



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

Basic Financial Statements and Single Audit Reports

June 30, 2006

(With Independent Auditors' Report Thereon)

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

June 30, 2006

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SECTION I

Introduction



KPMG LLP
PO Box 4150
Honolulu, HI 96812-4150

May 31, 2007

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, 2006. We have also audited the Department's compliance with requirements applicable to its major federal financial assistance programs. We submit herein our reports on the Department's basic financial statements and federal financial assistance programs.

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, 2006, 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, 2006, 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
May 31, 2007

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, 2006, and our report thereon. It also contains management's discussion and analysis on the Department's financial activities for the year ended June 30, 2006.
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 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
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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, 2006, 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, 2006, 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, 2006, 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 May 31, 2007 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 12 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*. 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

May 31, 2007

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

Management's Discussion and Analysis

Year ended June 30, 2006

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, 2006.

Financial Highlights

- The assets of the Department exceeded its liabilities at June 30, 2006 by \$571.8 million (net assets).
- Of the total net assets at June 30, 2006, the amount of \$563.7 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.
- The Department's liabilities reported in the statement of net assets increased during the current fiscal year to \$15.8 million, an increase of \$400,000 or 2.6% from the prior year.
- At June 30, 2006, the Department reported governmental fund balances of \$19.1 million, an increase of \$3.0 million or 18.5% 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).

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

Management's Discussion and Analysis

Year ended June 30, 2006

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.

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 13 and 14 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 15 and 17 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 19 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.

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

Management's Discussion and Analysis

Year ended June 30, 2006

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 20 – 22 of this report.

Fiduciary Funds

Fiduciary funds are used to account for resources held for the benefit of parties outside the State. 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.

The fiduciary funds financial statements can be found on page 23 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 \$571.8 million, and increased \$79.0 million or 16.0% over the course of this fiscal year's operations.

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

Management's Discussion and Analysis

Year ended June 30, 2006

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

Summary Schedule of Net Assets

June 30, 2006 and 2005

Assets	FY 2006	FY 2005
Cash	\$ 533,039,754	\$ 458,081,528
Unemployment taxes receivable	40,234,107	37,182,126
Advances to subrecipients and others	921,565	860,371
Due from Federal Government and other	4,135,375	1,997,153
Other assets	1,147,186	1,217,005
Capital assets, net	<u>8,122,248</u>	<u>8,866,589</u>
Total assets	<u>587,600,235</u>	<u>508,204,772</u>
Liabilities		
Vouchers payable	6,322,179	5,036,580
Accrued expenses and other	3,665,263	4,468,414
Long-term obligation – accrued vacation	<u>5,771,015</u>	<u>5,853,749</u>
Total liabilities	<u>15,758,457</u>	<u>15,358,743</u>
Net Assets		
Invested in capital assets	8,122,248	8,866,589
Unrestricted	<u>563,719,530</u>	<u>483,979,440</u>
Total net assets	<u>\$ 571,841,778</u>	<u>\$ 492,846,029</u>

Analysis of Net Assets

Total assets increased by \$79.4 million or 15.6% from the prior fiscal year, primarily due to a \$75.4 million or 18.1% increase in cash held in Federal Treasury and a \$3.1 million or 8.2% increase 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 \$400,000 or 2.6% from the prior fiscal year, due primarily to a \$1.3 million or 25.5% increase in vouchers payable offset by an \$806,000 or 29.1% decrease in due to individuals and others.

The Department's unrestricted net assets increased to \$563.7 million at June 30, 2006 from \$484.0 million at June 30, 2005, an increase of \$79.7 million or 16.5%. A substantial portion of the unrestricted net assets consists of cash amounts held by the Department's enterprise funds and reported 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 \$513.0 million and \$439.0 million at June 30, 2006 and 2005, respectively.

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

Management's Discussion and Analysis

Year ended June 30, 2006

At June 30, 2006, the Department is able to report positive balances of net assets for governmental and business-type activities.

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

For the fiscal years ended June 30, 2006 and 2005

	FY 2006	FY 2005
Revenues:		
Program revenues:		
Charges for services	\$ 180,105,665	\$ 161,283,259
Operating grants and contributions	42,917,169	42,106,571
General revenues (expenses):		
State appropriations	22,465,209	21,535,822
Interest income	22,629,997	22,320,913
Total revenues	268,118,040	247,246,565
Expenses:		
Assistance in work-related difficulties	142,813,926	144,018,936
Full opportunity to work	23,098,403	25,639,183
Program support	18,893,295	17,309,664
Fair and just employment practices	3,749,106	3,372,942
Labor-management relations	567,561	536,633
Total expenses	189,122,291	190,877,358
Change in net assets	78,995,749	56,369,207
Net assets, beginning of year	492,846,029	436,476,822
Net assets, end of year	\$ 571,841,778	\$ 492,846,029

Analysis of Changes in Net Assets

The Department's net assets increased by \$79.0 million or 16.0% during the fiscal year ended June 30, 2006. Revenues increased by \$20.9 million or 8.4% from the prior fiscal year, due primarily to an \$18.8 million or 11.7% increase in charges for services as a result of the increased employer contributions of \$13.6 million. In fiscal year 2006, the labor force grew by 2.6% while employment rose 2.9%. Approximately 67.2% of the Department's total revenues came from charges for services (as compared to 65.2% for 2005), while 16.0% resulted from operating grants and contributions (including federal aid). The largest expenses were for assistance in work-related difficulties (unemployment and workers' compensation benefits).

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

Management's Discussion and Analysis

Year ended June 30, 2006

Total expenses decreased by \$1.8 million or 0.9% from the prior fiscal year, due primarily to a \$1.2 million or 0.8% decrease in assistance in work-related difficulties as a result of the lower unemployment rate of 2.6%. Expenses also decreased due to a \$2.5 million or 9.9% decrease in full opportunity to work as a result of less federal funds under the Workforce Investment Act.

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 \$19.1 million, an increase of \$3.0 million or 18.5% 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 \$1.6 million and \$1.4 million, respectively, which reflect an increase of \$286,000 in the general fund and an increase of \$1.3 million 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 \$550.4 million, an increase of \$76.7 million or 16.2% from the prior year.

At the end of the current fiscal year, the unemployment compensation fund net assets increased by \$79.3 million or 17.5% from the prior year and the disability compensation fund net assets decreased by \$2.6 million or 12.1% 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.

General Fund Budgetary Highlights

Actual general fund revenues were more than the final budget of \$17.6 million by \$296,000, and actual general fund expenditures were less than the final budget of \$17.6 million by \$145,000. The effect of the above resulted in a favorable variance between the final budget and actual results on a budgetary basis of \$440,000 in fiscal year 2006.

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

Management's Discussion and Analysis

Year ended June 30, 2006

Federal Fund Budgetary Highlights

Actual federal fund revenues were less than the original and final budget of \$46.9 million by \$3.4 million, and actual federal fund expenditures were less than the original and final budget of \$89.7 million by \$42.7 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 \$39.4 million in fiscal year 2006.

Capital Assets

The Department's investment in capital assets as of June 30, 2006 and 2005 amounted to \$8.1 million and \$8.9 million, respectively, (net of accumulated depreciation of \$16.1 million and \$15.3 million at June 30, 2006 and 2005, 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 2006, both Hawaii's civilian labor force and employment increased over fiscal year 2005. The labor force grew by 2.6%, while employment rose by 2.9%. During fiscal year 2006, an average of 622,050 people were employed statewide, an increase of 17,600 over fiscal year 2005. The unemployment rate in fiscal year 2006 was 2.6%, down from 2.9% in fiscal year 2005.

The number of wage and salary jobs was up 2.8% for fiscal year 2006 compared to fiscal year 2005. Jobs are up most notably in construction; professional and business services; and transportation, warehousing, and utilities, each with an increase of at least 28,700 jobs.

Unemployment remains low with the statewide seasonally adjusted unemployment rate of 2.6% for the past six months. One year ago, Hawaii's seasonally adjusted unemployment rate was 2.9%, while the seasonally adjusted national unemployment rate was 5.3%.

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 2006. 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 2006 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, 2006

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, 2006

Assets	Governmental activities	Business-type activities	Total
Petty cash and imprest funds	\$ 54,381	\$ —	\$ 54,381
Cash in State Treasury	20,012,840	20,571,223	40,584,063
Cash held in Federal Treasury	—	492,401,310	492,401,310
Unemployment taxes receivable	—	40,234,107	40,234,107
Advances to subrecipients and others	921,565	—	921,565
Due from Federal Government and other	3,574,164	561,211	4,135,375
Internal balances	60,208	(60,208)	—
Inventory	87,083	—	87,083
Prepaid expenses	66,535	993,568	1,060,103
Capital assets, net	8,122,248	—	8,122,248
Total assets	32,899,024	554,701,211	587,600,235
Liabilities			
Liabilities:			
Vouchers payable	1,999,527	4,322,652	6,322,179
Accrued payroll and benefits	1,644,117	—	1,644,117
Due to State General Fund	54,381	—	54,381
Due to individuals and others	1,966,765	—	1,966,765
Long-term obligation – accrued vacation:			
Due within one year	1,886,545	—	1,886,545
Due in more than one year	3,884,470	—	3,884,470
Total liabilities	11,435,805	4,322,652	15,758,457
Net Assets			
Invested in capital assets	8,122,248	—	8,122,248
Unrestricted	13,340,971	550,378,559	563,719,530
Total net assets	\$ 21,463,219	\$ 550,378,559	\$ 571,841,778

See accompanying notes to basic financial statements.

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

Statement of Activities

Year ended June 30, 2006

	<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	\$ 18,893,295	\$ 10,813,740	\$ —	\$ (8,079,555)	\$ —	\$ (8,079,555)
Full opportunity to work	23,098,403	19,777,612	2,962,190	(358,601)	—	(358,601)
Fair and just employment practices	3,749,106	395,246	—	(3,353,860)	—	(3,353,860)
Labor – management relations	567,561	—	—	(567,561)	—	(567,561)
Assistance in work-related difficulties	20,580,505	11,930,571	717,336	(7,932,598)	—	(7,932,598)
Nonwork connected disability	57,441	—	2,804	(54,637)	—	(54,637)
Premium supplementation	233,596	—	101	(233,495)	—	(233,495)
Total governmental activities	<u>67,179,907</u>	<u>42,917,169</u>	<u>3,682,431</u>	<u>(20,580,307)</u>	<u>—</u>	<u>(20,580,307)</u>
Business-type activities:						
Unemployment compensation	103,655,225	—	161,455,045	—	57,799,820	57,799,820
Disability compensation	18,287,159	—	14,968,189	—	(3,318,970)	(3,318,970)
Total business-type activities	<u>121,942,384</u>	<u>—</u>	<u>176,423,234</u>	<u>—</u>	<u>54,480,850</u>	<u>54,480,850</u>
	<u>\$ 189,122,291</u>	<u>\$ 42,917,169</u>	<u>\$ 180,105,665</u>	<u>(20,580,307)</u>	<u>54,480,850</u>	<u>33,900,543</u>
General revenues:						
State appropriations, net				22,465,209	—	22,465,209
Interest income				434,051	22,195,946	22,629,997
Net general revenues				<u>22,899,260</u>	<u>22,195,946</u>	<u>45,095,206</u>
Change in net assets				2,318,953	76,676,796	78,995,749
Net assets:						
Beginning of year				<u>19,144,266</u>	<u>473,701,763</u>	<u>492,846,029</u>
End of year				<u>\$ 21,463,219</u>	<u>\$ 550,378,559</u>	<u>\$ 571,841,778</u>

See accompanying notes to basic financial statements.

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

Balance Sheet – Governmental Funds

June 30, 2006

Assets	General Fund	Federal Fund	Nonmajor Governmental Funds	Total
Petty cash and imprest funds	\$ 16,664	\$ 37,717	\$ —	\$ 54,381
Cash in State Treasury	2,202,327	1,725,616	16,084,897	20,012,840
Advances to subrecipients and others	—	921,565	—	921,565
Due from Federal Government and other	67,393	3,506,771	—	3,574,164
Due from enterprise funds	—	—	60,208	60,208
Inventory	—	87,083	—	87,083
Prepaid expenses	13,563	52,972	—	66,535
Total assets	\$ 2,299,947	\$ 6,331,724	\$ 16,145,105	\$ 24,776,776
Liabilities and Fund Balances				
Liabilities:				
Vouchers payable	\$ 103,736	\$ 1,891,051	\$ 4,740	\$ 1,999,527
Accrued payroll and benefits	622,477	1,021,640	—	1,644,117
Due to State General Fund	16,664	37,717	—	54,381
Due to individuals and others	—	1,966,765	—	1,966,765
Total liabilities	742,877	4,917,173	4,740	5,664,790
Fund balances:				
Unreserved	1,456,175	1,327,468	—	2,783,643
Reserved for encumbrances	100,895	—	—	100,895
Reserved for inventory	—	87,083	—	87,083
Reserved for unemployment insurance administration	—	—	1,567,053	1,567,053
Reserved for employment and training	—	—	2,578,248	2,578,248
Reserved for occupational safety and health training and assistance	—	—	157,344	157,344
Reserved for nonwork related disability	—	—	8,578,855	8,578,855
Reserved for health care insurance premium supplementation	—	—	3,258,865	3,258,865
Total fund balances	1,557,070	1,414,551	16,140,365	19,111,986
Total liabilities and fund balances	\$ 2,299,947	\$ 6,331,724	\$ 16,145,105	\$ 24,776,776

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

Year ended June 30, 2006

Total fund balances – governmental funds	\$	19,111,986
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	\$	24,261,532
Accumulated depreciation		<u>(16,139,284)</u>
Total capital assets		8,122,248
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the fund financial statements		<u>(5,771,015)</u>
Net assets of governmental activities	\$	<u><u>21,463,219</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, 2006

	<u>General Fund</u>	<u>Federal Fund</u>	<u>Nonmajor Governmental Funds</u>	<u>Total</u>
Revenues:				
State allotted appropriations:				
Full opportunity to work	\$ 2,491,226	\$ —	\$ —	\$ 2,491,226
Fair and just employment practices	2,377,047	—	—	2,377,047
Labor – management relations	424,963	—	—	424,963
Assistance in work related difficulties	5,177,576	—	—	5,177,576
Overall program support	7,398,864	—	—	7,398,864
Total State allotted appropriations	<u>17,869,676</u>	<u>—</u>	<u>—</u>	<u>17,869,676</u>
Nonimposed employee fringe benefits	<u>4,685,278</u>	<u>—</u>	<u>—</u>	<u>4,685,278</u>
Total general revenues	<u>22,554,954</u>	<u>—</u>	<u>—</u>	<u>22,554,954</u>
Program revenues:				
Operating grants and contributions	—	42,917,169	—	42,917,169
Employment and training assessments	—	—	2,809,388	2,809,388
Other assessments	—	—	873,043	873,043
Total program revenues	<u>—</u>	<u>42,917,169</u>	<u>3,682,431</u>	<u>46,599,600</u>
Interest income	<u>—</u>	<u>—</u>	<u>434,051</u>	<u>434,051</u>
Total revenues	<u>22,554,954</u>	<u>42,917,169</u>	<u>4,116,482</u>	<u>69,588,605</u>
Expenditures:				
Full opportunity to work	2,896,303	17,470,273	2,436,545	22,803,121
Fair and just employment practices	3,259,827	448,836	—	3,708,663
Labor – management relations	553,934	—	—	553,934
Assistance in work-related difficulties	6,771,260	13,510,435	291,035	20,572,730
Overall program support	8,717,658	9,995,679	—	18,713,337
Capital outlays	28,265	138,250	—	166,515
Total expenditures	<u>22,227,247</u>	<u>41,563,473</u>	<u>2,727,580</u>	<u>66,518,300</u>
Excess of revenues over expenditures	327,707	1,353,696	1,388,902	3,070,305
Other financing uses:				
Lapsed appropriations related to previous years	(42,002)	—	—	(42,002)
Transfers out	<u>—</u>	<u>(47,743)</u>	<u>—</u>	<u>(47,743)</u>
Net change in fund balances	285,705	1,305,953	1,388,902	2,980,560
Fund balances:				
Beginning of year	<u>1,271,365</u>	<u>108,598</u>	<u>14,751,463</u>	<u>16,131,426</u>
End of year	<u>\$ 1,557,070</u>	<u>\$ 1,414,551</u>	<u>\$ 16,140,365</u>	<u>\$ 19,111,986</u>

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, 2006

Total net change in fund balances of governmental funds	\$	2,980,560
<p>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:</p>		
Capital asset expenditures	\$	166,515
Depreciation expense		(909,488)
Loss on disposals		(1,368)
		(744,341)
<p style="padding-left: 40px;">Excess of depreciation expense and loss on disposal over capital asset expenditures</p>		
<p>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</p>		
		82,734
Change in net assets of governmental activities	\$	2,318,953

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, 2006

	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	\$ 17,561,169	\$ 17,573,843	\$ 17,869,676	\$ 295,833	\$ —	\$ —	\$ —
Operating grants and contributions	—	—	—	—	46,859,000	43,478,152	(3,380,848)
Total revenues	<u>17,561,169</u>	<u>17,573,843</u>	<u>17,869,676</u>	<u>295,833</u>	<u>46,859,000</u>	<u>43,478,152</u>	<u>(3,380,848)</u>
Expenditures:							
Full opportunity to work	2,441,505	2,441,505	2,491,225	(49,720)	62,204,049	23,758,566	38,445,483
Fair and just employment practices	2,320,949	2,320,949	2,377,047	(56,098)	545,706	434,930	110,776
Labor – management relations	421,716	421,716	424,963	(3,247)	—	—	—
Assistance in work-related difficulties	5,053,665	5,053,665	5,177,576	(123,911)	15,465,561	13,427,754	2,037,807
Overall program support	7,323,334	7,336,008	6,958,433	377,575	11,450,850	9,297,028	2,153,822
Total expenditures	<u>17,561,169</u>	<u>17,573,843</u>	<u>17,429,244</u>	<u>144,599</u>	<u>89,666,166</u>	<u>46,918,278</u>	<u>42,747,888</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 440,432</u>	<u>\$ 440,432</u>	<u>\$ (42,807,166)</u>	<u>\$ (3,440,126)</u>	<u>\$ 39,367,040</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, 2006

Assets	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Cash and deposits:			
Cash in State Treasury	\$ 134,052	\$ 20,437,171	\$ 20,571,223
Cash in Federal Treasury	492,401,310	—	492,401,310
	492,535,362	20,437,171	512,972,533
Unemployment taxes receivable	40,234,107	—	40,234,107
Prepaid expense	—	993,568	993,568
Due from State agencies	561,211	—	561,211
Total assets	533,330,680	21,430,739	554,761,419
Liabilities and Net Assets			
Liabilities:			
Vouchers payable	1,889,992	2,432,660	4,322,652
Due to special revenue funds	60,208	—	60,208
Total liabilities	1,950,200	2,432,660	4,382,860
Net assets – unrestricted	\$ 531,380,480	\$ 18,998,079	\$ 550,378,559

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, 2006

	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Operating revenues:			
Employer contributions	\$ 150,740,147	\$ —	\$ 150,740,147
Workers' compensation assessments	—	14,781,040	14,781,040
Intergovernmental contributions	10,714,898	—	10,714,898
Fines and penalties	—	56,784	56,784
Other	—	130,365	130,365
Total operating revenues	<u>161,455,045</u>	<u>14,968,189</u>	<u>176,423,234</u>
Operating expenses:			
Assistance in work-related difficulties	<u>103,655,225</u>	<u>18,287,159</u>	<u>121,942,384</u>
Operating income (loss)	57,799,820	(3,318,970)	54,480,850
Nonoperating revenues:			
Interest income	<u>21,486,588</u>	<u>709,358</u>	<u>22,195,946</u>
Change in net assets	79,286,408	(2,609,612)	76,676,796
Net assets:			
Beginning of year	<u>452,094,072</u>	<u>21,607,691</u>	<u>473,701,763</u>
End of year	<u>\$ 531,380,480</u>	<u>\$ 18,998,079</u>	<u>\$ 550,378,559</u>

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, 2006

	Enterprise Funds		Total
	Unemployment Compensation Fund	Disability Compensation Fund	
Cash flows from operating activities:			
Cash received from contributions and assessments	\$ 158,403,064	\$ 14,968,189	\$ 173,371,253
Cash paid for work-related difficulties	(104,568,341)	(17,021,769)	(121,590,110)
Net cash provided by (used in) operating activities	53,834,723	(2,053,580)	51,781,143
Cash flows provided by investing activities:			
Interest from investments	21,486,588	709,358	22,195,946
Net increase (decrease) in cash and deposits	75,321,311	(1,344,222)	73,977,089
Cash and deposits:			
Beginning of year	417,214,051	21,781,393	438,995,444
End of year	\$ 492,535,362	\$ 20,437,171	\$ 512,972,533
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 57,799,820	\$ (3,318,970)	\$ 54,480,850
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Decrease (increase) in assets:			
Receivables	(3,051,981)	—	(3,051,981)
Prepaid expense	—	11,484	11,484
Increase (decrease) in liabilities:			
Vouchers and other payables	549,056	1,253,906	1,802,962
Due to special revenue funds	14,581	—	14,581
Due to other State agencies	(1,476,753)	—	(1,476,753)
Net cash provided by (used in) operating activities	\$ 53,834,723	\$ (2,053,580)	\$ 51,781,143

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, 2006

Agency Funds					
Assets	Temporary Deposits	Temporary Disability Insurance	Unemployment Compensation	Wage Claim and Other	Total
Cash in State Treasury	\$ 2,000	\$ 830	\$ 821,231	\$ 2,517,963	\$ 3,342,024
Investments	—	1,603,000	—	—	1,603,000
Total assets	\$ 2,000	\$ 1,603,830	\$ 821,231	\$ 2,517,963	\$ 4,945,024
Liabilities					
Due to individuals and others	\$ 2,000	\$ 1,603,830	\$ 821,231	\$ 2,517,963	\$ 4,945,024
Total liabilities	\$ 2,000	\$ 1,603,830	\$ 821,231	\$ 2,517,963	\$ 4,945,024

See accompanying notes to basic financial statements.

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

Notes to Basic Financial Statements

June 30, 2006

(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, 2006

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, 2006

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.

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.

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

Notes to Basic Financial Statements

June 30, 2006

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.

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.

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

Notes to Basic Financial Statements

June 30, 2006

(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.

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.

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

Notes to Basic Financial Statements

June 30, 2006

(g) *New Accounting Pronouncement*

Governmental Accounting Standards Board Statement No. 42

The State adopted GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, effective July 1, 2005. This statement established guidance for accounting and reporting for the impairment of capital assets and for insurance proceeds. GASB Statement No. 42 did not have an impact on the Department's basic financial statements for the fiscal year ended June 30, 2006.

Governmental Accounting Standards Board Statement No. 47

The State adopted GASB Statement No. 47, *Accounting for Termination Benefits*, effective July 1, 2005. This statement establishes standards for employers accounting of benefits associated with either voluntary or involuntary terminations. GASB Statement No. 47 did not have an impact on the Department's basic financial statements for the fiscal year ended June 30, 2006.

(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), 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 2004 – 2006 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, 2006

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, 2006, 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 revenues over (under) expenditures – actual (budgetary basis)	\$ 440,432	\$ (3,440,126)
Reserve for encumbrances at fiscal year-end	100,895	—
Expenditures for liquidation of prior fiscal year encumbrances	(1,785,062)	(367,485)
Accrued revenues and expenditures not recognized for budgetary purposes – net of prior-year accruals	1,529,440	5,113,564
Net change in fund balances – actual (GAAP basis)	\$ 285,705	\$ 1,305,953

(4) Cash and Investments

(a) Cash in State Treasury

The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The State Director of Finance pools and invests any monies 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.

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.

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

Notes to Basic Financial Statements

June 30, 2006

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, 2006

The carrying value of the Department's cash in State Treasury at June 30, 2006 was \$43,926,087 (\$20,012,840 for the governmental funds, \$20,571,223 for the proprietary funds, and \$3,342,024 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, as summarized in the table below, is 1.0%

	<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	\$ 2,248,159	\$ 2,248,159	\$ —	\$ —
Investments:				
Certificates of deposit	76,644	18,299	58,345	—
U.S. government securities	1,466,725	182,135	1,284,579	11
Repurchase agreements	581,288	331,952	249,336	—
Total investments	<u>2,124,657</u>	<u>532,386</u>	<u>1,592,260</u>	<u>11</u>
Total State Treasury	<u>\$ 4,372,816</u>	<u>\$ 2,780,545</u>	<u>\$ 1,592,260</u>	<u>\$ 11</u>

(b) Cash in Bank

The carrying value of the Department's cash in bank balance of \$54,381 for the governmental funds equals the bank balance and was uncollateralized at June 30, 2006.

(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 \$492,401,310 at June 30, 2006.

(d) Investments

Investments in the fiduciary funds amounted to \$1,603,000 at June 30, 2006. 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, 2006

At June 30, 2006, investments consist of the following:

U.S. Treasury note, maturing October 15, 2006	\$ 1,600,000
Certificate of deposit	<u>3,000</u>
	<u><u>\$ 1,603,000</u></u>

(5) Capital Assets

The following is a summary of changes in capital assets:

	Balance, June 30, 2005	Additions	Retirements	Balance, June 30, 2006
Buildings	\$ 20,614,785	\$ —	\$ —	\$ 20,614,785
Furniture and equipment	3,562,952	166,515	(107,120)	3,622,347
Vehicles	<u>24,400</u>	<u>—</u>	<u>—</u>	<u>24,400</u>
Total capital assets	<u>24,202,137</u>	<u>166,515</u>	<u>(107,120)</u>	<u>24,261,532</u>
Less accumulated depreciation for:				
Buildings	(12,372,434)	(668,609)	—	(13,041,043)
Furniture and equipment	(2,941,154)	(238,439)	105,752	(3,073,841)
Vehicles	<u>(21,960)</u>	<u>(2,440)</u>	<u>—</u>	<u>(24,400)</u>
Total accumulated depreciation	<u>(15,335,548)</u>	<u>(909,488)</u>	<u>105,752</u>	<u>(16,139,284)</u>
Capital assets – net	<u><u>\$ 8,866,589</u></u>	<u><u>\$ (742,973)</u></u>	<u><u>\$ (1,368)</u></u>	<u><u>\$ 8,122,248</u></u>

During the fiscal year ended June 30, 2006, depreciation expense was charged to functions of the Department as follows:

Program support	\$ 200,229
Full opportunity to work	308,891
Fair and just employment practices	56,245
Labor-management relations	15,861
Assistance in work-related difficulties	<u>328,262</u>
Total depreciation expense	<u><u>\$ 909,488</u></u>

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

Notes to Basic Financial Statements

June 30, 2006

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

The changes to the accrued vacation liability during the fiscal year ended June 30, 2006 are as follows:

Balance at July 1, 2005	\$	5,853,749
Vacation earned		2,437,672
Vacation utilized		<u>(2,520,406)</u>
Balance at June 30, 2006		5,771,015
Less current portion		<u>(1,886,545)</u>
	\$	<u><u>3,884,470</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 \$4,685,278 for the fiscal year ended June 30, 2006, 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, 2006

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, 2006, 2005, and 2004, the Department made contributions of approximately \$1,547,000, \$1,259,000, and \$1,283,000, respectively, which were equal to its required contributions.

ERS issues a Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information which 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 25,000 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 basis. For the fiscal year ended June 30, 2006, the Department's contribution for postretirement healthcare and life insurance benefits was approximately \$942,000.

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.

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

Notes to Basic Financial Statements

June 30, 2006

(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, 2006, accumulated sick leave approximated \$23,740,000 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.

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, 2006:

Fiscal year ending June 30:	
2007	\$ 923,000
2008	380,000
2009	390,000
2010	231,000
2011	19,000
	<hr/>
	\$ 1,943,000
	<hr/> <hr/>

Rent expenditures for the fiscal year ended June 30, 2006 approximated \$1,038,000.

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

Notes to Basic Financial Statements

June 30, 2006

(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, 2006, 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.

(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, 2006 is included in revenues of the federal fund and approximated \$910,000.

(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, 2006 were approximately \$15,920,000.

SECTION III

Supplementary Information

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

Combining Balance Sheet – Nonmajor Governmental Funds

June 30, 2006

	Special Revenue Funds						Total Nonmajor Governmental Funds
	Employment and Training Fund	Occupational Safety and Health Training and Assistance Fund	Boiler/ Elevator Safety Fund	Special Unemployment Insurance Administration Fund	Nonwork Connected Disability Fund	Premium Supplementation Fund	
Cash in State Treasury	\$ 2,574,526	\$ 157,344	\$ —	\$ 1,510,567	\$ 8,579,237	\$ 3,263,223	\$ 16,084,897
Due from enterprise funds	3,722	—	—	56,486	—	—	60,208
Total assets	<u>\$ 2,578,248</u>	<u>\$ 157,344</u>	<u>\$ —</u>	<u>\$ 1,567,053</u>	<u>\$ 8,579,237</u>	<u>\$ 3,263,223</u>	<u>\$ 16,145,105</u>
Liability and Fund Balances							
Liability:							
Vouchers payable	\$ —	\$ —	\$ —	\$ —	\$ 382	\$ 4,358	\$ 4,740
Fund balances:							
Reserved for unemployment insurance administration	—	—	—	1,567,053	—	—	1,567,053
Reserved for employment and training	2,578,248	—	—	—	—	—	2,578,248
Reserved for occupational safety and health training and assistance	—	157,344	—	—	—	—	157,344
Reserved for nonwork-related disability	—	—	—	—	8,578,855	—	8,578,855
Reserved for health care insurance premium supplementation	—	—	—	—	—	3,258,865	3,258,865
Total fund balances	<u>2,578,248</u>	<u>157,344</u>	<u>—</u>	<u>1,567,053</u>	<u>8,578,855</u>	<u>3,258,865</u>	<u>16,140,365</u>
Total liability and fund balances	<u>\$ 2,578,248</u>	<u>\$ 157,344</u>	<u>\$ —</u>	<u>\$ 1,567,053</u>	<u>\$ 8,579,237</u>	<u>\$ 3,263,223</u>	<u>\$ 16,145,105</u>

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, 2006

	Special Revenue Funds						Total Nonmajor Governmental Funds
	Employment and Training Fund	Occupational Safety and Health Training and Assistance Fund	Boiler/ Elevator Safety Fund	Special Unemployment Insurance Administration Fund	Nonwork Connected Disability Fund	Premium Supplementation Fund	
Revenues:							
Program revenues:							
Employment and training assessments	\$ 2,809,388	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 2,809,388
Other assessments	—	152,803	—	717,336	2,804	100	873,043
Total program revenues	2,809,388	152,803	—	717,336	2,804	100	3,682,431
Interest income	—	—	—	—	308,429	125,622	434,051
Total revenues	2,809,388	152,803	—	717,336	311,233	125,722	4,116,482
Expenditures:							
Full opportunity to work	2,436,545	—	—	—	—	—	2,436,545
Assistance in work-related difficulties	—	—	—	—	57,440	233,595	291,035
Total expenditures	2,436,545	—	—	—	57,440	233,595	2,727,580
Excess (deficiency) of revenues over (under) expenditures	372,843	152,803	—	717,336	253,793	(107,873)	1,388,902
Other financing uses:							
Transfers in/out	—	2,599	(2,599)	—	—	—	—
Net change in fund balances	372,843	155,402	(2,599)	717,336	253,793	(107,873)	1,388,902
Fund balances:							
Beginning of year	2,205,405	1,942	2,599	849,717	8,325,062	3,366,738	14,751,463
End of year	<u>\$ 2,578,248</u>	<u>\$ 157,344</u>	<u>\$ —</u>	<u>\$ 1,567,053</u>	<u>\$ 8,578,855</u>	<u>\$ 3,258,865</u>	<u>\$ 16,140,365</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, 2006, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated May 31, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and 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 May 31, 2007.

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

May 31, 2007

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, 2006. 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, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 06-01 and 06-02.

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 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 the internal control over compliance in accordance with OMB Circular A-133.

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

This report is intended solely for the information and use of the 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

May 31, 2007

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal grantor/pass-through grantor/Program or cluster title</u>	<u>CFDA number</u>	<u>Grant number</u>	<u>Federal expenditures</u>
U.S. Department of Agriculture:			
Emergency Food Assistance Cluster:			
Emergency Food Assistance Program – Administrative Costs:			
Commodity Assistance Program	10.568	2006IY810547	\$ 110,463
Commodity Assistance Program		7HI810HI8	97,704
Food Stamp		7HI400HI2	6,226
Subtotal CFDA No. 10.568			<u>214,393</u>
Emergency Food Assistance Program – Food Commodities	10.569	7HI810HI8	955,096
Subtotal Emergency Food Assistance Program Cluster			<u>1,169,489</u>
Passed through from the State Department of Human Services:			
State Administrative Matching Grants for the Food Stamp Program:			
DHS Food Stamps – Kona	10.561	AGREEMENT	439
DHS Food Stamps – Kauai		AGREEMENT	(90)
DHS Food Stamps – Kona		AGREEMENT	1,792
DHS Food Stamps – Hilo		AGREEMENT	23,173
DHS Food Stamps – Kauai		AGREEMENT	33,032
DHS Food Stamps – Hilo		AGREEMENT	30,817
DHS Food Stamps		AGREEMENT	83,363
Subtotal CFDA No. 10.561			<u>172,526</u>
Seniors Farmers' Market Nutrition Pilot Program	10.576	8HI810082	448,230
Total U.S. Department of Agriculture			<u>1,790,245</u>
U.S. Department of Housing and Urban Development:			
Civil Rights Commissions	14.401	FF209K989004	118,387
Total U.S. Department of Housing and Urban Development			<u>118,387</u>

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

Federal grantor/pass-through grantor/Program or cluster title	CFDA number	Grant number	Federal expenditures
U.S. Department of Labor:			
BLS Current Employment Statistics	17.002	W9J58015	\$ 37,238
BLS Local Area Unemployment Statistics		W9J58015	19,012
BLS Occupational Employment Statistics		W9J58015	36,164
BLS Employment and Wages Report		W9J58015	62,155
BLS Occupational Employment Statistics		W9J58015	12,165
BLS LAUS AAMC		W9J58015	9,573
BLS Current Employment Statistics		W9J68015	103,349
BLS Local Area Unemployment Statistics		W9J68015	53,543
BLS Occupational Employment Statistics		W9J68015	112,876
BLS Employment and Wages Report		W9J68015	140,958
BLS Mass Layoff Statistics		W9J68015	21,830
BLS OSHS		W9J68115	185,400
Subtotal CFDA No. 17.002			794,263
Occupational Safety and Health:			
OSHA BLS	17.005	W9J68115	55,543
OSHA BLS		W9J58115	18,345
OSHA BLS		W9J68115	9,637
OSHA BLS		W9J58115	1,504
Subtotal CFDA No. 17.005			85,029
Alien Labor Certification			
Alien Labor Certification	17.203	ES-13992-04-55	18,639
Alien Labor Certification		ES-14860-05-55	25,989
Subtotal CFDA No. 17.203			44,628

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal grantor/pass-through grantor/Program or cluster title</u>	<u>CFDA number</u>	<u>Grant number</u>	<u>Federal expenditures</u>
Employment Service Cluster:			
Employment Service:			
Employment Service Grant	17.207	ES-13050-03-55	\$ 536,650 *
Employment Service Grant		ES-14860-05-55	2,994,106 *
Reemployment Services		ES-13050-03-58	377 *
Reemployment Services		ES-13050-04-58	60,361 *
Workforce Opportunities Tax Credit		ES-13050-04-58	31,219 *
Workforce Opportunities Tax Credit		ES-14860-05-55	64,000 *
Employment Services One-Stop – LMI		ES-14860-05-55	320,794 *
Subtotal CFDA No. 17.207			<u>4,007,507 *</u>
Disabled Veterans’ Outreach Program:			
Disabled Veterans’ Outreach Program	17.801	E-9-5-5-5086	189,765 *
Disabled Veterans’ Outreach Program		E-9-5-6-5086	208,208 *
Subtotal CFDA No. 17.801			<u>397,973 *</u>
Local Veterans’ Employment Representative Program:			
Local Veterans’ Employment Representative Program	17.804	E-9-5-5-5086	185,512 *
Local Veterans’ Employment Representative Program		E-9-5-6-5086	364,171 *
Subtotal CFDA No. 17.804			<u>549,683 *</u>
Subtotal Employment Service Cluster			<u>4,955,163 *</u>
Unemployment Insurance:			
Unemployment Insurance Grants	17.225	UI-13543-04-55	434,160
Unemployment Insurance Grants		UI-14430-05-55	4,632,422
Unemployment Insurance Grants		UI-15117-06-55	10,334,807
Unemployment Insurance Disaster Assistance		P.L.97-300	(25)
Unemployment Insurance – TEUC		UI-12634-03-55	289

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<u>Federal grantor/pass-through grantor/Program or cluster title</u>	<u>CFDA number</u>	<u>Grant number</u>	<u>Federal expenditures</u>
Unemployment Insurance – TEUC		UI-13543-04-55	\$ 31,903
Unemployment Insurance – Trade Benefits		UI-13543-05-55	976
Subtotal CFDA No. 17.225			<u>15,434,532</u>
Senior Community Services Employment Program (SCSEP)	17.235	AD-14082-04-60	<u>1,764,164</u> *
Trade Adjustment Assistance – Training	17.245	TA-13490-04-55	<u>34,505</u>
Workforce Investment Act Cluster:			
Adult Program	17.258	AA-12921-03-50	(280,961)
Adult Program		AA-13794-04-50	873,400
Adult Program		AA-14671-05-55	<u>1,828,461</u>
Subtotal CFDA No. 17.258			<u>2,420,900</u>
Youth Program	17.259	AA-13794-04-50	2,182,338
Youth Program		AA-14671-05-55	<u>1,882,168</u>
Subtotal CFDA No. 17.259			<u>4,064,506</u>
WIA National Emergency Grant	17.260	EM-13419-03-60	113,772
WIA National Emergency Grant		EM-15547-06-60	3,444
Dislocated Workers Program		AA-14671-05-55	1,326,039
Dislocated Workers Program		AA-13794-04-50	824,799
National Emergency Grant		EM-14938-05-60	<u>668</u>
Subtotal CFDA No. 17.260			<u>2,268,722</u>

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

<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	\$ 523,644
Local Administration		AA-13794-04-50	410,973
Rapid Response		AA-13794-04-50	8,459
Statewide Activities		AA-14671-05-55	813,808
Local Administration		AA-14671-05-55	397,586
Rapid Response		AA-14671-05-55	18,460
Statewide activities		AA-12921-03-50	318,731
Subtotal CFDA No. 17.000			<u>2,491,661</u>
Earmark Program	17.261	EA-15351-06-60	<u>13,506</u>
Subtotal Workforce Investment Act Cluster			<u>11,259,295</u>
National Farm Workers Job Program	17.264	AC-15051-05-60	<u>188,426</u>
Occupational Safety and Health Administration			
OSHA 23G	17.503	60F5-00	441,318 *
OSHA 23G		60F6-0092	1,021,228 *
Subtotal CFDA No. 17.503			<u>1,462,546 *</u>
OSHA 21D	17.504	E9F5-0992	173,735
OSHA BLS Survey		E9F5-3792	441
OSHA 21D		E9F6-0992	243,587
OSHA BLS Survey		E9F6-0992	3,034
Subtotal CFDA No. 17.504			<u>420,797</u>
Total U.S. Department of Labor			<u>36,443,348</u>

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

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	3FPSLP0246/0001	\$ 19,111
Equal Employment Opportunity Commission		5FPSLP0164	251,149
Total Equal Employment Opportunity Commission			<u>270,260</u>
U.S. Department of Energy:			
Weatherization Assistance for Low-Income Persons	81.042	FG26-03R021429	223,918
Weatherization Assistance for Low-Income Persons		FG26-06R021679	729
Total U.S. Department of Energy			<u>224,647</u>
U.S. Department of Education:			
Career Resource Network Grant	84.346A	V346A000054-06	75,212
Career Resource Network Grant		V346A000054-06	75,100
Total U.S. Department of Education			<u>150,312</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	<u>903,563</u>
Refugee and Entrant Assistance – State Administered Programs:			
Cash, Medical and Administration	93.566	G05AAHI9100	84,517
Cash, Medical and Administration		G06AAHI9100	30,458
Social Services		G06AAHI9110	65,053
Social Services		G05AAHI9110	51,098
Subtotal CFDA No. 93.566			<u>231,126</u>

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

Schedule of Expenditures of Federal Awards

Year ended June 30, 2006

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	\$ 2,576,015 *
Community Services Block Grant Program		G05B1HICOSR	1,333,465 *
Subtotal CFDA No. 93.569			<u>3,909,480 *</u>
Community Food and Nutrition Program	93.571	G04B3HICOSR	<u>1,106</u>
Hawaii Family Support			
Hawaii Family Support	93.631	90DN0203/02	205,638
Hawaii Family Support		90DN0203/01	78,978
Subtotal CFDA No. 93.631			<u>284,616</u>
Total U.S. Department of Health and Human Services			<u>5,329,891</u>
Total Expenditures of Federal Awards			<u>\$ 44,327,090</u>

* Denotes major program as defined by OMB Circular A-133

See accompanying independent auditors' report.

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

Notes to Schedule of Expenditures of Federal Awards

June 30, 2006

(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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

(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:		
Emergency Food Assistance Cluster	10.569	\$ 941,733
Seniors Farmers' Market Nutrition Pilot Program	10.576	448,230
Total U.S. Department of Agriculture		<u>1,389,963</u>
U.S. Department of Labor:		
Senior Community Service Employment Program Grants	17.235	<u>1,628,359</u>
Workforce Investment Act Cluster:		
Adult Programs	17.258	2,420,900
Youth Programs	17.259	4,064,506
Dislocated Workers Programs	17.260	2,150,838
Statewide Activities	17.000	1,656,183
Local Admin	17.000	808,559
Total U.S. Department of Labor		<u>11,100,986</u>
		<u>12,729,345</u>
U.S. Department of Energy:		
Weatherization Assistance for Low-Income Persons	81.042	<u>206,234</u>
U.S. Department of Health and Human Services:		
Refugee and Entrant Assistance – State Administered Programs:		
Cash, Medical, and Administration	93.566	22,686
Social Services	93.566	78,806
		<u>101,492</u>
Community Services Block Grants	93.569	<u>3,178,027</u>
Total U.S. Department of Health and Human Services		<u>3,279,519</u>
Total provided to subrecipients		<u>\$ 17,605,061</u>

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

Schedule of Findings and Questioned Costs

Year ended June 30, 2006

(1) Summary of Auditors' Results

- (a) The type of report issued on the basic financial statements: **Unqualified opinions**
- (b) Reportable conditions in internal control which were disclosed by the audit of the basic financial statements: **None reported**

Material weaknesses: **None noted**
- (c) Noncompliance which is material to the financial statements: **None noted**
- (d) Reportable conditions 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 .510(a) of OMB Circular A-133: **Yes, see Findings 06-01 and 06-02**
- (g) Major programs:

U.S. Department of Labor:

Employment Service Cluster – CFDA Nos. 17.207, 17.801, and 17.804

Senior Community Services Employment Program – CFDA No. 17.235

Occupational Safety and Health Administration 23G – CFDA No. 17.503

Community Services Block Grant Program – CFDA No. 93.569

- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$1,329,813**
- (i) Auditee qualified as a low-risk auditee under Section .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, 2006

(3) Findings and Questioned Costs Relating to Federal Awards

Finding 06-01 – Reporting – Nonsubmittal of Financial Status Reports

Information on Federal Programs: U.S. Department of Health and Human Services, Community Services Block Grant – CFDA 93.569, Federal Award Nos.: G05B1HICOSR and G06B1HICOSR, Award Years: October 1, 2004 to September 30, 2006 and October 1, 2005 to September 30, 2007.

Specific Requirement: Interim SF-269A Financial Status Report is due 90 days after the end of the respective grant year and the Final SF-269A Financial Status Report is due one year after the interim report is due.

Condition: During our review of the submission of the SF-269A Financial Status Reports, we noted that the Final SF-269A Financial Status Report for the 2004 grant year and the Interim SF-269A Financial Status Report for the 2005 grant year were not submitted to the federal government within the established deadlines. The deadline for both reports was December 31, 2005.

Questioned Costs: NA

Systemic or Isolated: Isolated

Effect: The potential effect of this condition is that failure to adhere to the federal reporting requirements could result in noncompliance with the grant agreement and may be the basis for withholding financial assistance payments, suspension, or termination of funding.

Recommendation: We recommend that the Department submit the required Financial Status Reports and implement procedures to ensure the timely submission of all required reports. In addition, adequate documentation to evidence compliance with the reporting requirements should be retained by the Department.

Views of Responsible Officials and Planned Corrective Action: The Department concurs with the finding and recommendation. In October 2006, the Department hired an additional accountant to assist in various processes, including ensuring the timely submission of the Financial Status Reports. The Department will attempt to be more diligent in its efforts to adhere to the reporting requirements.

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

Schedule of Findings and Questioned Costs

Year ended June 30, 2006

Finding 06-02 – Subrecipient Monitoring – Noncompletion of Fiscal Monitoring Reports

Information on Federal Programs: U.S. Department of Health and Human Services, Community Services Block Grant – CFDA 93.569, Federal Award Nos.: G05B1HICOSR and G06B1HICOSR, Award Years: October 1, 2004 to September 30, 2006 and October 1, 2005 to September 30, 2007.

Specific Requirement: States must conduct full onsite reviews of each eligible subgrantee once every three years to check conformity with performance goals, administrative standards, financial management rules, and other requirements. Follow-up reviews, including prompt return visits to eligible entities and their programs, are required for entities that fail to meet the goals, standards, and requirements established by the State.

Condition: During our review of the subrecipient monitoring requirements, we noted that no Fiscal Monitoring Reports have been completed since the 2003 grant year. As the Department did not complete the Fiscal Monitoring Reports for the 2006 grant year, the three years requirement has not been met.

Questioned Costs: NA

Systemic of Isolated: Isolated

Effect: The potential effect of this condition is that failure to adhere to the Federal subrecipient monitoring requirements could result in noncompliance with the grant agreement and may be the basis for withholding financial assistance payments, suspension, or termination of funding.

Recommendation: We recommend that the Department complete the required Fiscal Monitoring Reports and implement procedures to ensure the timely completion of all required reports. In addition, adequate documentation to evidence compliance with the subrecipient monitoring requirements should be retained by the Department.

Views of Responsible Officials and Planned Corrective Action: The Department concurs with the finding and recommendation. In October 2006, the Department hired an additional accountant to assist in various processes, including ensuring the timely completion of the Fiscal Monitoring Reports. The Department will attempt to be more diligent in its efforts to adhere to the subrecipient monitoring requirements.