upon the employees' years of service and job classification. Effective July 1, 2004, all employees earn sick leave credits at the rate of one and three-quarters working days for each month of service. Sick leave credits may accumulate without limit, but may be taken only in the event of illness and are not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2007, accumulated sick leave approximated \$23,852,000 for the Department.

(d) *Deferred Compensation Plan*

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

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

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 accompanying basic financial statements.

(9) Commitments

(a) Operating Leases

The Department leases various office facilities under lease agreements expiring through fiscal year 2011. The following is a schedule of minimum future rentals on noncancelable operating leases with lease terms over a year at June 30, 2007:

Fiscal year ending June 30:	
2008	\$ 972,000
2009	401,000
2010	242,000
2011	30,000
2012	11,000
Thereafter	<u>7,000</u>
	<u>\$ 1,663,000</u>

Rent expenditures for the fiscal year ended June 30, 2007 approximated \$1,075,000.

(b) Insurance Coverage

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 records a liability for risk financing and insurance-related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2007, the State recorded an estimated loss for workers' compensation, automobile, and general liability claims as long-term debt as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's general fund and not by the Department.

(c) Litigation

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 and not by the Department.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2007

(10) Food Distribution Program

The Department receives food commodities from the U.S. Department of Agriculture, Food and Nutrition Service Agency, under The Emergency Food Distribution Program. The Department's Office of Community Services distributes the food to community action agencies responsible for distributing The Emergency Food Distribution Program commodities to needy households or other charitable organizations. The value of food commodities received by the Department during the fiscal year ended June 30, 2007 is included in revenues of the federal fund and approximated \$625,000.

(11) Special Compensation Fund – Workers' Compensation

HRS Section 386-151 established the Special Compensation Fund. This fund is authorized to levy and collect assessments from insurers and employers for current and projected obligations for workers' compensation payments. The State Director of Finance is the custodian of the fund, and disbursements are made by the State Director of Finance upon orders from the Director of Labor and Industrial Relations.

HRS Section 386-56 states that the Director of Labor and Industrial Relations shall pay the full amount of all compensation awards and benefits from the Special Compensation Fund to an employee or dependent who fails to receive prompt and proper workers' compensation. The defaulting employer shall then reimburse the fund for the amounts paid to the employee. Total expenditures for the fiscal year ended June 30, 2007 were approximately \$17,609,000.

SECTION III

Supplementary Information

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Combining Balance Sheet – Nonmajor Governmental Funds

June 30, 2007

	Special Revenue Funds					
	Employment and Training Fund	Occupational Safety and Health Training and Assistance Fund	Special Unemployment Insurance Administration Fund	Nonwork Connected Disability Fund	Premium Supplementation Fund	Total Nonmajor Governmental Funds
Cash in State Treasury	\$ 2,269,802	306,720	1,863,512	8,916,341	3,088,123	16,444,498
Due from enterprise funds	135,466	—	43,064	—	—	178,530
Total assets	\$ 2,405,268	306,720	1,906,576	8,916,341	3,088,123	16,623,028
Liabilities and Fund Balances						
Liabilities:						
Vouchers payable	\$ 53,889	—	—	—	417	54,306
Accrued payroll	10,325	—	—	—	—	10,325
Total liabilities	64,214	—	—	—	417	64,631
Fund balances:						
Reserved for unemployment insurance administration	—	—	1,906,576	—	—	1,906,576
Reserved for employment and training	2,341,054	—	—	—	—	2,341,054
Reserved for occupational safety and health training and assistance	—	306,720	—	—	—	306,720
Reserved for nonwork-related disability	—	—	—	8,916,341	—	8,916,341
Reserved for healthcare insurance premium supplementation	—	—	—	—	3,087,706	3,087,706
Total fund balances	2,341,054	306,720	1,906,576	8,916,341	3,087,706	16,558,397
Total liabilities and fund balances	\$ 2,405,268	306,720	1,906,576	8,916,341	3,088,123	16,623,028

See accompanying independent auditors' report.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Combining Statement of Revenues, Expenditures, and Changes in Fund Balances – Nonmajor Governmental Funds

Year ended June 30, 2007

	Special Revenue Funds					
	Employment and Training Fund	Occupational Safety and Health Training and Assistance Fund	Special Unemployment Insurance Administration Fund	Nonwork Connected Disability Fund	Premium Supplementation Fund	Total Nonmajor Governmental Funds
Revenues:						
Program revenues:						
Employment and training assessments	\$ 2,923,787	—	—	—	—	2,923,787
Other assessments	2,886	149,376	661,502	910	17	814,691
Total program revenues	<u>2,926,673</u>	<u>149,376</u>	<u>661,502</u>	<u>910</u>	<u>17</u>	<u>3,738,478</u>
Interest income	—	—	—	371,618	137,155	508,773
Total revenues	<u>2,926,673</u>	<u>149,376</u>	<u>661,502</u>	<u>372,528</u>	<u>137,172</u>	<u>4,247,251</u>
Expenditures:						
Full opportunity to work	3,163,867	—	—	—	—	3,163,867
Assistance in work-related difficulties	—	—	321,979	35,042	308,331	665,352
Total expenditures	<u>3,163,867</u>	<u>—</u>	<u>321,979</u>	<u>35,042</u>	<u>308,331</u>	<u>3,829,219</u>
Net change in fund balances	(237,194)	149,376	339,523	337,486	(171,159)	418,032
Fund balances:						
Beginning of year	<u>2,578,248</u>	<u>157,344</u>	<u>1,567,053</u>	<u>8,578,855</u>	<u>3,258,865</u>	<u>16,140,365</u>
End of year	<u>\$ 2,341,054</u>	<u>306,720</u>	<u>1,906,576</u>	<u>8,916,341</u>	<u>3,087,706</u>	<u>16,558,397</u>

See accompanying independent auditors' report.

SECTION IV

Compliance and Internal Control over Financial Reporting



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

**Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

The Director
Department of Labor and Industrial Relations
State of Hawaii:

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department of Labor and Industrial Relations, State of Hawaii (the Department), as of and for the year ended June 30, 2007, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated June 17, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Department in a separate letter dated June 17, 2008.

This report is intended solely for the information and use of the Department's management, the U.S. Department of Labor, and other 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.

KPMG LLP

June 17, 2008

SECTION V

Compliance and Internal Control over Federal Awards



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

The Director
Department of Labor and Industrial Relations
State of Hawaii:

Compliance

We have audited the compliance of the Department of Labor and Industrial Relations, State of Hawaii (the 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, 2007. The Department'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 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 of 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, 2007. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding 07-01.

Internal Control over Compliance

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

compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the entity's internal control over compliance that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Department's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Department's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Department's management, the U.S. Department of Labor, and other 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.

KPMG LLP

June 17, 2008

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
U.S. Department of Agriculture:			
Emergency Food Assistance Cluster:			
Emergency Food Assistance Program – Administrative Costs:			
Commodity Assistance Program	10.568	2006IY810547	\$ 20,562
Commodity Assistance Program		2007IY810547	46,012
Food Stamp		2006IS220247	13,942
Miscellaneous		2006CY810547	570
Subtotal CFDA 10.568			<u>81,086</u>
Emergency Food Assistance Program – Food Commodities	10.569	2007IY810547	<u>642,198</u>
Passed through from the State Department of Human Services:			
State Administrative Matching Grants for the Food Stamp Program:			
DHS Food Stamps – Hawaii	10.561	AGREEMENT	115,452
DHS Food Stamps – Kauai		AGREEMENT	59,611
Subtotal CFDA No. 10.561			<u>175,063</u>
Seniors Farmers’ Market Nutrition Pilot Program	10.576	8HI810082	<u>525,822</u>
Total U.S. Department of Agriculture			<u>1,424,169</u>
U.S. Department of Housing and Urban Development:			
Civil Rights Commissions – HUD	14.401	FF209K89004	120,876
Civil Rights Commissions – HUD		FF209K009004	246,050
Civil Rights Commissions – HUD		FF209K029004	313,949
Civil Rights Commissions – HUD		FF209K989004	(64,411)
Total U.S. Department of Housing and Urban Development			<u>616,464</u>

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
U.S. Department of Labor:			
BLS Local Area Unemployment Statistics AAMC	17.002	W9J58015	\$ 2,927
BLS Current Employment Statistics		W9J68015	38,220
BLS Local Area Unemployment Statistics		W9J68015	28,700
BLS Occupational Employment Statistics		W9J68015	51,605
BLS Employment and Wages Report		W9J68015	60,849
BLS Mass Layoff Statistics		W9J68015	11,181
BLS Current Employment Statistics		W9J78015	78,336
BLS Local Area Unemployment Statistics		W9J78015	52,127
BLS Occupational Employment Statistics		W9J78015	104,266
BLS Employment and Wages Report		W9J78015	171,182
BLS Mass Layoff Statistics		W9J78015	21,173
BLS Local Area Unemployment Statistics AAMC		W9J78015	5,891
Subtotal CFDA No. 17.002			626,457
Occupational Safety and Health:			
OSHA BLS	17.005	W9J68115	25,301
OSHA BLS		W9J68115	68,599
Subtotal CFDA No. 17.005			93,900
Alien Labor Certification	17.203	ES-14860-05-55	88,602

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
Employment Service Cluster:			
Employment Service:			
Employment Service Grant	17.207	ES-14860-05-55	\$ 3,132,428
Reemployment Services		ES-13050-04-58	1,966
Reemployment Services		ES-14860-05-55	49,705
Workforce Opportunities Tax Credit		ES-14860-05-55	8,205
Employment Services One-Stop – LMI		ES-14860-05-55	179,483
Employment Services One-Stop – Workforce Info Grants		ES-15691-06-55	160,717
Subtotal CFDA No. 17.207			<u>3,532,504</u>
Disabled Veterans’ Outreach Program:			
Disabled Veterans’ Outreach Program	17.801	E-9-5-6-5086	140,011
Disabled Veterans’ Outreach Program		E-9-5-7-5086	127,441
Subtotal CFDA No. 17.801			<u>267,452</u>
Local Veterans’ Employment Representative Program:			
Local Veterans’ Employment Representative Program	17.804	E-9-5-6-5086	260,545
Local Veterans’ Employment Representative Program		E-9-5-7-5086	296,258
Subtotal CFDA No. 17.804			<u>556,803</u>
Subtotal Employment Service Cluster			<u>4,356,759</u>
Unemployment Insurance:			
Unemployment Insurance Grants	17.225	UI-13543-04-55	332,724
Unemployment Insurance Grants		UI-14430-05-55	224,293
Unemployment Insurance Grants		UI-15117-06-55	3,904,704
Unemployment Insurance Grants		UI-15794-07-55	9,537,051
Unemployment Insurance – TEUC		UI-13543-04-55	217
Unemployment Insurance – TEUC		UI-15794-07-55	36,907
Unemployment Insurance – Trade Benefits		UI-15117-06-55	(406)

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
Unemployment Insurance – Trade Benefits Reed Act		UI-15794-07-55 N/A	\$ 19,667 349,019
Subtotal CFDA No. 17.225			14,404,176
Senior Community Services Employment Program (SCSEP)	17.235	AD-14082-04-60	1,799,618
Trade Adjustment Assistance – Training	17.245	TA-13490-04-55	121,047
Workforce Investment Act Cluster:			
Adult Program	17.258	AA-14671-05-55	416,224
Adult Program		AA-15475-06-55	1,873,327
Subtotal CFDA No. 17.258			2,289,551
Youth Program	17.259	AA-14671-05-55	810,513
Youth Program		AA-15475-06-55	1,495,274
Subtotal CFDA No. 17.259			2,305,787
Dislocated Workers Program	17.260	AA-14671-05-55	608,666
Dislocated Workers Program		AA-15475-06-55	956,877
National Emergency Grant		EM-14938-05-60	5,142
National Emergency Grant		EM-15989-07-60	115,038
National Emergency Grant		EM-15547-06-60	193,885
National Emergency Grant		EM-15989-07-60-A-15	39,345
Subtotal CFDA No. 17.260			1,918,953

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

<u>Federal grantor/pass-through grantor/Program or cluster title</u>	<u>CFDA number</u>	<u>Grant number</u>	<u>Federal expenditures</u>
Statewide Activities:			
Statewide Activities	17.000	AA-13794-04-50	\$ 141,538
Statewide Activities		AA-14671-05-55	465,778
Local Administration		AA-14671-05-55	362,470
Rapid Response		AA-14671-05-55	6,540
Statewide Activities		AA-15475-06-55	837,548
Local Administration		AA-15475-06-55	438,305
Rapid Response		AA-15475-06-55	33,380
Subtotal CFDA No. 17.000			<u>2,285,559</u>
Earmark Program	17.261	EA-15351-06-60	<u>350,103</u>
Workforce Investment Grant	17.266	WI-15559-06-60	<u>286,974</u>
Subtotal Workforce Investment Act Cluster			<u>9,436,927</u>
National Farm Workers Job Program	17.264	AC-15051-05-60	<u>255,188</u>
Occupational Safety and Health Administration:			
OSHA 23G	17.503	60F6-0092	676,829
OSHA 23G		60F7-0092	1,293,315
Subtotal CFDA No. 17.503			<u>1,970,144</u>
OSHA 21D	17.504	E9F6-0992	216,413
OSHA BLS Survey		E9F6-0992	2,198
OSHA 21D		E9F6-0992	369,575
OSHA BLS Survey		E9F7-3792	4,482
Subtotal CFDA No. 17.504			<u>592,668</u>
Total U.S. Department of Labor			<u>33,745,486</u>

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
Equal Employment Opportunity Commission:			
Equal Employment Opportunity Commission	30.002	5FPSLP0164	\$ (226,430)
Total Equal Employment Opportunity Commission			<u>(226,430)</u>
U.S. Department of Energy:			
Weatherization Assistance for Low-Income Persons	81.042	FG26-03R021429	2,695
Weatherization Assistance for Low-Income Persons		FG26-06R021679	218,665
Total U.S. Department of Energy			<u>221,360</u>
U.S. Department of Education:			
Career Resource Network Grant	84.346A	V346A000054-06	29,878
Total U.S. Department of Education			<u>29,878</u>
U.S. Department of Health and Human Services:			
Passed through from the State Department of Human Services:			
First-to-Work	93.558	04-BESSD-1704	750,327
Refugee and Entrant Assistance – State Administered Programs:			
Cash, Medical, and Administration	93.566	G06AAHI9100	5,287
Cash, Medical, and Administration		G07AAHI9100	13,954
Social Services		G06AAHI9110	25,799
Social Services		G07AAHI9110	59,466
Subtotal CFDA No. 93.566			<u>104,506</u>

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards

Year ended June 30, 2007

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
Community Services Block Grant:			
Community Services Block Grant Program	93.569	G06B1HICOSR	\$ 1,603,418
Community Services Block Grant Program		G07B1HICOSR	1,797,826
Subtotal CFDA No. 93.569			<u>3,401,244</u>
Community Food and Nutrition Program	93.571	G04B3HICOSR	<u>15,000</u>
Hawaii Family Support:			
Hawaii Family Support	93.631	90DN0203/02	137,957
Hawaii Family Support		90DN0203/03	153,656
Subtotal CFDA No. 93.631			<u>291,613</u>
Total U.S. Department of Health and Human Services			<u>4,562,690</u>
Total Expenditures of Federal Awards			<u><u>\$ 40,373,617</u></u>

See accompanying independent auditors' report.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Schedule of Expenditures of Federal Awards

June 30, 2007

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department of Labor and Industrial Relations, State of Hawaii (the Department), and is presented on the modified-accrual basis of accounting, which is described in note 2 to the Department's basic financial statements. The information in this schedule is presented in accordance with the requirements of U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Notes to Schedule of Expenditures of Federal Awards

June 30, 2007

(2) Subrecipients

Of the federal expenditures presented in the schedule, the Department provided federal awards to subrecipients as follows:

<u>Program title</u>	<u>CFDA number</u>	<u>Amount provided to subrecipients</u>
U.S. Department of Agriculture:		
Seniors Farmers' Market Nutrition Pilot Program	10.576	\$ <u>525,785</u>
U.S. Department of Labor:		
Senior Community Service Employment Program	17.235	1,799,618
Reed Act	17.225	349,019
Workforce Investment Act Cluster:		
Adult Programs	17.258	2,289,551
Youth Programs	17.259	2,305,787
Dislocated Workers Programs	17.260	1,565,543
National Emergency Grant	17.260	115,038
Earmark Program	17.261	350,103
Statewide Activities	17.000	1,444,864
Local Administration	17.000	<u>800,775</u>
		<u>8,871,661</u>
Total U.S. Department of Labor		<u>11,020,298</u>
U.S. Department of Energy:		
Weatherization Assistance for Low-Income Persons	81.042	<u>204,771</u>
U.S. Department of Health and Human Services:		
Refugee and Entrant Assistance – State Administered Programs:		
Cash, Medical, and Administration	93.566	16,193
Social Services	93.566	<u>85,265</u>
		101,458
Community Services Block Grant	93.569	<u>3,401,244</u>
Total U.S. Department of Health and Human Services		<u>3,502,702</u>
Total provided to subrecipients		<u>\$ <u>15,253,556</u></u>

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2007

(1) Summary of Auditors' Results

(a) The type of report issued on the basic financial statements: **Unqualified opinions for the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Department of Labor and Industrial Relations, State of Hawaii (the Department), which collectively comprise the Department's basic financial statements**

(b) Internal control over financial reporting:

- Material weaknesses: **None noted**
- Significant deficiency identified not considered to be a material weakness: **None reported**

(c) Noncompliance which is material to the financial statements: **None noted**

(d) Significant deficiencies in internal control over major programs: **None reported**

Material weaknesses: **None noted**

(e) The type of report issued on compliance for major programs: **Unqualified opinion**

(f) Any audit findings which are required to be reported under Section 0.510(a) of OMB Circular A-133: **Yes. See Finding 07-01**

(g) Major programs:

U.S. Department of Labor:

Workforce Investment Act Cluster – CFDA Nos. 17.000, 17.258 – 17.260

Community Services Block Grant Program – CFDA No. 93.569

(h) Dollar threshold used to distinguish between Type A and Type B programs: **\$1,211,200**

(i) Auditee qualified as a low-risk auditee under Section 0.530 of OMB Circular A-133: **Yes**

(2) Findings Relating to the Basic Financial Statements which are required to be Reported in Accordance with *Government Auditing Standards*

None noted

**DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2007

(3) Findings and Questioned Costs Relating to Federal Awards

Finding 07-01 – Subrecipient Monitoring-Non-Performance of On-Site Monitoring

Information on the Federal Programs

U.S. Department of Labor, Workforce Investment Act – CFDA Nos. 17.000, 17.258, 17.259, and 17.260

Specific Requirements

Per 20 CFR section 667.410(b), the Department must conduct an annual on-site monitoring review of each local area's compliance with the U.S. Department of Labor uniform administrative requirements, including the appropriate administrative requirements and cost principles for subrecipients and other entities receiving Workforce Investment Act funds.

Condition

During our testwork over the subrecipient monitoring requirements, we noted that the Department did not perform its annual on-site financial monitoring in a timely manner for one of its subrecipients and the annual on-site performance monitoring report for another one of its subrecipients was drafted, but not finalized.

Questioned Costs

N/A

Systemic or Isolated: Isolated

Effect

The potential effect of this condition is that the Department's subrecipients may be unaware of instances on noncompliance with U.S. Department of Labor administrative requirements.

Recommendation

We recommend that the Department be more diligent in ensuring that all annual on-site financial and performance monitoring requirements are completed in a timely manner. In addition, we also recommend that the Department identify alternate reviewers in the event that a supervisor, who normally performs the review of these reports, is not available.

Views of Responsible Officials and Planned Corrective Action

The Department continues to strive to be more diligent in meeting its subrecipient monitoring requirements. In addition, an alternate reviewer has been identified to ensure that the reviews of these reports will still be completed in a timely manner, in the event of the absence of the supervisor.