Financial Audit of the Harbors Division

A Report to the Governor and the Legislature of the State of Hawaii

Report No. 97-5
February 1997

THE AUDITOR
STATE OF HAWAII

The Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits,* which are also referred to as *performance audits,* examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits,* when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits,* when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds and existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

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STATE OF HAWAII

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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Financial Audit of the Harbors Division

Summary

The Office of the Auditor contracted with the certified public accounting firm of Nishihama & Kishida, CPA's, Inc. to conduct a financial audit of the Harbors Division for the fiscal year July 1, 1995 to June 30, 1996. The audit examined the department's financial records and its systems for accounting and internal controls and tested these for compliance with applicable laws and regulations. In the opinion of Nishihama & Kishida, CPA's, Inc., the financial statements of the division present fairly the financial position and results of its operations for the year ended June 30, 1996.

However, we found three reportable conditions relating to its fiscal and property management operations. One of them is considered to be a material weakness in the report on the division's internal control structure. A material weakness in the internal control structure is the worst possible reportable condition. As defined by the American Institute of Certified Public Accountants (AICPA), a material weakness exists when internal controls are such that significant errors or irregularities may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. In other words, illegal acts such as thefts could go undetected. The lack of financial information for management to review is a material weakness as defined by the AICPA.

The harbors' operating costs are paid for with harbor fees and property lease rents. Because the Harbors Division is a monopoly, those who use it have no choice but to pay the fees set by the division. Harbors users and the public have a right to expect that the fees are reasonable and necessary to pay the division's operating costs. The division should be fiscally accountable and make every effort to control costs.

Specifically we found that there is no financial reporting within the division. Needed financial reports are not prepared and the division has to pay its outside auditors to prepare accounting records and schedules so that its financial audits can be completed. Also, property management practices are deficient. The division does not have an adequate inventory of property owned to ensure that all lease rents are collected. Month-to-month-lease arrangements have gone on for years.

In addition, controls over cash receipts and billings at three district offices and certain harbors are seriously deficient. Without proper internal controls there is no assurance that all cash receipts are properly deposited.

Recommendations and Response

We recommend that the Department of Transportation and the Harbors Division take steps to ensure that needed financial reports are prepared for management. We also made specific recommendations to improve property management and controls over cash collections and billings.

The department agrees with some of our specific findings. It agrees that the Harbors Division does not currently provide monthly statements of revenues and expenditures and that financial reporting has benefits. It states that it will now try to provide reports, especially to district offices. The department also agrees with our findings relating to controls over cash receipts and billings at three district offices and certain harbors. The department points out that it is taking steps to make needed improvements and we are encouraged by its efforts in this direction.

However, the department does not agree that there is a material weakness in the division's fiscal operations. It points to a financial model it uses periodically. But our reference is to regular revenue and expenditure information, which the department has agreed to provide. The department defends its practice of relying on costly outside auditors to prepare audit schedules for the division. It feels that this is a better management approach than hiring year-round staff for what it considers temporary work. We stand on our report. Spending in excess of $90,000 a year for accounting work that is the year-round responsibility of the division cannot be a better management approach. The department needs to reexamine what tasks need to be done, by whom, and when.

The department also provided an explanation of the problems surrounding a lease renewal that has gone unresolved for 12 years. It states that it is trying to do what is best for the State. This lease came up for renewal in 1984 and the rental amount has remained unchanged since 1975. With respect to the lack of a required property inventory, the department states that it is taking steps to merge existing inventory and tenant lists to develop the type of property inventory record required by its own operating manual.

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Financial Audit of the Harbors Division

A Report to the Governor and the Legislature of the State of Hawaii

Conducted by

The Auditor
State of Hawaii
and
Nishihama &
Kishida, CPA's, Inc.

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 97-5
February 1997

Foreword

This is a report of our financial audit of the Harbors Division of the Department of Transportation for the fiscal year July 1, 1995 to June 30, 1996. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions. The audit was conducted by the Office of the Auditor and the certified public accounting firm of Nishihama & Kishida, CPA's, Inc.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Harbors Division.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the Harbors Division of the Department of Transportation. The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of Nishihama & Kishida, CPA's, Inc. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes (HRS), which requires the State Auditor to conduct postaudits of the transactions, accounts, programs and performance of all departments, offices, and agencies of the State and its political subdivisions.

Background

Section 266-1, HRS, gives jurisdiction of "All commercial harbors and roadsteads, and all commercial harbor and waterfront improvements belonging to or controlled by the State, and all vessels and shipping within the commercial harbors and roadsteads..." to the Department of Transportation. In July 1961, the Harbors Division was established within the Department of Transportation. The division is responsible for the administration, operation, and maintenance of all State of Hawaii commercial harbors, water navigational facilities, and related properties, except those principally used for recreation and the landing of fish.

The Harbors Division as a whole generates revenues of approximately $50,000,000 annually. The division is self-supporting in that its operations are entirely special-funded and it does not receive any general funds. In addition, the division issues bonds to finance its capital improvement projects.

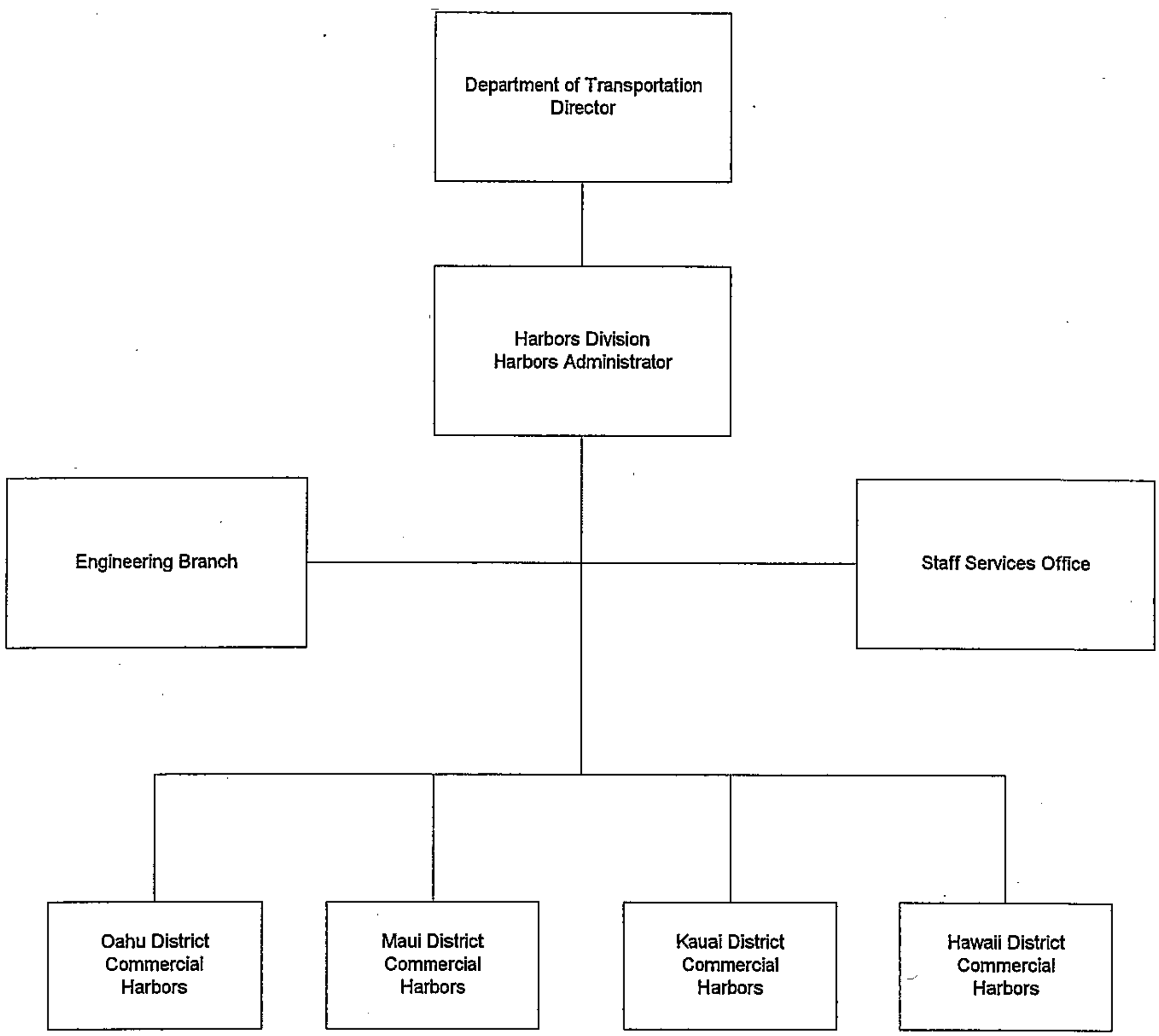
Organization of the Harbors Division

The Harbors Division controls nine commercial ports: Honolulu Harbor, Barbers Point Harbor, and Kewalo Basin on Oahu; Hilo Harbor and Kawaihae Harbor on Hawaii; Nawiliwili Harbor and Port Allen on Kauai; and Kahului Harbor and Kaunakakai Harbor in the Maui District. Exhibit 1.1 illustrates the organization of the Harbors Division.

Harbors Administrator

The Harbors Administrator is responsible for directing, coordinating, and maintaining the operations of the State's harbors program by providing for, equipping, and regulating the state system of harbors and related facilities. Activities include planning, designing, and constructing new harbors and facilities as well as maintaining those that exist.

Exhibit 1.1
Organization of the Harbors Division



Staff Services Office

The Staff Services Office advises the harbors administrator and other managers within the division in matters relating to the division's organization, personnel, fiscal, and property management. In addition, the office develops, implements, and maintains program planning and management control systems and monitors programs and control systems to ensure their continued progress and effectiveness. The Staff Services Office includes staff in the following sections: Office Services; Personnel Management; Financial Management; Property Management; and Methods, Standards, and Evaluation.

Engineering Branch

The Engineering Branch is responsible for the planning, design, construction, and maintenance of facilities for the State commercial harbors system. It consists of five sections: Engineering Systems; Planning; Design; Maintenance; and Construction.

District Offices

Four district offices on Oahu, Hawaii, Kauai, and Maui carry out commercial harbor programs as directed by the Harbors Administrator. Each district office is headed by a district manager who reports to the harbors administrator. Each district office plans, directs, controls, and coordinates the activities of the district personnel in the management, operations, and maintenance of the harbors and related facilities within its district.

Objectives of the Audit

1. Report on the fair presentation of the financial statements of the Harbors Division of the Department of Transportation.

2. Assess the adequacy, effectiveness, and efficiency of the systems and procedures for the financial accounting, internal control, and financial reporting of the Harbors Division of the Department of Transportation; and recommend improvements to such systems, procedures, and reports.

3. Ascertain whether expenditures and other disbursements have been made and all revenues and other receipts have been collected and accounted for in accordance with federal and state laws, rules and regulations, and policies and procedures.

Scope and Methodology

We audited the financial records and transactions and reviewed the related systems of accounting and internal controls of the Harbors Division within the Department of Transportation for the fiscal year July 1, 1995 to June 30, 1996. Included in our audit were tests of the financial data to provide us with a basis to report on the fairness of the presentation of the financial statements. We also reviewed the Harbors Division's transactions, systems, accounting of revenues and other receipts, and leasing practices for compliance with applicable laws and regulations.

We examined the existing accounting, reporting, and internal control structure and identified deficiencies and weaknesses therein. We made recommendations for improvements including, but not limited to, the forms and records, the management information system, and the accounting and operating procedures.

The independent auditor's opinion as to the fairness of the financial statements presented in Chapter 3 is that of Nishihama & Kishida, CPA's, Inc. The audit was conducted from June 1996 through November 1996 in accordance with generally accepted government auditing standards.

Chapter 2

Internal Control Practices

Internal controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the financial accounting and internal control practices and procedures of the Harbors Division of the State Department of Transportation.

Summary of Findings

We found serious deficiencies in the division's fiscal operations. These deficiencies are serious enough that the certified public accounting firm of Nishihama & Kishida, CPA's, Inc. has reported one of them as a material weakness and another as an instance of noncompliance with applicable regulations. These findings are summarized below:

1. There is no financial reporting within the division. Needed financial reports are not prepared and the division has to pay its outside auditors to prepare accounting records and schedules so that its financial audits can be completed.

2. Property management practices are deficient. The division does not have an adequate inventory of property owned to ensure that all lease rents are collected and month-to-month lease arrangements have gone on for years.

3. Controls over cash receipts and billings at three district offices and certain harbors are seriously deficient. Without proper internal controls there is no assurance that all cash receipts are properly deposited.

Material Weakness and Reportable Conditions Reflect Serious Problems

The harbors' operating costs are paid for with harbor fees and property lease rents. Because the Harbors Division is a monopoly, those who use it have no choice but to pay the division's fees. Harbors users and the public have a right to expect that the fees are reasonable and necessary to pay the division's operating costs. The division should be fiscally accountable and make every effort to control costs. It should also ensure that lease rents are proper and that rent collections are timely.

We found serious deficiencies in the fiscal operations of the division. A complete lack of timely financial information leaves district and harbor staff in the dark about their operating costs. Property management practices do not ensure that all lease rents are collected. Poor controls over cash receipts and billings at three district offices and certain harbors can result in lost revenues.

Reportable conditions are significant deficiencies in the design or operation of an organization's internal control structure that could adversely affect its ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness in the internal control structure is the worst possible reportable condition. A material weakness exists when internal controls are such that significant errors or irregularities may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. In other words, illegal acts such as thefts could go undetected. The lack of financial information for management to review is a material weakness.

In the following sections, we discuss the reportable conditions at the Harbors Division.

The Division Does Not Have Needed Financial Information

The Department of Transportation and the Harbors Division are responsible for ensuring that the division is accountable for its fiscal and other resources. We found that the Harbors Division has not achieved fiscal accountability because its management lacks the appropriate financial information needed to assess the results of its operations and to hold its management accountable for meeting the division's needs within its resources.

Adequate financial information is developed from proper recording of financial transaction data and the preparation of financial reports from that data. It involves not only an accounting and financial reporting system, but also staff sufficient in numbers and skills to process the data and prepare reports. The department and the division have failed to ensure that the division has staff necessary to prepare essential financial reports.

There is a complete lack of needed financial information

Timely financial reports are essential for effective management of operations. They enable management to quickly identify problem areas or reporting errors that need correction. Monthly financial reports should normally take from two to three weeks to complete. The Financial Management Staff of the Harbors Division is responsible for preparing financial reports for the division. The staff have been unable to provide financial information needed to enable management to do its job.

Monthly reports should include a balance sheet, a statement of revenues and expenses, and summaries of key operating statistics. Another critical report is of expenditures by location and by type (e.g., electricity expense, repairs, etc.). The division does not provide this information to its operating units during the year. District offices only receive expenditure reports at the end of the fiscal year. Units are expected to use these reports only as a basis for preparing next year's operating budgets.

Useful reports are not requested from FAMIS

Annual expenditure reports provided to the districts are prepared by the state's Financial and Management Information System (FAMIS). FAMIS maintains the official accounting records of the State as well as detailed records of departmental expenditures. It does provide monthly expenditure reports to state agencies that request them. However, Financial Management Staff only requests these reports at the end of the fiscal year. These and other reports available from FAMIS could be of use to management. We found that because Financial Management Staff is unaware of available FAMIS reports, it does not request them.

The division's current functional statement outlines the responsibilities of the Financial Management Staff and its individual sections. The functional statement for the Financial Management Staff states that it "Oversees and operates the Division's comprehensive accounting system; prepares financial statements and advises the Staff Services Officer on the Division's financial status..."

No financial statements or other statistical reports are prepared as required by the current functional statements. We found no evidence that management has taken steps to hold the Financial Management Staff responsible for meeting the requirements of the division's functional statements.

Division relies on costly outside auditors

In addition to the cost of its annual financial audits, the division has paid its outside auditors $286,000 for other assistance over the past three fiscal years. The division expects to pay its outside auditors at least $190,000 for these services over the next two fiscal years. The auditors' services have included preparing financial schedules and statements so that its audits could be completed and providing other accounting and consulting services.

In addition, the auditors have assisted the division in management decisions such as which repairs and maintenance should be capitalized, recorded in the fixed assets records, and depreciated over time. The division also relied upon its outside auditors to compute depreciation of assets and prepare fixed asset and depreciation schedules at the end of the year. Most organizations do this work as part of the normal processing of accounting transaction data. They also do their own "audit schedule preparation" to reduce audit costs.

The amounts paid to the outside auditors are over and above the standard costs for financial audits. These costs could be avoided if staff performed the duties and responsibilities outlined in their functional statements.

Scheduled audit work had to be postponed

The specifications for this financial audit of the Harbors Division contained a timetable for completion of the audit by October 7, 1996. The timetable was discussed at an initial survey meeting, and assurances were given that the timetable could be met. At a June 5, 1996 entrance meeting with Harbors Division staff, the timetable was once again reviewed and again assurances were given that the timetable would be met. This was not the case.

The department contracted with its outside auditors to prepare financial and accounting schedules needed to complete this audit. Because the division was unable to assure that the work of its outside auditors could be completed as promised, Nishihama & Kishida had to stop their work until necessary recordkeeping was completed. Records and schedules were finally ready for audit at the end of October—after the original completion date for this audit. As a result, this audit was completed long after the deadline of our contract with Nishihama & Kishida.

Department was made aware of the problem

In 1994, the Department of Transportation paid KPMG Peat Marwick LLP $75,000 to conduct a management audit of the Harbors Division. In its report to the department dated November 25, 1994, KPMG Peat Marwick LLP stated:

> The Harbors Division is not capable of generating timely, periodic financial information during the fiscal year. Accurate financial information is usually not available to management until several months after year end when the annual audit is completed.

These delays continue to plague the department. The department and the division need to address this issue, because the division has a responsibility to the public, its customers, its operating staff, and the Legislature to be fiscally accountable. The department and the division should review the division's Financial Management Staff needs and take steps to ensure that the Financial Management Staff is capable of carrying out its required duties.

Division's proposed reorganization misses the mark

The Harbors Division has proposed a reorganization of its Financial Management Staff that runs counter to sound management principles. If approved, the reorganization would eliminate necessary requirements of the Financial Management Staff. Furthermore, it would result in a questionable promotion and management of resources. The current organization of the Financial Management Staff is presented in Exhibit 2.1.

Proposal would no longer require preparation of needed financial reports

The proposed reorganization includes changes to the functional statements that would remove the requirement that the Accounting Section be responsible for preparing financial statements and statistical reports. Instead, it would replace this requirement with the following: "[The Accounting Section] Maintains the Division's general ledger which provides the information necessary for our year end financial audit."

If the proposed reorganization is approved, existing practices would likely continue and there would be no improvements in financial reporting.

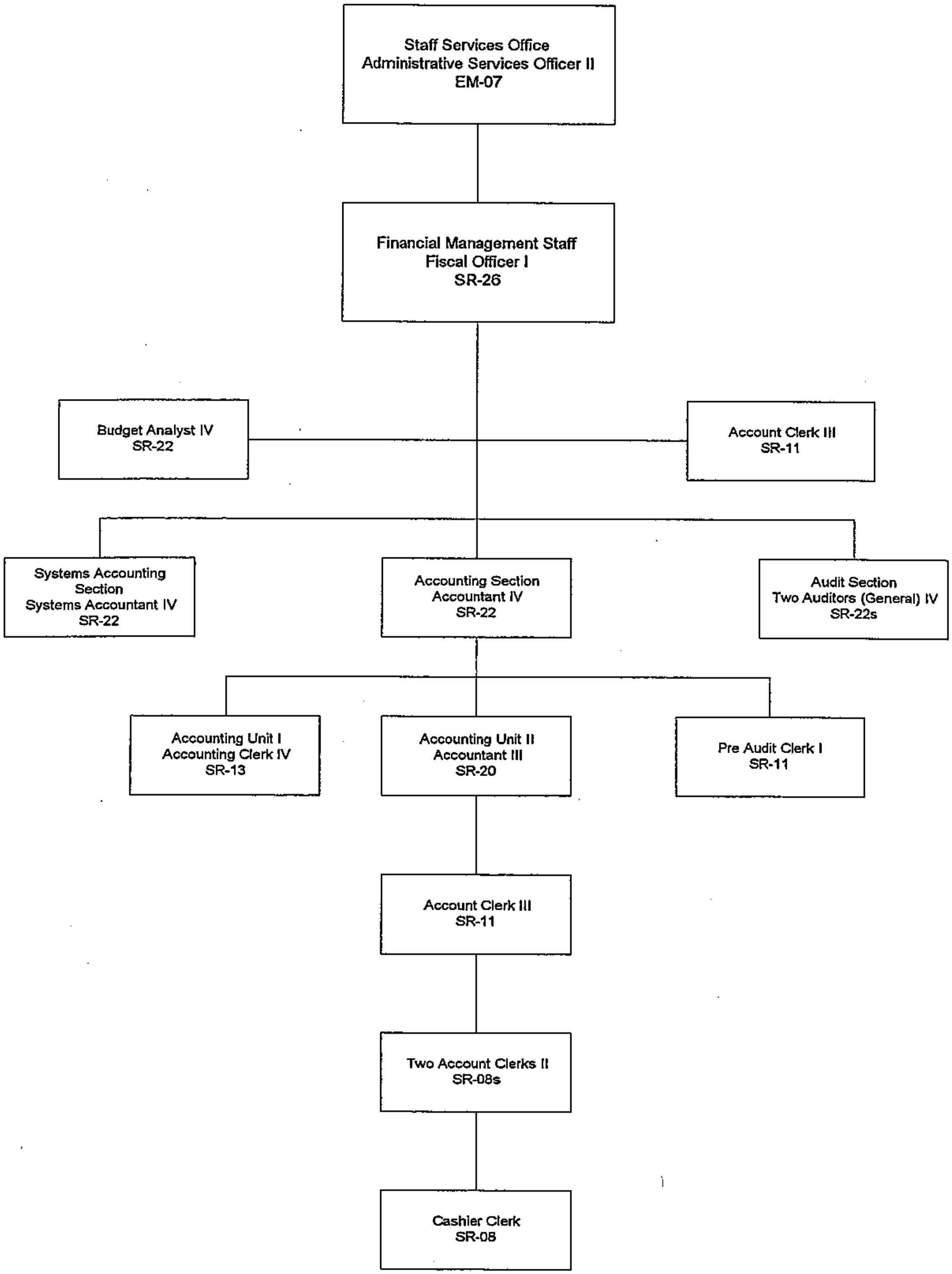
Proposal would add staff and increase costs

In this era of re-engineering, organizations are expected to do more with less. But this proposed reorganization places less responsibility on the Accounting Section, while increasing the salary of the section's head—the individual who is responsible for producing the financial statements that are currently not being prepared.

The proposed reorganization would promote a current Accounting Section staff member from an Accountant IV to an Accountant V. An Accountant IV is classified as an SR-22 with an annual salary range of $32,544 to $46,356. An Accountant V is classified as an SR-24 with an annual salary range of $36,636 to $52,152. The proposal would also add another staff member to process transactions and upgrade another existing position.

Before proceeding with any reorganization of its Financial Management Staff, the division should first determine why current financial statements are not being prepared as required.

Exhibit 2.1
Financial Management Staff Organizational Chart



Property Management Needs Improvement

The Property Management Office of the Harbors Division rents properties under its administration to third parties through lease agreements and the issuance of revocable permits. As of June 30, 1996, the Harbors Division had 75 lease agreements and 224 revocable permits. The Departmental Staff Manual issued by the State Department of Transportation provides guidance for property management.

Good property management ensures that the State receives fair property rental amounts and that the use of properties is consistent with the division's mission. Poor controls have weakened the division's ability to optimize rental revenues and have allowed properties to be used for non-maritime related activities for extended periods of time.

Harbors Division lacks adequate property inventory report

The Property Management Office does not have an adequate inventory of real property under its control or a listing of properties in use or available for rent or sale. Without an adequate inventory of property, the Property Management Office is unable to effectively and efficiently manage all properties under its jurisdiction.

Section 8.14.04 of the Departmental Staff Manual states that "Each division shall maintain an inventory of all lands under its jurisdiction. Each division shall also maintain a computerized listing of all of its properties in use or available for rent or sale." The manual also states that "Each division shall maintain tax maps for all properties under its jurisdiction. Each division shall maintain a set of tenant maps showing the location of each tenant."[1]

The division does have a listing of property placed under its jurisdiction by executive order. The list does not contain the required information such as total properties occupied or in use and total properties available for rent or sale.

Rentals for non-maritime related activities circumvent departmental policy

The Department of Transportation's operating manual requires that property leases granted by the Harbors Division for non-maritime related activities be subject to additional approvals. Leases for non-maritime activities must be approved by the Department of Transportation, the Board of Land and Natural Resources, and the Governor.

The division has 12 properties that have been used for non-maritime activities since before 1992. It has not sought the necessary approvals for leases of these properties. Instead, the division has allowed the properties to be used for non-maritime activities through the use of revocable permits. Revocable permits are temporary permits for the use of temporary revocable permits. They can be renewed by the division. The revocable permits for use of these 12 properties have been renewed annually. Two of the permits were granted in the 1970s.

The long-term use of these properties for non-maritime activities indicates the properties may not be needed for harbor operations. The Departmental Staff Manual deals with the issue of excess property. It states:

> Each division shall periodically review its inventory of land to determine whether any of the real property under its jurisdiction or control is in excess to the need of [the Department of Transportation]. Should such excess property be determined to exist, the cognizant division shall request [the Department of Land and Natural Resources] to withdraw the land from its inventory.[2]

The Departmental Staff Manual also states: "Divisions shall refrain from issuing revocable permits which become inordinately long in term, unless there is a pressing reason to do so."[3] We could find no pressing reason for granting revocable permits.

The division should stop renewing these revocable permits. It should determine if the properties are not needed for harbor operations and, therefore, excess. If the properties are not excess properties, the division should follow required procedures for long-term leases of properties to be used for non-maritime purposes. If the properties are excess the division should request the Department of Land and Natural Resources to withdraw the land from the division's inventory.

Lease renewal is not pursued on a timely basis

The Harbors Division issued a revocable permit in 1984 to Honolulu Shipyard, Inc. while renewal of the shipyard's long-term lease, which expired in October 1984, was being negotiated. To date, no lease has been finalized and Honolulu Shipyard continues to operate on the Harbors Division's property under a revocable permit.

Honolulu Shipyard continues to rent the division's property at its previous lease rent amount that was established in 1975. We found no evidence of any rent negotiations between the shipyard and the division from 1986 to 1990, and 1993 to 1995. In 1991, an appraisal was performed of the property rented by Honolulu Shipyard. Based on the appraisal, a rent of approximately twice the 1975 rate was proposed to and rejected by the shipyard. Currently, the Harbors Division is waiting for a response from the Director of Transportation regarding the approval of a proposed rent amount based on market rates. The shipyard will continue to operate under a revocable permit until an increase is approved. At such time, the Harbors Division intends to pursue a long-term lease.

In a draft of its 2020 Master Plan, the Harbors Division hopes to convert the property rented by the shipyard into a container yard by the year 2015. Because the redevelopment of the property is not expected to be completed for some time, the shipyard may occupy the property for years to come.

As a result of the prolonged negotiation, the Harbors Division has lost revenues from potential rent increases for the past 12 years. The present rent is about one third of the proposed rent. Assuming that the rent proposed by the Harbors Division to the Director of Transportation in 1996 is acceptable, the Harbors Division will have lost a potential of approximately $770,000 in revenues for one year.

To maximize revenues, the Harbors Division must ensure that every effort is made to execute lease renewals in a timely manner.

Billings are not always updated for rent increase in timely manner

Our testing revealed that two tenants were not billed for rent increases totaling $21,385 per month at the time that the increases were effective as stipulated in the lease agreements. The Property Management Office noticed the error a few months after the effective date and billed the tenants for the increase retroactively. Although the Property Management Office detected and corrected the error, the delay in billing for the correct amount would not have occurred under an efficient billing system.

Present billing procedures are inadequate and increase the risk of overlooking rent escalation. Each month, a property manager reviews a listing of leases for rent increases that will be effective for the upcoming month. A billing request is prepared by the property manager and submitted to the district office to change the monthly rent on the computerized billing system. Because the leases reviewed are listed alphabetically rather than chronologically by rental periods, an upcoming rent increase may be overlooked. In addition, the review is not performed on a specific day of the month (e.g., the 20th day of the month).

Reviewing for upcoming changes in rents on a specific day of each month reduces the risk that the review will be overlooked. In addition, the division will have sufficient time to effect the change. The review process could be made even more efficient by noting the upcoming rent increases on a calendar at the beginning of the year or listing the rent escalation dates chronologically. Under the present process, the entire lease listing must be reviewed. By reporting the rent escalation chronologically, leases with rent increases for the upcoming month are more easily identifiable.

We understand that the division is planning to develop a new information system that would include property management functions. We encourage the division to include property information such as rent escalation and rental renegotiation dates in the system.

Controls Over Cash Receipts and Billings at Three District Offices and Certain Harbors Are Seriously Deficient

Without proper internal controls there is no assurance that all cash receipts are properly deposited. Improper or deficient billings may result in lost revenues. We found serious deficiencies at division offices and certain harbor offices. Nishihama & Kishida CPA's, Inc. have classified these deficiencies as reportable conditions in their auditors' report on the internal control structure in Chapter 3.

There are no internal controls for over-the-counter collections on Kauai

Internal controls over the use of cash receipt forms are critical in ensuring that cash collections are properly accounted for. Proper internal controls require that only one pre-numbered receipt book be used at all times. The stock of blank receipt books should be kept in a secured area and be accessible only to authorized employees. All receipts should be issued in numerical sequence. Furthermore, only authorized employees should issue receipts and accept cash collections. Receipts should be prepared only when the transaction is completed and should never be done in advance. Someone independent of the receipt preparation process should review the receipt book daily to ensure all receipts are properly accounted for and deposited.

Pre-numbered manual receipts are issued to customers for over-the-counter payments to a district office for miscellaneous collections such as parking permits, temporary mooring permits, etc. During our review of over-the-counter collections at the Kauai District Office (Kauai), we noted the following conditions:

1. Several receipt books were used simultaneously for the receipt of over-the-counter transactions. Therefore, it was difficult to account for all receipts issued during the fiscal year.

2. The receipts were not issued in numerical sequence. In addition, no one reviewed the receipt books to ensure the day's cash collections were accounted for and deposited. We noted five instances in which cash collections were not deposited with checks received on the same day. The cash collections were deposited one to three deposits later. Exhibit 2.2 shows the details of these deposits.

Exhibit 2.2
Late Deposits of Cash Collections

Receipt No.	Receipt Date	Amount	Validated Deposit Slip Date	Other Deposits Between the Date of Receipt and Deposit
8277	09/18/95	$509.00	10/12/95	09/22/95, 09/26/95, 10/05/95
8286	10/05/95	$18.75	10/17/95	10/12/95
8295	12/05/95	$5.00	12/22/95	12/08/95, 12/15/95
8310	01/22/96	$165.00	02/09/96	01/26/96, 02/02/96
8312	02/06/96	$19.00	02/20/96	02/09/96, 02/16/96

3. Numerous receipts were issued by a person who was not a Harbors Division employee. Until June 1996, the Kauai District Office shared office space with the Small Boat Harbors Division (SBHD) under the State Department of Land and Natural Resources. The Kauai District Office and SBHD operated independently, each with its own personnel. Small Boat Harbors Division personnel were allowed to issue receipts and accept payments on behalf of the Kauai District Office.

4. Small Boat Harbors Division receipt books were used for Harbors Division collections. SBHD's receipt books were not available for review and we could not determine whether other SBHD receipts were issued for Harbors Division cash collections.

5. Manual receipts were prepared before the cash was received. Receipts were prepared based upon permit applications taken over the phone. Cash collections occurred when the permits were picked up. Preparing receipts before actually receiving the payment defeats the purpose of issuing receipts.

Without adequate internal controls for over-the-counter collections, the Kauai District Office cannot ensure that all cash receipts are properly deposited.

Controls over deposits are needed at Kaunakakai and Port Allen harbors

The smaller harbors of Port Allen and Kaunakakai forward bank validated deposit slips and pre-numbered manual receipts supporting the deposits to the appropriate district offices (Kauai and Maui, respectively). Although the district offices verify the total collections per the receipts against the deposit, no one accounts for the numerical sequence of the receipts. This makes the collections susceptible to misplacement and/or misappropriation.

There is inadequate segregation of duties at the district offices

Most, if not all, of a district office's billings and collections are handled by the district office's account clerk. At the district offices of Hawaii, Kauai and Maui, the account clerk is responsible for issuing receipts; reconciling receipts to the cash/checks collected; preparing the deposits; recording the receipts in the customers' accounts; and preparing the customers' invoices. The account clerk at the Hawaii District Office is also responsible for the follow-up of delinquent accounts.

At the end of each month, district office managers reconcile the beginning accounts receivable balance, receipts, current billings, and ending accounts receivable balance per the customers' accounts to the deposit and billing records. The district office managers on Kauai and Maui also review the accounts receivable records for unusual adjustments and delinquencies. Although the district office manager reconciles the accounts receivable ledger to the supporting records, it is still possible for funds to be misappropriated because the account clerk is responsible for all phases of billings and collections.

No one person should perform all billings and collections. No one person should have access to the cash, maintain the cash accounting records, prepare the billings, maintain billing records, and perform all other duties of the billings and collections. Without adequate segregation of duties, funds may be lost, unrecorded, or misused. If it is not possible to segregate these duties, other controls should be in place to compensate for the lack thereof. If possible, all parts of an accounting cycle should be assigned to different employees. However, if this is not possible, compensating controls should be established such as the following:

- The office manager should review deposits and ensure that remittances, check stubs and pre-numbered receipts reconcile with the deposit slip and should account for the numerical sequence of the pre-numbered receipts.

- The office manager or someone independent of the collection process should follow-up on delinquent accounts and review the accounts receivable detail ledger for unusual adjustments.

- The office manager should also continue to reconcile billings and receipts posted to the accounts receivable ledger with other supporting records.

Fees charged are not consistent between district offices

Title 19, Chapter 44 of the Hawaii Administrative Rules provides guidance on assessing fees for the Department of Transportation. We noted inconsistencies in the fees charged by the district offices due to noncompliance with the Hawaii Administrative Rules. In addition, certain fees such as water meter readings and processing fees are not specifically established in the Hawaii Administrative Rules, but are charged by some of the district offices. Exhibit 2.3 shows inconsistencies in the fees charged by the district offices.

Because of inconsistencies, the percentage of revenues earned in relation to the costs incurred for such expenditures as electricity and water varies greatly between districts.

As the harbors are operated statewide under a single agency, the type of fees and the method used to calculate fees should be consistent among the district offices.

Conclusion

The Harbors Division needs to operate in a more business-like manner. It should be fiscally accountable and should assure that useful financial information is readily available to management. Management should use the information to review operations and control costs. Property management practices need to be more tightly controlled. Property not needed for maritime related activities should not be kept indefinitely by the division. Finally, controls necessary to assure that all revenues are properly collected and deposited should be developed.

Recommendations

1. The Department of Transportation and the Harbors Division should take steps necessary to ensure that needed financial reports are prepared for management.

2. The Department of Transportation should not approve any proposed reorganization of the Financial Management Staff that does not clearly assign responsibility for preparation of needed financial reports.

3. The Harbors Division should take steps to improve its property management. We recommend that it:

    a. prepare a complete inventory of property under its jurisdiction as required by the Departmental Staff Manual;

    b. cease its practice of renewing revocable permits for non-maritime related activities;

    c. determine which of its properties are excess properties and transfer them to the Department of Land and Natural Resources;

    d. execute lease renewals in a timely manner; and

Exhibit 2.3
Inconsistencies in Fees Charged by District Offices

DESCRIPTION OF FEES CHARGED	HAWAII ADMINISTRATIVE RULES	DISTRICT			
		HAWAII	KAUAI	MAUI	OAHU
Water - moored vessel	$10 per month, where water service is available Section 19-44-31	None	None	based upon actual cost per 1,000 gallons	based upon rates set in the Hawaii Administrative Rules
Electricity - large vessels	Cost of electricity charged to the department, plus an electricity surcharge of 15% for furnishing the electricity Section 19-44-2	rates dependent on pier, type of vessel, and length of stay	None	varies by vessel size and length of stay	varies by vessel size and length of stay
Electricity - moored vessels	Cost of the electricity charged to the department, or a flat rate of $4 per day for 110 volts and $10 per day for 220 volts, if meters are not available Section 19-44--31	None	None	varies by vessel size	based on rates set in the Hawaii Administrative Rules
Key deposit	$25 if access is required for more than a 90-day period $30 if access is required for less than a 90-day period Section 19-44-10	based on rates set in the Hawaii Administrative Rules	None	based on rates set in the Hawaii Administrative Rules	based on rates set in the Hawaii Administrative Rules
Water meter reading	Not established in the Hawaii Administrative Rules	None	$40 per reading for large berthed vessels	$20 per reading	None
Temporary mooring permit processing fee	Not established in the Hawaii Administrative Rules	None	$5	None	reprocessing charge - 15% of mooring fee

  e. develop a reliable method of identifying lease escalation dates in a timely manner.

3. The division should take steps to improve controls over cash collections and billings. We recommend that:

  a. the division implement controls for over-the-counter collections on Kauai;

  b. it require Kauai and Maui district offices to verify the numerical sequence of pre-numbered receipts accompanying bank validated deposit slips;

  c. district offices segregate cash handling and recording duties if possible. If staff size makes this infeasable, the division should require that other management controls be followed to review cash transactions; and

  d. the division should assure that fees charged by district offices are proper and consistent.

Chapter 3

Financial Audit Reports

This chapter presents the results of the financial audit of the Harbors Division of the Department of Transportation of the State of Hawaii (Harbors Division) as of and for the fiscal year ended June 30, 1996. This chapter includes the independent auditors' report and reports on the internal control structure and tests of compliance with laws and regulations as it relates to the Harbors Division. It also displays financial statements together with explanatory notes, and supplemental schedules.

Summary of Findings

In the opinion of Nishihama & Kishida, CPA's, Inc. based on its audit, the financial statements present fairly, in all material respects, the financial position of the Harbors Division as of June 30, 1996, and the results of its operations and cash flows for the fiscal year then ended in conformity with generally accepted accounting principles.

Nishihama & Kishida, CPA's, Inc. noted matters involving the internal control structure and its operation that they considered to be reportable conditions, including a material weakness as defined in the report on the internal control structure. They also noted that, with respect to items tested, except for one instance of noncompliance, the Harbors Division has complied, in all material respects, with laws and regulations applicable to the Department of Transportation of the State of Hawaii that are required to be reported under *Government Auditing Standards*.

Independent Auditors' Report

To the Auditor
State of Hawaii

We have audited the following financial statements of the Harbors Division of the Department of Transportation of the State of Hawaii (Harbors Division) relating to the Public Undertaking:

Balance sheet of the Public Undertaking - June 30, 1996 (Exhibit A);

Statement of operations of the Public Undertaking - fiscal year ended June 30, 1996 (Exhibit B);

Statement of retained earnings of the Public Undertaking - fiscal year ended June 30, 1996 (Exhibit C);

Statement of cash flows of the Public Undertaking - fiscal year ended June 30, 1996 (Exhibit D).

These financial statements are the responsibility of the management of the Harbors Division. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in the notes to the financial statements, the financial statements present only the activities of the Harbors Division and are not intended to present fairly the financial position of the State of Hawaii and the results of its operations, and the cash flows of its proprietary fund type in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Harbors Division relating to the Public Undertaking as of June 30, 1996, and the results of its operations and its cash flows for the fiscal year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. Schedule I through Schedule XI are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 19, 1996 on our consideration of the Harbor Division's internal control structure and a report dated November 19, 1996 on its compliance with laws and regulations.

/s/Nishihama & Kishida, CPA's, Inc.

Honolulu, Hawaii
November 19, 1996

Independent Auditors' Report on the Internal Control Structure Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Auditor
State of Hawaii

We have audited the financial statements of the Harbors Division of the Department of Transportation of the State of Hawaii (Harbors Division) relating to the Public Undertaking as of and for the fiscal year ended June 30, 1996, and have issued our report thereon dated November 19, 1996.

We conducted our audit in accordance with generally accepted auditing standards and *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.

The management of the Harbors Division is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of the inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Harbors Division, for the fiscal year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Harbors Division's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions that we noted are described in Chapter 2.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe that the reportable condition relating to the lack of timely financial information to be a material weakness as defined above. This condition was considered in determining the nature, timing, and extent of the procedures to be performed in our audit of the financial statements of the Harbors Division for the fiscal year ended June 30, 1996.

We also noted other matters involving the internal control structure and its operation that we have reported to the Auditor, State of Hawaii, and the management of the Department of Transportation of the State of Hawaii, which are described in Chapter 2.

This report is intended for the information of the Auditor, State of Hawaii and the management of the Department of Transportation of the State of Hawaii. However, this report is matter of public record and its distribution is not limited.

/s/Nishihama & Kishida, CPA's, Inc.

Honolulu, Hawaii
November 19, 1996

Independent Auditors' Report on Compliance Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Auditor
State of Hawaii

We have audited the financial statements of the Harbors Division of the Department of Transportation of the State of Hawaii (Harbors Division) relating to the Public Undertaking as of and for the fiscal year ended June 30, 1996, and have issued our report thereon dated November 19, 1996.

We conducted our audit in accordance with generally accepted auditing standards and *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.

Compliance with laws, regulations, and contracts applicable to the Harbors Division is the responsibility of the Harbors Division's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Harbors Division's compliance with certain provisions of laws, regulations, and contracts, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

We noted an immaterial instance of noncompliance with the Hawaii Administrative Rules relating to fees charged as described in Chapter 2.

This report is intended for the information of the Auditor, State of Hawaii and the management of the Department of Transportation of the State of Hawaii. However, this report is a matter of public record and its distribution is not limited.

/s/Nishihama & Kishida, CPA's, Inc.

Honolulu, Hawaii
November 19, 1996

Descriptions of Financial Statements and Supplemental Schedules

The following is a brief description of the financial statements and supplemental schedules audited by Nishihama & Kishida, CPA's, Inc., which are attached at the end of this chapter.

Balance sheet of the Public Undertaking (Exhibit A). This statement presents assets, liabilities, and fund equity of the Harbors Division at June 30, 1996.

Statement of operations of the Public Undertaking (Exhibit B). This statement presents revenues and expenses for the Harbors Division for the fiscal year ended June 30, 1996.

Statement of retained earnings of the Public Undertaking (Exhibit C). This statement summarizes the changes in retained earnings for the fiscal year ended June 30, 1996.

Statement of cash flows of the Public Undertaking (Exhibit D). This statement presents cash flows from operating, investing, and financing activities for the fiscal year ended June 30, 1996.

Cash and cash equivalents and investments in time certificates of deposit and repurchase agreements of the Public Undertaking (Schedule I). This schedule summarizes unrestricted and restricted cash and cash equivalents, and investments in time certificate of deposits and repurchase agreements.

Investments in securities held by the Public Undertaking (Schedule II). This schedule summarizes the investment in United States Treasury notes held by the Harbors Division.

Harbor facilities and related accumulated depreciation of the Public Undertaking (Schedule III). This schedule summarizes the changes in fixed assets and the related accumulated depreciation.

Construction in progress of the Public Undertaking (Schedule IV). This schedule summarizes the construction in progress and the related source of funds.

General obligation bonds of the Public Undertaking (Schedule V). This schedule summarizes the outstanding general obligation bonds which are reimbursable to the State of Hawaii.

Revenue bonds of the Public Undertaking (Schedule VI). This schedule summarizes the outstanding revenue bond balances.

Operating revenues by district of the Public Undertaking (Schedule VII). This schedule summarizes the operating revenues for each district of the Harbors Division.

Selected operating expenses by district of the Public Undertaking (Schedule VIII). This schedule summarizes selected operating expenses for each district of the Harbors Division.

Revenue bond reserve requirements of the Public Undertaking (Schedule IX). This schedule summarizes the restricted assets for revenue bond reserve requirements.

Harbor capital improvement revenue bonds - minimum net revenue requirement of the Public Undertaking (Schedule X). This schedule summarizes net revenues in comparison to harbor capital improvement revenue bond debt service requirements.

Harbor revenue bonds - minimum net revenue requirement of the Public Undertaking (Schedule XI). This schedule summarizes net revenue in comparison to harbor revenue bond debt service requirements.

Notes to the Financial Statements of the Public Undertaking

Explanatory notes which are pertinent to an understanding of the financial statements and financial condition of the Harbors Division included in the scope of the audit are discussed in this section.

Note 1 - Financial reporting entity

In 1959, the Harbors Division was established within the Department of Transportation of the State of Hawaii (DOT) effective July 1, 1961. All functions and powers to administer, control, and supervise all State of

Hawaii (State) harbors and water navigational facilities were assigned to the Director of DOT on that date.

The Harbors Division is part of the DOT which is part of the executive branch of the State. The Harbors Division's financial statements reflect only its portion of the proprietary fund. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually, which includes the Harbors Division's financial activities.

The "Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Harbor Capital Improvement Revenue Bonds," dated September 1, 1967 (1967 Certificate), and "Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Harbor Revenue Bonds," dated November 15, 1990 (1990 Certificate), define the "Undertaking" as all of the harbor and waterfront improvements and other properties under the jurisdiction, control and management of the Harbors Division, except those principally used for recreation and the landing of fish.

Note 2 - Summary of significant accounting policies

Measurement focus and basis of accounting. The accounting policies of the Harbors Division conform to generally accepted accounting principles as applicable to enterprise activities of governmental units. An enterprise fund is used to account for the acquisition, operation and maintenance of government facilities and services that are entirely or predominantly supported by user charges. The Harbors Division's operations are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting is utilized. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Harbors Division applies all applicable Financial Accounting Standards Board pronouncements on accounting and reporting that were issued on or before November 30, 1989.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

Investments. Unrestricted investments are recorded at cost. The resultant variance from generally accepted accounting principles, which provides for such investments to be valued at amortized cost, is not significant.

In accordance with the provisions of the 1967 Certificate, monies accumulated in the debt service reserve and extraordinary renewal and replacement reserve accounts, which have been designated to provide added collateral for the retirement of the revenue bonds, are invested in obligations of the United States. These investments are required by the debt provisions to be valued at the lower of face value or market. The resultant variance from generally accepted accounting principles, which provides for such investments to be valued at amortized cost, is not significant.

In accordance with the provisions of the 1990 Certificate, monies accumulated in the harbor debt service reserve and harbor reserve and contingency accounts are invested by the Director of Finance. These investments are valued at the lower of face value or market. The resultant variance from generally accepted accounting principles, which provides for such investments to be valued at amortized cost, is not significant.

Accounts receivable. Accounts receivable consists primarily of amounts due from third parties who rent harbor facilities.

Harbor facilities and depreciation. Harbor facilities are stated at cost. Depreciation of harbor facilities is computed using the composite straight-line method over the estimated useful lives of the assets. Depreciation is not provided for in the year of acquisition, but is provided for the entire year in the year of disposal. Disposals of assets are recorded by removing the cost and related accumulated depreciation from the accounts with the resulting gain or loss reflected in operations.

Harbor facilities and their related composite straight-line rates used to compute depreciation are as follows:

	Rates
Land improvements	1.0% - 4.0%
Wharves	1.0 - 10.0
Buildings	1.5 - 10.0
Other improvements	2.5 - 20.0
Equipment	8.0

Maintenance and repairs, as well as minor replacements, renewals and betterments, are charged to operations; major renewals, replacements and betterments are capitalized. Interest cost is capitalized during the period of construction for all capital improvement projects except those projects funded by grants from the State or the federal government.

Depreciation on harbor facilities acquired with contributed capital is reflected as an offset against contributed capital.

Bond issue costs. Costs relating to the issuance of bonds are amortized by the straight-line method over the term of the obligations.

Unamortized debt discount. Debt discount is amortized ratably over the term of the related debt, and the unamortized balance is reflected as an offset against the long-term debt in the balance sheet.

Refunding of debt. The Harbors Division adopted the provisions of Statement No. 23 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities* effective July 1, 1994. Under Statement No. 23, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported as a deduction from or an addition to the new debt liability. Prior to the adoption of Statement No. 23, the difference between the reacquisition price and the net carrying amount of the old debt was reported as an extraordinary item in the statement of operations for the period in which the gain or loss occurred.

Contributions. Contributions used for construction and/or property acquisitions are stated net of the depreciation on the related property. No contributions were received during the fiscal year. Depreciation of $319,430 is included as an expense on the statement of operations but is transferred in the statement of retained earnings to the contribution account.

Accrued vacation. Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the balance sheet.

Note 3 - Cash and investments

At June 30, 1996, information relating to the insurance and collateral of cash deposits is not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are either federally insured or collateralized with obligations of the State or the United States. 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.

Statutes authorize the Harbors Division to invest, with certain restrictions, in obligations of the State or the United States, in federally insured savings accounts, time certificates of deposit and repurchase agreements with federally insured banks and savings and loan associations authorized to do business in the State. Money held as reserves may be invested in obligations of the United States, the State or any subdivision of the State. Investments are insured or collateralized with securities held by the State or by its agent in the State's name.

At June 30, 1996, the investments in the U.S. government securities, which were purchased through Bank of Hawaii as agent for the Harbors Division, are held in a trust account with a custodial bank in the custodial bank's name for Bank of Hawaii.

Note 4 - Harbor facilities

The changes in harbor facilities were as follows:

	Balance, July, 1, 1995	Additions	Deductions	Balance, June 30, 1996
Land and land improvements	$220,872,745	$ —	$736,088	$220,136,657
Wharves	108,552,735	4,604,538	172	113,157,101
Buildings	22,297,044	820,966	4,181,305	18,936,705
Other improvements	20,930,654	2,431,517	2,244,756	21,117,415
Equipment	9,693,543	307,088	251,470	9,749,161
	382,346,721	8,164,109	7,413,791	383,097,039
Less accumulated depreciation	70,791,106	6,334,297	7,272,316	69,853,087
	311,555,615	1,829,812	141,475	313,243,952
Construction in progress	140,442,594	31,947,249	7,166,562	165,223,281
	$451,998,209	$33,777,061	$ 7,308,037	$478,467,233

Note 5 - Revenue bonds payable

Pursuant to authorization from the State Legislature, the Director of DOT issued the 1967 Certificate and 1990 Certificate, which provides for the issuance of bonds at any time and from time to time upon compliance with certain conditions of the respective Certificate.

The harbor capital improvement revenue bonds and harbor revenue bonds (Bonds) are collateralized by a charge and lien on the gross revenues of the Public Undertaking and upon all improvements and betterments thereto and all funds and securities created in whole or part from revenues or from the proceeds of any Bonds issued.

The Bonds are subject to redemption at the option of the Director of DOT and the State during specific years at prices ranging from 102-1/2% to 100% of face value.

The following is a summary of the Bonds as of June 30, 1996:

Year of Issue	Final Redemption Date	Interest Rates	Original Amount of Issue	Current: Principal Due July 1 1996	Current: Installment Payments Due in Anticipation of Principal Payments on July 1, 1997	Noncurrent
Harbor capital improvement revenue bonds:						
1967	July 1, 1997	5.200%	$20,000,000	$1,700,000	$1,780,000	$ —
1989	July 1, 2013	6.600 - 8.600%	21,200,000	150,000	125,000	19,915,000
Harbor revenue bonds:						
1990	July 1, 2017	6.100 - 7.250%	57,890,000	550,000	625,000	55,505,000
1992	July 1, 2019	5.100 - 6.500%	19,450,000	390,000	415,000	18,280,000
1992	July 1, 2008	4.750 - 6.200%	13,195,000	—	815,000	12,380,000
1993	July 1, 2008	4.500 - 6.400%	16,525,000	1,060,000	1,125,000	13,330,000
1994	July 1, 2024	5.500 - 6.250%	54,010,000	—	—	54,010,000
			$202,270,000	3,850,000	4,885,000	173,420,000
Less:						
Unamortized discount				—	238,498	2,933,013
Unamortized loss on refunding				—	—	591,819
				$3,850,000	$4,646,502	$169,895,168

Maturities and sinking fund requirements for revenue bonds, including interest of $159,755,958 in each of the next five years and thereafter are as follows:

Fiscal Year Ending June 30	Amount
1997	$ 16,515,372
1998	15,154,775
1999	15,149,600
2000	15,145,940
2001	16,753,285
Thereafter	259,341,986
	$ 338,060,958

Note 6 - Harbor capital improvement revenue bond requirements

Minimum net revenue requirement. Pursuant to Section 6.03 of the 1967 Certificate, the Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, it will enforce and collect fees, rates, rents and charges for the Public Undertaking that will yield net revenues, as defined by the 1967 Certificate, for the immediately ensuing

12 months, in an amount at least equal to the amount computed in accordance with Section 6.03 of the 1967 Certificate as follows:

A. An aggregate sum equal to at least 1-1/2 times the total amount of: (1) the interest payments for such 12 months on all Bonds outstanding, (2) the principal amount of the serial bonds maturing by their terms during such 12 months, and (3) the minimum sinking fund payments for all Bonds required to be made during such 12 months; and

B. Such sums as may be required to maintain the bond reserve and debt service accounts for the better collateralizing of such Bonds.

The harbor capital improvement revenue bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1967 Certificate, was $3,483,513. Net revenues of the Public Undertaking amounted to $32,223,202 or 9.25 times of the minimum net revenue requirement.

Insurance requirement. The Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, the Public Undertaking shall, at all times, be insured against losses resulting from fire, with extended coverage endorsement, to the greatest amount obtainable not exceeding the full insurable value; maintain worker's compensation insurance and public liability insurance of not less than $500,000 for each person and not less than $2,000,000 for two or more persons in each accident, respectively, and property damage insurance of not less than $50,000 for each accident. (See note 14).

Harbor capital improvement special fund. Act 221, Session Laws of Hawaii (SLH) of 1967, authorized the establishment of the harbor capital improvement special fund. This fund was created to provide for payments of principal and interest on the Bonds and for extraordinary renewals and replacements. Section 5.01 of the 1967 Certificate requires that the following accounts be established for the purpose of accounting for all monies in the harbor capital improvement special fund:

A. Interest Account

Equal monthly installments sufficient to pay for the interest next becoming due on the Bonds are required to be paid into this account. This requirement was met as of June 30, 1996.

B. Sinking Fund Account

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Bonds scheduled for redemption on the following July 1. This requirement was met as of June 30, 1996.

C. Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Bonds, the Harbors Division is required to deposit in the harbor capital improvement special fund an amount equal to the interest to accrue on the Bonds during the ensuing 24 months. This requirement was met as of June 30, 1996.

D. Harbor Extraordinary Renewal and Replacement Reserve Account

As further and additional reserve for the payment of the Bonds, during each fiscal year, the Harbors Division is required to pay into this account not less than $50,000 until there shall be credited to this account the sum of $500,000. Thereafter, whenever any withdrawals are made from this account or in the event the consulting engineer certifies that the aggregate sum of $500,000 is insufficient for the purposes for which the account was created, additional amounts will be paid into this account until there is again on credit to this account the amount of $500,000 or such larger amount as may have been certified by the consulting engineer. The monies on credit to this account are to be applied only to make up deficiencies in the interest account, sinking fund account and the debt service reserve account in the harbor capital improvement special fund; to nonrecurring extraordinary major maintenance, repairs, renewals and replacement to the Public Undertaking; and to the restoration or rebuilding of damaged properties of the Public Undertaking not covered by insurance. This requirement was met as of June 30, 1996.

Note 7 - Harbor revenue bond requirements

Minimum net revenue requirement. Pursuant to Section 6.03 of the 1990 Certificate, the Harbors Division covenants and agrees that so long as any of the Bonds remain outstanding, it will enforce and collect fees, rates, rents and charges for the Public Undertaking that will yield net revenue, as defined by the 1990 Certificate, for the immediately ensuing 12 months, in an amount at least sufficient to:

A. Pay when due all Bonds issued under the 1967 Certificate, interest thereon and reserves therefore;

B. The amount computed in accordance with Section 6.03 of the 1990 Certificate:

1. Together with funds legally available therefore including any amounts on deposit in the harbor reserve and contingency account; an aggregate sum equal to at least 1.35 times the total amount of: (a) the interest payments for such 12 months on all the Bonds outstanding under the 1990 Certificate, (b) the principal amount of the Bonds maturing by their terms during such 12 months and (c) the minimum sinking fund payments for all Bonds required to be made during such 12 months; and

2. Without consideration of other funds, shall be at least equal to 1.00 times the bond service for such 12 months.

The harbor revenue bond debt service requirements, including minimum sinking fund payments during the current fiscal year, computed in accordance with Section 6.03 of the 1990 Certificate was $12,202,591. Net revenues of the Public Undertaking amounted to $28,739,689 or 2.36 times of the minimum net revenue requirement.

Harbor revenue special fund. This fund was created to provide for payments of principal and interest on the Bonds and for extraordinary renewals and replacements. Section 5.01 of the 1990 Certificate requires that the following accounts be established for the purpose of accounting for all monies in the harbor revenue special fund:

A. Harbor Interest Account

Equal monthly installments sufficient to pay for the interest next becoming due on the Bonds are required to be paid into this account. This requirement was met as of June 30, 1996.

B. Harbor Principal Account

Commencing with the first business day of each fiscal year, equal monthly payments are required to be made to this account sufficient to redeem the Bonds scheduled for redemption on the following July 1. This requirement was met as of June 30, 1996.

C. Harbor Debt Service Reserve Account

In order to provide a reserve for the payment of the principal and interest on the Bonds, the Harbors Division is required to deposit in the harbor revenue special fund an amount equal to the lesser of: (1) the average annual bond service on such series and (2) the amount permitted by the Internal Revenue Code of 1986 in order that the interest on such series is excluded from gross income for federal income tax purposes. Furthermore, the Harbors Division is required to satisfy the reserve requirement of maximum aggregate bond service by no later than the first date on which a principal installment is payable (June 30, 1996).

In lieu of the credit of monies to the harbor debt service reserve account, the Harbors Division may cause to be so credited a surety bond or an insurance policy payable to the Harbors Division for the benefit of the holders of the Bonds of a series or a letter of credit in an amount equal to the difference between the reserve requirement and the amounts then on credit to the harbor debt service reserve account. In the event a surety bond, insurance policy, or letter of credit is secured to satisfy that portion of the reserve requirement allocable to a series of Bonds, so long as such surety bond, insurance policy, or letter of credit is in effect, the owners of such series of Bonds shall not be entitled to payment from or a lien on the funds on deposit in the harbor revenue special fund credited to the harbor debt service reserve account to satisfy that portion of the reserve requirement allocable to other series of Bonds, nor shall the owners of Bonds of such other series be entitled to any payment from such surety bond, insurance policy or letter of credit. The surety bond, insurance policy or letter of credit shall be payable (upon the giving of notice as required thereunder) on any date on which monies will be required to be applied from the harbor debt service reserve account to the payment of the principal of or interest on any Bonds of such series and such withdrawals may not be made from amounts credited to the harbor debt service reserve account for such series of Bonds.

Prior to the use of a surety bond, insurance policy or letter of credit pursuant to the provisions of this paragraph (other than any such use at the time of issuance of the 1990 Series bonds), DOT shall receive written confirmation from the rating agency that the rating on the Bonds outstanding as then in effect shall not be reduced as a result of such use. If a disbursement is made pursuant to a surety bond, an insurance policy or a letter of credit provided pursuant to this paragraph, the Harbors Division shall be obligated either (1) to reinstate the maximum limits of such surety bond, insurance policy or letter of credit or (2) to credit to the harbor debt service reserve account, funds in the amount of the disbursement made under such surety bond, insurance policy or letter of credit, or a combination of such alternatives, as shall provide that the amount credited to the harbor debt service reserve account allocable to a series of Bonds equals that portion of the reserve requirement allocable to such series; provided, however, a failure to immediately restore such reserve requirement shall not constitute an event of default if the reserve requirement is restored within the time period permitted by Section 11.01(c) (90 days following the required notice). Notwithstanding the provisions of Section 11.01(c), the Harbors Division shall not permit any surety bond, insurance policy or letter of credit which has been established in lieu of a deposit into the harbor revenue special fund for credit to the harbor debt service reserve account to terminate or expire prior to depositing to such fund for credit to such account the amount satisfied previously by the surety bond, insurance policy or letter of credit.

D. Harbor Reserve and Contingency Account

Monies on credit to the harbor reserve and contingency account may be used to make up any deficiency with respect to any series of Bonds in the harbor interest account, the harbor principal account and the harbor debt service reserve account. To the extent not used to make up any such deficiencies, monies on credit to the harbor reserve and contingency account may be used for any other purpose within the jurisdiction, powers, duties and functions of the Harbors Division.

Note 8 - Special facility lease and revenue bonds

The State Legislature, in its 1980 session, authorized the issuance of special facility revenue bonds for the construction, acquisition, remodeling, furnishing and equipping of State-owned special facilities for lease to parties engaged in maritime operations.

Pursuant to this authorization, $15,700,000 of 8-1/2% special facility revenue bond anticipation notes were issued in 1981 to finance the construction of container terminal facilities on Sand Island for the exclusive use of Matson Terminals, Inc. In 1983, special facility revenue bonds of $16,750,000 were issued to refund the notes and to provide additional funds for construction. On April 15, 1994, special facility revenue bonds of $16,500,000 were issued to refund the outstanding 1983 Series bonds.

These bonds, which bear interest at 5.75% per annum, mature on March 1, 2013, subject to optional redemption on or after March 1, 2003 at prices ranging from 102 to 100% of face value. Matson Navigation Company, Inc., parent company of the lessee, has provided a guaranty agreement as to payment of principal and interest on the bonds.

The special facility lease with Matson Terminals, Inc. is accounted for as a direct financing lease. The following lists the components of the net investment in direct financing lease as of June 30, 1996:

	Amount
Total minimum lease payments receivable	$32,312,500
Estimated unguaranteed residual value	3,600,000
Less unearned income	18,023,740
Net investment in direct financing lease	$17,888,760

Minimum future rentals to be received as of June 30, 1996 under the direct financing lease are as follows:

Fiscal Year Ending June 30	Amount
1997	$948,750
1998	948,750
1999	948,750
2000	948,750
2001	948,750
Thereafter	27,568,750
	$32,312,500

Note 9 - General obligation bonds payable

The Harbors Division is required to reimburse the State General Fund for principal and interest on the following State general obligation bonds authorized and issued to finance certain capital improvement projects of the Public Undertaking.

				Current		
Year of Issue	Last Installment Due Date	Interest Rates	Original Amount of Issue	Principal Due July 1996	Payments Due in Anticipation of Principal July 1, 1997	Noncurrent
1978	February 1, 1998	5.00 - 6.00%	$1,360,475	$—	$75,552	$75,552
1986	November 1, 1996	6.00 - 6.80%	172,465	—	13,265	—
1991	November 1, 2003	5.30 - 7.25%	382,801	—	21,284	148,871
1992	March 1, 2012	5.15 - 6.40%	12,870	—	715	10,724
1993	February 1, 2003	3.85 - 5.00%	468,363	—	58,556	351,251
1993	July 1, 2002	3.25 - 4.60%	3,412,058	379,093	379,094	1,895,468
1993	November 1, 2010	4.00 - 5.00%	160,901	—	10,728	150,173
			$5,969,933	$379,093	$559,194	$2,632,039

Maturities of general obligation bonds, including interest of $561,933 in each of the next five years and thereafter are as follows:

Fiscal Year Ending June 30	Amount
1997	$704,603
1998	668,456
1999	569,097
2000	548,633
2001	527,359
Thereafter	735,018
	$3,753,166

Note 10 - Interest cost

Total interest cost incurred for the fiscal year ended June 30, 1996 amounted to $13,364,441. Of this amount, $2,792,180 was capitalized as part of the construction cost of harbor facilities.

Note 11 - Leasing operations

The Harbors Division's leasing operations consist principally of the leasing of land, wharf, and building space under revocable permits and long-term leases. The revocable permits provide for tenancy on a month-to-month basis and are renewable annually at the option of the State. The long-term leases, which are classified as operating leases, expire in various years through 2058. These leases generally call for rental increases every five to ten years based on independent appraisals of the fair rental value of the leased property.

The following is a schedule of approximate future minimum lease rentals on noncancelable operating leases as of June 30, 1996:

Fiscal Year Ending June 30	Amount
1997	$6,179,000
1998	5,915,000
1999	5,963,000
2000	5,399,000
2001	5,243,000
Thereafter	87,646,000
	$116,345,000

The above schedule does not include estimated future rental revenues of approximately $1,527,000 annually until the year 2058 from the Aloha Tower Development Corporation. (See note 17).

The Harbors Division estimates that approximately 10% of the land area (excluding submerged lands) and floor space of the harbor facilities is leased or held for lease. Information regarding the cost and related accumulated depreciation of these facilities, which is required by Statement of Financial Accounting Standards No. 13, *Accounting for Leases* to be disclosed, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum lease rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

Note 12 - Retirement benefits

Employees' retirement system. Substantially all eligible employees of the Harbors Division are members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan covering eligible employees of the State and counties. The ERS provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to create 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.

The ERS's funding policy provides for employer contributions at actuarially determined rates that should provide sufficient resources to pay member pension benefits when due. The funding method used to calculate the total employer contribution required is the frozen initial liability method.

Under this method, the total employer contribution is comprised of the "normal cost" plus the level annual payment required to amortize the frozen unfunded accrued liability. The employer normal cost is the level percentage of payroll contribution to pay all future benefits, after subtracting expected future member contributions, the unfunded accrued liability, and the assets accumulated as of the valuation date. Actuarial gains and losses resulting from differences between actual and assumed experience are reflected in the employer normal cost rates.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on

Accumulated sick leave pay. Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a Harbors Division employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 1996, approximated $4,122,000.

Deferred compensation plan. In 1993, the State established a deferred compensation plan which enables state employees to defer a portion of their compensation. The State Department of Human Resource Development has the fiduciary responsibility of administering the plan. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the State's general creditors in an amount equal to the fair market value of the deferred account for each participant.

Environmental issues. The Harbors Division is subject to laws and regulations relating to the protection of the environment. Migration of contamination from the Nimitz Highway area to Harbors Division property in the Honolulu area from Piers 19 to 38 was discovered during the fiscal year ended June 30, 1996. The State Department of Health is presently conducting a study of the contaminated area. The Harbors Division has not been identified as a potentially responsible party. If the Harbors Division is identified as a responsible party, the Harbors Division would share in the responsibility for remediation of the contaminated property with all other responsible parties. The Harbors Division is unable to predict the outcome of the study or estimate the potential cost of remediation.

Note 14 - Risk management

The Harbors Division is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets; natural disasters; and injuries to employees.

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

vested and nonvested benefits and other aspects of the ERS is also not available on a departmental or agency basis. The disclosures required by Governmental Accounting Standards Board Statement No. 5 are presented in the ERS' Comprehensive Annual Financial Report (CAFR). The following data is provided as of June 30, 1995 for the entire ERS from the disclosures contained in the CAFR for the fiscal year then ended, the most recent available information.

Pension benefit obligation:		
Pensioners and beneficiaries currently receiving benefits and terminated members not yet receiving benefits		$3,477,479,800
Current members:		
Accumulated member contributions		780,674,400
Employer-financed vested		1,655,288,900
Employer-financed nonvested		1,476,465,500
Total pension benefit obligation		7,389,908,600
Net assets available for pension benefits, at cost:		
Pension Accumulation Fund	$4,818,382,899	
Annuity Savings Fund	780,674,416	5,599,057,315
Unfunded pension benefit obligation		$1,790,851,285

The pension benefit obligation is a standardized measure of the present value of credited projected pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

Ten-year historical trend information designed to provide information about the ERS's progress in accumulating sufficient assets to pay benefits when due is included in the separately issued audited financial statements of the ERS.

The entire ERS actuarially determined employer contribution requirements were met as of June 30, 1996.

Post-retirement health care and life insurance benefits. In addition to providing pension benefits, the State provides certain health care and life insurance benefits to retired State employees. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. The Harbors Division's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 1996, was approximately $321,600.

Note 13 - Commitments and contingencies

Construction contracts. The Harbors Division is committed under contracts awarded and orders placed for construction, expenses, supplies, etc. These commitments amounted to approximately $15,688,000 at June 30, 1996.

Property and liability insurance. The State has purchased property damage insurance for losses that may occur from fire for substantially all State facilities, including those of the Harbors Division. The policies provide for coverage of $100,000,000 with a $250,000 deductible to be paid from the risk management fund administered by the State Department of Accounting and General Services. Included in the property damage insurance is flood insurance for coverage up to $50,000,000 with a deductible of 5% of loss subject to the $250,000 deductible. In addition, the State is the owner of an $8,000,000 public liability insurance policy with a $2,000,000 deductible. Losses not covered by property and liability insurance are paid from legislative appropriations of the State General Fund.

Workers' Compensation Policy. The State has a self-insured workers' compensation policy. Accordingly, the Harbors Division is liable for all workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred as of June 30, 1996 and the amount of those claims are reasonably estimable. These liabilities include an amount for claims that have been incurred but not reported. In the opinion of management, the Harbors Division has adequately reserved for such claims.

Note 15 - Ceded lands

Portions of the lands within the DOT commercial harbors system (Honolulu, Kewalo Basin, Hilo, Kawaihae, Kahului, Kaunakakai and Nawiliwili) were ceded by the Republic of Hawaii to the United States in 1898 and subsequently conveyed to the State by the United States at or following Hawaii's admission to the Union in 1959 (ceded lands). Under State law, State agencies are required to pay 20% of proprietary revenues derived from the use of the ceded lands to the Office of Hawaiian Affairs (OHA), which will administer such funds for the benefit of native Hawaiians.

Beginning in fiscal year 1992, 20% of proprietary revenues derived from the use of ceded lands which comprise portions of the DOT commercial harbors system are payable to OHA. Amounts due to OHA are treated as an operating expense of the DOT commercial harbors system. Payments are made on a quarterly basis.

Payments amounting to $3,595,567 were paid to OHA for the fiscal year ended June 30, 1996. In the future, tariffs will need to be increased to assure that they are sufficient to satisfy debt service coverage, OHA payment requirements, other operational expenses, and capital improvement projects.

On January 4, 1994, OHA filed a complaint alleging, among other things, that the State had failed to fully and properly account for and pay over to OHA the full pro-rata share of revenue and proceeds derived from ceded lands during the period June 16, 1980 through June 30, 1991.

In May 1996, OHA filed four motions for partial summary judgement as to the State's liability to pay OHA 20% of moneys from four specific sources, and the State opposed OHA's four motions on the merits, as well as on the basis on non-justiciability (political question doctrine), waiver, laches and estoppel, res judicata/collateral estoppel, failure to exhaust administrative remedies and several statutes of limitation. The State also filed a motion to dismiss on sovereign immunity grounds.

The circuit court denied the State's motion to dismiss and granted OHA's four motions for partial summary judgement on October 24, 1996. The State filed an immediate appeal from the order denying its motion to dismiss to the Hawaii Supreme Court, and filed a second appeal from both orders after it was granted leave to file an interlocutory appeal to the Hawaii Supreme Court from both orders by the circuit court. All other proceedings, including the trial previously scheduled to begin on November 18, 1996, have been stayed pending the Hawaii Supreme Court's disposition of the two appeals.

Given that OHA's complaint and motions do not specify the dollar amount of its claims against the State, the express statement by the circuit court in its October 24, 1996 order granting OHA's motions for partial summary judgement that it was not ruling as to such amounts, the dispute as to the basis and methodology for calculating any such amount and the uncertain timing of any final disposition of the case, the State is not able to predict with reasonable certainty the magnitude of its potential liability, if any. Nevertheless, an ultimate decision against the State could have a material adverse effect on the State's and Harbors' financial condition. The State's potential liability for OHA's four partial summary judgement motions for the years 1981 through 1991 (but not thereafter) was stated to be approximately $178,000,000 by the auditor retained by OHA to assist it in determining the amount payable for the period in connection with the case. OHA has not provided complete information for its claims for the period from 1981 through 1991, and has provided no information as to its claims for the period from 1991 to the present. The actual amount, if any, of the State's and Harbors' potential liability will not be determined until the Hawaii Supreme Court rules on the State's interlocutory appeal and, if the State is unsuccessful, after any subsequent trial and related appeals have been concluded—a process that might take years.

Note 16 - Transactions with other government agencies

The State assesses a surcharge of 5% for central service expenses on all receipts of the Harbors Division, after deducting any amounts pledged, charged, or encumbered for the payment of bonds and interest during the fiscal year. The assessment amounted to $1,549,192 for the fiscal year ended June 30, 1996.

The Harbors Division is assessed a percentage of the cost of DOT's general administration expense. The assessment amounted to $741,710 for the fiscal year ended June 30, 1996.

The DOT Highways Division provides surveying services for the Harbors Division. The Harbors Division was billed approximately $6,200 for these services for the fiscal year ended June 30, 1996.

The Harbors Division incurred $1,289,401 for fireboat operation services provided by the City and County of Honolulu during the fiscal year ended June 30, 1996.

The Harbors Division's law enforcement function and personnel were transferred to the State Department of Public Safety beginning in fiscal year 1992. Costs relating to the harbor patrol services provided by that department amounted to $1,049,763 during the fiscal year ended June 30, 1996.

The Small Boat Harbors Boating Program (Program) was transferred from DOT to the State Department of Land and Natural Resources (DLNR) in fiscal year 1992. Services performed by the Harbors Division for the Program are fully reimbursed by the Program. Services rendered during the fiscal year ended June 30, 1996 amounted to $345,868.

The Harbors Division transferred certain lands at Keehi Lagoon to DLNR, effective June 1992. Lost revenues reimbursable to the Harbors Division amounted to $836,000 for the fiscal year ended June 30, 1996. (See note 18 for discussion of transfer of land to DLNR.)

Note 17 - Aloha Tower complex development

In 1981, the State created the Aloha Tower Devemopment Corporation ("ATDC") to redevelop portions of the Honolulu Harbor (the "Aloha Tower Complex"). To implement the Aloha Tower Complex, in 1993, the Harbors Division transferred to ATDC portions of Piers 5 through 23 pursuant to a lease agreement under which ATDC is required annually to reimburse the Harbors Division for any losses in revenues caused by any action of ATDC or a developer, and to provide replacement facilities for maritime activities at no cost to the Division. ATDC thereafter entered into a sublease and other agreements with a private developer to develop portions of the Aloha Tower Complex at Piers 7, 8 and 9 into 200,00 square feet of a variety of commercial, retail and eating establishments, and to reimburse the Harbors Division its lost revenues and replacement facility costs on ATDC's behalf. During 1996, ATDC sent to its developer default notices, including the developer's failure to pay reimbursements to the Division. The developer's mortgage lender paid the deficiency.

As of June 30, 1996, the amount due to the Harbors Division was approximately $2.73 million of which $1.35 million was collected after June 30, 1996. The losses in revenues for the fiscal year ended June 30, 1996, amounted to $1,622,039, and has been included in rental revenues for the fiscal year.

There have been continuing negotiations among various parties to seek new sources of financing to complete the development project. Neither the Harbors Division nor ATDC can predict the outcome of such negotiations or the receipt of future reimbursements.

Note 18 - Transfer of land to other state agencies

In the 1990 session of the State Legislature, House Concurrent Resolution No. 40 (Resolution) was enacted, which transferred certain lands of Keehi Lagoon, currently occupied by the tenants of the Keehi Industrial Park Association (KIPA) under the jurisdiction of the Harbors Division, to DLNR. Approximately 15.34 acres of the Harbors Division's land was transferred to DLNR under the Resolution. The Resolution provides for DLNR to ensure the preservation of any bond covenants or conditions placed on the annual income of these lands to secure the debt of outstanding and future DOT harbor revenue bonds. DLNR shall pay to DOT, on a quarterly basis, not less than the current rentals and other proceeds collected, approximately $836,000 annually. As of June 30, 1996, amounts due to DOT were $296,000. The obligation of DLNR to make payments to DOT shall terminate upon the repayment in full of the 1990 Harbor Revenue Bonds which are scheduled to mature on July 1, 2017.

In the 1990 session of the State Legislature, Act 86 was enacted, which transfers certain lands in Kewalo Basin and Fort Armstrong under the jurisdiction of the Harbors Division to the Hawaii Community Development Authority (HCDA), a State agency which oversees the development of the Kakaako Community Development District (District). Approximately 73 acres of the Harbors Division's land was transferred to HCDA under Act 86. Act 86 provides for HCDA to ensure due and adequate satisfaction of provisions for any covenant between the State or any county or any department or board thereof and the holders of bonds issued by the State or such county, department or board, if any.

As part of HCDA's development of the District, two structures from which the Harbors Division received revenue were demolished and the land improved. The Harbors Division expects to enter negotiations with HCDA regarding the revenues lost due to the demolition of these structures as well as issues relating to leases, security, maintenance and repair of facilities, and capital improvement projects. The effect on revenues in the future as the District development progresses cannot be determined with certainty at this time. The Harbors Division continues to operate the harbor facilities at Kewalo Basin and Fort Armstrong pending completion of the negotiations. Additionally, the Harbors Division expects to continue operating Kewalo Basin based on its discussions with HCDA.

Note 19 - Kapalama Land Development

In 1993, the State issued a request for proposals (RFP) to have a private developer develop a portion of the former Kapalama Military Reservation. Negotiations were conducted with a developer, but were terminated and the State plans to issue another RFP. The proposed uses are undetermined, and therefore, the effect on the Harbors Division is uncertain. The State Department of Business, Economic Development & Tourism will provide suggested uses for consideration by DOT. The previously proposed uses included a container terminal and a pier for the Harbors Division, facilities for the Airports Division, and possibly a federal detention facility.

An apportionment of the property may be made to the Harbors Division and the Airports Division. At the time of the apportionment, a reduction to the land and land improvements balance may occur with a corresponding reduction to the contributed capital from the State balance.

Note 20 - Arbitrage

The Harbors Division is required to annually calculate rebates due to the U.S. Treasury on the harbor capital improvement revenue and harbor revenue bonds issued from 1986. In accordance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 1996, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

Note 21 - Subsequent event

The Harbors Division plans to issue and sell approximately $38 million of revenue bonds, 1997 Series, at interest rates ranging from 5.0% to 7.0% which will mature through the year 2027. Bond proceeds will provide for the construction of certain new facilities and the improvement of certain existing facilities of the commercial harbors system.

Exhibit A

State of Hawaii
Department of Transportation
Harbors Division
BALANCE SHEET OF THE PUBLIC UNDERTAKING
June 30, 1996

ASSETS

CURRENT ASSETS	
Cash and cash equivalents (Notes 3 and 5)	$ 16,662,459
Investments in time certificates of deposits (Notes 3 and 5)	12,645,000
Investments in repurchase agreements (Notes 3 and 5)	13,485,000
Investments in U.S. Treasury obligations (market value of $1,285,200) (Notes 3 and 5)	1,277,648
Receivables:	
Accounts receivable, less allowance for doubtful accounts of $1,260,000	6,526,342
Interest	539,233
Materials and supplies, at cost	38,572
Prepaid insurance and others	23,021
Total current assets	51,197,275
RESTRICTED ASSETS	
Current	
Cash and cash equivalents (Notes 3 and 5)	26,208,923
Investments in time certificates of deposit (Notes 3 and 5)	2,422,570
Investments in repurchase agreements (Notes 3 and 5)	6,675,310
Investments in U.S. Treasury obligations (market value of $3,917,407) (Notes 3 and 5)	3,917,266
Total current restricted assets	39,224,069
Net investment in direct financing lease (Note 8)	17,888,760
Total restricted assets	57,112,829
HARBOR FACILITIES (Note 4, 5, 10, 11, and 19)	383,097,039
Less accumulated depreciation	69,853,087
	313,243,952
Construction in progress	165,223,281
	478,467,233
OTHER ASSET	
Unamortized bond issue costs	2,012,212
TOTAL ASSETS	$ 588,789,549

Continued

State of Hawaii
Department of Transportation
Harbors Division
BALANCE SHEET OF THE PUBLIC UNDERTAKING (Continued)
June 30, 1996

LIABILITIES AND FUND EQUITY

CURRENT LIABILITIES (payable from current assets)	
Accounts payable	$ 467,210
Contracts payable, including retainages	328,762
Accrued vacation	1,282,314
Unearned rental income	209,311
Due to Department of Budget and Finance	1,143,135
Due to Office of Hawaiian Affairs (Note 15)	--
Total current liabilities (payable from current assets)	3,430,732
CURRENT LIABILITIES (payable from restricted assets)	
Contracts payable, including retainages	2,901,211
Matured revenue bonds and interest payable	617,751
Revenue bonds payable, current maturities, less unamortized discount of $238,498 (Notes 5, 6, and 7)	8,496,502
General obligation bonds payable, current maturities (Note 9)	938,287
Accrued interest payable	5,989,773
Security deposits	962,728
Advances for repairs	1,471,504
Total current liabilities (payable from restricted assets)	21,377,756
LONG-TERM DEBT, LESS CURRENT MATURITIES	
Revenue bonds payable, less unamortized discount of $2,933,013, and unamortized deferred loss on refunding of $591,819 (Notes 5, 6, and 7)	169,895,168
Special facility revenue bonds payable (Note 8)	16,500,000
General obligation bonds payable (Note 9)	2,632,039
Total long-term debt	189,027,207
Total liabilities	$ 213,835,695

Continued

Exhibit A

State of Hawaii
Department of Transportation
Harbors Division
BALANCE SHEET OF THE PUBLIC UNDERTAKING (Continued)
June 30, 1996

FUND EQUITY	
Contributed capital	
From federal government	$ 54,909,929
From State of Hawaii	122,827,783
From other sources	334,167
	178,071,879
Less accumulated depreciation	6,412,315
Total contributed capital	171,659,564
Retained earnings	
Reserved for	
Bond requirements (Notes 6 and 7)	4,048,687
Other	350,000
Total reserved retained earnings	4,398,687
Unreserved	198,895,603
Total retained earnings	203,294,290
Total fund equity	374,953,854
TOTAL LIABILITIES AND FUND EQUITY	$ 588,789,549

See accompanying notes to financial statements.

State of Hawaii
Department of Transportation
Harbors Division
STATEMENT OF OPERATIONS OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

OPERATING REVENUES	
Services	$ 30,453,173
Rentals	18,099,421
Others	1,189,334
	49,741,928
OPERATING EXPENSES BEFORE DEPRECIATION	
Personal services	7,456,961
Harbor operations	5,240,695
Maintenance	3,753,931
Department of Public Safety, patrol service operations (Note 16)	1,049,763
Fireboat operations (Note 16)	1,289,401
General administration	1,035,512
Department of Transportation, general administration expenses (Note 16)	741,710
State of Hawaii, surcharge for central service expenses (Note 16)	1,549,192
	22,117,165
Income from operations before depreciation	27,624,763
DEPRECIATION	
On assets acquired with own funds	6,014,867
On assets acquired from contributions	319,430
	6,334,297
Income from operations	21,290,466
NONOPERATING INCOME (EXPENSE)	
Interest income	
Time certificates of deposit	2,587,128
Investment in direct financing lease	1,070,971
Investments in U.S. Treasury obligations	462,119
Interest expense (Note 10)	
Revenue bonds	(9,022,413)
Special facility revenue bonds	(948,750)
General obligation bonds	(203,295)
Amortization of bond discount, issue costs and loss on refunding	(397,803)
Loss on disposal of harbor facilities	(16,952)
Other, net	596,013
	(5,872,982)
NET INCOME	$ 15,417,484

See accompanying notes to financial statements.

State of Hawaii
Department of Transportation
Harbors Division
STATEMENT OF RETAINED EARNINGS OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

Retained earnings at July 1, 1995	$ 187,584,594
Net income	15,417,484
Credit arising from transfer of depreciation to contributed capital	319,430
Increase in valuation allowance on investments in revenue bond reserve accounts	(27,218)
Retained earnings at June 30, 1996	$ 203,294,290

See accompanying notes to financial statements.

State of Hawaii
Department of Transportation
Harbors Division
STATEMENT OF CASH FLOWS OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

INCREASE (DECREASE) IN CASH	
Cash flows from operating activities	
Income from operations	$ 21,290,466
Adjustments to reconcile income from operations to net cash provided by operating activities:	
Depreciation	6,334,297
Other income, net	596,013
Increase in receivables	(47,505)
Increase in materials and supplies	(4,207)
Increase in prepaid insurance and others	(6)
Decrease in payables	(408,471)
Increase in accrued vacation	18,571
Increase in unearned rental income	71,005
Decrease in security deposits	(392,213)
Net cash provided by operating activities	27,457,950
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(33,080,856)
Principal paid on bonds	(5,334,533)
Interest paid on bonds	(13,072,101)
Proceeds from issuance of general obligation bonds	386,494
Net cash used in capital and related financing activities	(51,100,996)
Cash flows from investing activities	
Purchases of investments	(93,896,864)
Proceeds from sale and maturities of investments	111,377,611
Interest received on investments	4,528,992
Net cash provided by investing activities	22,009,739
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,633,307)
Cash and cash equivalents at July 1, 1995	44,504,689
Cash and cash equivalents at June 30, 1996	$ 42,871,382

Continued

State of Hawaii
Department of Transportation
Harbors Division
STATEMENT OF CASH FLOWS OF THE PUBLIC UNDERTAKING (Continued)
Fiscal Year Ended June 30, 1996

SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES

Amortization of bond discount, issue costs and loss on refunding amounted to $397,803.

SUPPLEMENTAL DISCLOSURE OF INVESTING ACTIVITIES

The Harbors Division experienced an increase in the valuation allowance on investments in the revenue bond reserve accounts of $27,218.

See accompanying notes to financial statements.

State of Hawaii
Department of Transportation
Harbors Division
CASH AND CASH EQUIVALENTS AND INVESTMENTS IN TIME CERTIFICATES OF DEPOSIT AND REPURCHASE AGREEMENTS OF THE PUBLIC UNDERTAKING
June 30, 1996

Unrestricted cash and cash equivalents, including time certificates of deposit of $160,000	$ 16,662,459
Unrestricted investments in time certificates of deposit	12,645,000
Unrestricted investments in repurchase agreements	13,485,000
	42,792,459
Restricted cash and cash equivalents and investments in time certificates of deposit and repurchase agreements	
For construction, including time certificates of deposit and repurchase agreements of $11,431,142	20,890,769
For repair of damages	1,775,731
For matured revenue bonds and interest coupons payable	617,751
For general obligation bond debt service payments, including time certificates of deposit and repurchase agreements of $641,738	783,993
For revenue bond debt service payments	9,818,276
For insurance deductible, including time certificates of deposit and repurchase agreements of $1,350,000	459,635
For security deposits	960,648
	35,306,803
Total	$ 78,099,262
Total cash	
With Director of Finance, State of Hawaii	$ 37,753,131
Time certificates of deposit and repurchase agreements	39,712,880
With fiscal agents	617,751
On hand	15,500
Total	$ 78,099,262

State of Hawaii
Department of Transportation
Harbors Division
INVESTMENTS IN SECURITIES HELD BY THE PUBLIC UNDERTAKING
June 30, 1996

	Interest Rate	Maturity Date	Face Value	Cost	Market Value	Lower of Face Value or Market
Restricted - harbor special fund						
Debt service reserve - U.S. Treasury notes	5.875%	April 30, 1998	$ 2,500,000	$2,496,484	$ 2,489,844	$2,489,844
	6.000%	May 31, 1998	1,000,000	996,719	997,500	997,500
			3,500,000	3,493,203	3,487,344	3,487,344
Harbor extraordinary renewal and replacement reserve - U.S. Treasury notes	7.250%	August 31, 1996	50,000	49,793	50,141	50,000
	5.000%	January 31, 1998	139,000	139,394	136,785	136,785
	5.125%	March 31, 1998	75,000	74,120	73,828	73,828
	5.875%	April 30, 1998	170,000	169,761	169,309	169,309
			434,000	433,068	430,063	429,922
			$ 3,934,000	$3,926,271	$ 3,917,407	$3,917,266

	Interest Rate	Maturity Date	Face Value	Cost	Market Value	Lower of Cost or Market
Unrestricted - harbor special fund						
Special fund - U.S. Treasury notes	7.000%	September 30, 1996	$ 1,280,000	$1,277,648	$ 1,285,200	$1,277,648

State of Hawaii
Department of Transportation
Harbors Division
HARBORS FACILITIES AND RELATED ACCUMULATED DEPRECIATION
OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

	Harbor Facilities				Accumulated Depreciation				Cost, less
	Balance, June 30, 1995	Additions*	Deductions	Balance, June 30, 1996	Balance, June 30, 1995	Additions	Deductions	Balance, June 30, 1996	Accumulated Depreciation
Land and land improvements	$ 220,872,745	$ --	$ 736,088	$220,136,657	$ 8,031,337	$ 1,643,704	$ 736,088	$ 8,938,953	$ 211,197,704
Wharves	108,552,735	4,604,538	172	113,157,101	35,251,232	2,612,479	172	37,863,539	75,293,562
Buildings	22,297,044	820,966	4,181,305	18,936,705	12,508,387	653,794	4,167,442	8,994,739	9,941,966
Other improvements	20,930,654	2,431,517	2,244,756	21,117,415	12,150,213	763,842	2,244,746	10,669,309	10,448,106
Equipment	9,693,543	307,088	251,470	9,749,161	2,849,937	660,478	123,868	3,386,547	6,362,614
Construction in progress (Schedule IV)	140,442,594	31,947,249	7,166,562	165,223,281	--	--	--	--	165,223,281
	$ 522,789,315	$40,111,358	$14,580,353	$548,320,320	$ 70,791,106	$ 6,334,297	$ 7,272,316	$ 69,853,087	$ 478,467,233

* Includes transfers from construction in progress of $5,688,194.

State of Hawaii
Department of Transportation
Harbors Division
CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

		Additions by Source of Funds						
	Balance, June 30, 1995	Harbor Special Fund	General Fund	State of Hawaii General Obligation Bonds	Harbor Revenue Bonds	Capitalized Interest	Transfer Out	Balance, June 30, 1996
2010 master plan - neighbor island ports	$ 28,636	$ --	$ --	$ --	$ --	$ --	$ 28,636	$ --
Statewide harbor planning	57,443	1,605	--	--	--	2,487	--	61,535
Statewide harbor water system master plans	174,924	37,660	--	--	--	10,155	--	222,739
Statewide harbor planning	--	2,261	--	--	--	37	--	2,298
Honolulu Harbor:								
Pier 39 renovations	406,410	--	--	--	--	--	--	406,410
Construction of Pier 53 extension CY6 and CY9, Sand Island	9,826,231	35,000	--	--	4,376	520,279	--	10,385,886
Waterfront improvement projects	64,613	--	--	--	--	3,205	--	67,818
Improvements to Pier 36	2,164,229	1,076,982	--	--	--	84,459	3,325,670	--
Construction of Pier 51 extension, Sand Island	5,159,013	654,616	--	--	8,777,412	526,403	--	15,117,444
Waterfront master plan	156,369	--	--	91,071	--	3,874	--	251,314
Development plan for Piers 19-35	308,526	42,000	--	50,000	--	16,754	--	417,280
Pier 39 landslide improvements	10,610,259	96,190	--	--	5,059,267	702,532	--	16,468,248
Piers 24-29 hydrocarbon study	56,624	3,127	--	--	--	--	--	59,751
Pier 51 container yard lighting	706,699	415,771	--	--	608,893	62,550	--	1,793,913
Maintenance baseyard fueling facility	48,640	--	--	--	--	--	48,640	--
Piers 52-53, upgrade light fixtures	130,100	--	--	--	--	--	--	130,100
New bollards	95,164	--	--	--	--	--	95,164	--
Pier 19 substructure repairs	128,145	--	--	--	--	--	128,145	--
Administration office asbestos removal	29,286	65,474	--	--	--	--	--	94,760
Pier 31, replace shed roof drain	61,428	--	--	--	--	--	61,428	--
Pier 26 vapor extraction system	176,616	--	--	--	--	--	176,616	--
Pier 8 substructure repairs	352,890	--	--	--	--	--	352,890	--
Pavement reconstruction, Sand Island	773,822	7,226	--	--	8,420	17,384	806,852	--
Intersection at Auiki and Libby Street	--	17,629	--	--	--	489	--	18,118
Pier 40 shed and landside improvement	--	21,262	--	--	--	590	--	21,852
Lead paint and galbestos study	--	47,487	--	--	--	417	--	47,904
Improvements to Pier 15	--	5,492	--	--	--	89	--	5,581
Pier 19 parking improvements	--	2,122	--	--	--	--	2,122	--

State of Hawaii
Department of Transportation
Harbors Division
CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (Continued)
Fiscal Year Ended June 30, 1996

	Balance, June 30, 1995	Additions by Source of Funds: Harbor Special Fund	General Fund	State of Hawaii General Obligation Bonds	Harbor Revenue Bonds	Capitalized Interest	Transfer Out	Balance, June 30, 1996
Honolulu Harbor, continued:								
Improvements to Pier 51 yard and Sand Island	$ --	$ 5,140	$ --	$ --	$ --	$ 95	$ --	$ 5,235
Economic Impact Analysis	--	38,900	--	--	--	87	--	38,987
Piers 24-29 shed demolition and site improvement	--	5,649	--	--	--	65	--	5,714
Pier P-5 extension and utility improvement	--	4,374	--	--	--	121	--	4,495
Fuel pier construction and utility	--	4,433	--	--	--	123	--	4,556
Pier 25 shed restroom reconstruction	--	13,811	--	--	--	--	--	13,811
Barbers Point Harbor:								
Deep draft harbor improvements	86,891,220	377,890	--	22,035	581,478	363,632	--	88,236,255
Land	6,000,000	--	--	--	--	--	--	6,000,000
Kahului Harbor:								
Drainage master plan	41,576	30,591	--	--	--	2,244	--	74,411
Statewide harbor planning	193,135	--	--	--	--	1,388	167,545	26,978
Statewide harbor planning - wave gauging study	723,754	92,000	--	--	--	40,667	--	856,421
Improvements to Pier 1	5,862	14,636	--	--	--	731	--	21,229
Land and land improvements	10,035,070	141,500	--	--	--	--	--	10,176,570
Piers 1A and 1B improvements	829,421	1,277,833	--	--	--	70,498	--	2,177,752
Development plan for expansion of interisland cargo yard	188,762	309	--	--	--	9,928	--	198,999
Security fencing	--	9,459	--	--	--	262	--	9,721
Storage yard paving and utility improvements	--	11,061	--	--	--	179	--	11,240
Barge terminal improvements	--	5,028	--	--	--	81	--	5,109
Pier 1 substructure repairs	--	133,180	--	--	--	--	--	133,180

State of Hawaii
Department of Transportation
Harbors Division
CONSTRUCTION IN PROGRESS OF THE PUBLIC UNDERTAKING (Continued)
Fiscal Year Ended June 30, 1996

	Balance, June 30, 1995	Additions by Source of Funds: Harbor Special Fund	General Fund	State of Hawaii General Obligation Bonds	Harbor Revenue Bonds	Capitalized Interest	Transfer Out	Balance, June 30, 1996
Kaunakakai Harbor:								
Ferry passenger terminal at Kaunakakai Harbor	$ 194,415	$ 16,301	$ --	$ --	$ --	$ 7,186	$ 217,902	$ --
New bollards at Kaunakakai Harbor	32,103	--	--	--	--	--	32,103	--
Harbor improvements	1,805	17,564	--	--	--	584	--	19,953
Hilo Harbor:								
Pier 1, fender system repairs	35,999	--	--	--	--	--	35,999	--
Demolish and reconstruct comfort station/ office building at Kailua-Kona	321,354	6,870	--	--	--	4,323	332,547	--
Yard improvements at Hilo Harbor	537,886	443,628	--	--	--	23,710	1,005,224	--
Harbor improvements	36,335	129,030	--	--	--	5,338	--	170,703
Pier 1 upgrade shed restroom	--	31,490	--	--	--	--	--	31,490
Pier 1, 2, 3 water system improvement	--	3,586	--	--	--	25	--	3,611
Kawaiahae Harbor:								
New motorized door	48,321	--	--	--	--	--	48,321	--
Nawiliwili Harbor:								
Improve lighting	118,618	--	--	--	--	--	118,618	--
Fender upgrades and new tires	18,406	--	--	--	--	--	--	18,406
Pier 1 improvements	2,394,271	148,287	--	--	6,651,177	273,693	--	9,467,428
Administration building	202,914	17,788	--	--	--	11,088	--	231,790
Pier 1 improvements, phase 2	2,080	1,414,710	--	--	--	18,857	--	1,435,647
Pier 3, construction of container yard	--	8,057	--	--	174,083	--	182,140	--
Realignment of Waapa Road	--	562	--	--	--	7	--	569
Pier 2, replace shed siding	--	88,786	--	--	--	--	--	88,786
Pier 2, waterline repairs	--	36,500	--	--	--	--	--	36,500
Port Allen Harbor:								
Shed renovations	73,220	1,070	--	--	64,930	5,564	--	144,784
	$ 140,442,594	$ 7,061,927	$ --	$ 163,106	$ 21,930,036	$ 2,792,180	$ 7,166,562	$ 165,223,281

State of Hawaii
Department of Transportation
Harbors Division
GENERAL OBLIGATION BONDS OF THE PUBLIC UNDERTAKING
June 30, 1996

	Date of Bond	Last Installment Due Date	Interest Rates	Original Amount of Issue	Amount Repaid	Balance, June 30, 1996 Current	Noncurrent	Total
State of Hawaii general obligation bonds:								
Series AM	February 1, 1978	February 1, 1998	5.00 - 6.00%	$ 1,360,475	$ 1,209,371	$ 75,552	$ 75,552	$ 151,104
Series BG	November 1, 1986	November 1, 1996	6.00 - 6.80%	172,465	159,200	13,265	--	13,265
Series CD	February 1, 1993	February 1, 2003	3.85 - 5.00%	468,363	58,556	58,556	351,251	409,807
Series CF	July 1, 1993	July 1, 2002	3.25 - 4.60%	3,412,058	758,403	758,187	1,895,468	2,653,655
Series BU	November 1, 1991	November 1, 2003	5.30 - 7.25%	382,801	212,646	21,284	148,871	170,155
Series BW	March 1, 1992	March 1, 2012	5.15 - 6.40%	12,870	1,431	715	10,724	11,439
Series CI	November 1, 1993	November 1, 2010	4.00 - 5.00%	160,901	--	10,728	150,173	160,901
				$ 5,969,933	$ 2,399,607	$ 938,287	$ 2,632,039	$ 3,570,326

State of Hawaii
Department of Transportation
Harbors Division
REVENUE BONDS OF THE PUBLIC UNDERTAKING
June 30, 1996

	Final Redemption Date	Interest Rates	Original Amount of Issue	Balance Current	Balance Noncurrent	Balance Total
Harbor capital improvement revenue bonds:						
Issue of 1967	July 1, 1997	5.200 %	$ 20,000,000	$ 3,480,000	$ --	$ 3,480,000
Issue of 1989	July 1, 2013	6.600-8.600 %	21,200,000	275,000	19,915,000	20,190,000
Harbor revenue bonds:						
Issue of 1990	July 1, 2017	6.100-7.250 %	57,890,000	1,175,000	55,505,000	56,680,000
Issue of 1992	July 1, 2019	5.100-6.500 %	19,450,000	805,000	18,280,000	19,085,000
Refunding issue of 1992	July 1, 2008	4.750-6.200 %	13,195,000	815,000	12,380,000	13,195,000
Refunding issue of 1993	July 1, 2008	4.500-6.400 %	16,525,000	2,185,000	13,330,000	15,515,000
Issue of 1994	July 1, 2024	5.500-6.250 %	54,010,000	--	54,010,000	54,010,000
			$ 202,270,000	$ 8,735,000	$ 173,420,000	$ 182,155,000

State of Hawaii
Department of Transportation
Harbors Division
OPERATING REVENUES BY DISTRICT OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

	Oahu	Hawaii	Maui	Kauai	Total
Services:					
Wharfage	$ 19,305,570	$2,013,610	$2,341,144	$ 971,766	$ 24,632,090
Dockage	2,528,079	166,437	189,834	128,467	3,012,817
Demurrage	1,030,310	68,819	71,884	5,871	1,176,884
Mooring charges	769,624	24,985	1,363	692	796,664
Service charges	587,598	65,345	63,395	37,246	753,584
Cleaning wharves	70,580	1,515	357	--	72,452
Other	2,372	675	1,494	4,141	8,682
Total services	24,294,133	2,341,386	2,669,471	1,148,183	30,453,173
Rentals:					
Wharf space and land	12,431,038	491,189	189,975	338,981	13,451,183
Storage	1,652,600	25,841	166,547	91,148	1,936,136
Auto parking	1,227,355	9,857	55,575	44,745	1,337,532
Pipelines:					
Oil	624,383	203,441	249,617	83,084	1,160,525
Water	69,573	6,211	17,089	13,752	106,625
Molasses	30,938	5,162	15,662	10,695	62,457
Bulk materials	14,964	6,613	9,569	3,997	35,143
Ammonia	2,840	118	1,459	1,003	5,420
Other	4,160	--	--	240	4,400
Total rentals	16,057,851	748,432	705,493	587,645	18,099,421
Others:					
Sales of utilities	546,403	26,009	61,715	17,460	651,587
Permits to vendors	356,062	16,558	8,621	660	381,901
Interest	58,958	1,478	1,863	534	62,833
Sale of dredged materials	--	13,861	--	--	13,861
Miscellaneous	63,192	4,435	10,410	1,115	79,152
Total others	1,024,615	62,341	82,609	19,769	1,189,334
	$ 41,376,599	$3,152,159	$3,457,573	$1,755,597	$ 49,741,928

State of Hawaii
Department of Transportation
Harbors Division
SELECTED OPERATING EXPENSES BY DISTRICT OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

	District					
	Oahu	Hawaii	Maui	Kauai	Administration	Total
Personal services	$ 3,589,908	$ 475,394	$ 514,172	$ 469,238	$ 2,408,249	$ 7,456,961
Harbor operations	1,259,482	83,868	137,719	64,218	3,695,408	5,240,695
Maintenance	1,856,960	422,609	573,279	350,909	550,174	3,753,931
General administration	54,900	61,265	14,235	8,144	896,968	1,035,512
	$ 6,761,250	$ 1,043,136	$ 1,239,405	$ 892,509	$ 7,550,799	$ 17,487,099

State of Hawaii
Department of Transportation
Harbors Division
REVENUE BOND RESERVE REQUIREMENTS OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

	Harbor Capital Improvement Special Fund		
	Debt Service Reserve	Harbor Extraordinary Renewal and Replacement Reserve	Total
Restricted assets			
Cash	$ 50,225	$ 81,196	$ 131,421
Investments, at lower of face value or market	3,487,344	429,922	3,917,266
	3,537,569	511,118	4,048,687
Minimum reserve requirements	2,969,065	500,000	3,469,065
Excess over minimum reserve requirements	$ 568,504	$ 11,118	$ 579,622

State of Hawaii
Department of Transportation
Harbors Division

HARBOR CAPITAL IMPROVEMENT REVENUE BONDS - MINIMUM NET REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING

Fiscal Year Ended June 30, 1996

Net revenues, as defined by the 1967 Certificate:		
Income from operations before depreciation		$ 27,624,763
Add:		
Interest income, exclusive of investment in direct financing lease	$ 3,049,247	
State of Hawaii, surcharge for central service expenses	1,549,192	4,598,439
		$ 32,223,202
Harbor capital improvement revenue bond debt service requirements under the 1967 Certificate, including minimum sinking fund payments during the current fiscal year		$ 3,483,513
Ratio of net revenues to harbor capital improvement revenue bond debt service requirements		9.25

State of Hawaii
Department of Transportation
Harbors Division
HARBOR REVENUE BONDS - MINIMUM NET REVENUE REQUIREMENT OF THE PUBLIC UNDERTAKING
Fiscal Year Ended June 30, 1996

Net revenues, as defined by the 1990 Certificate:		
Income from operations before depreciation		$ 27,624,763
Add:		
Interest income, exclusive of investment in direct financing lease	$ 3,049,247	
State of Hawaii, surcharge for central service expenses	1,549,192	
Cash available in the harbor reserve and contingency account	--	4,598,439
		32,223,202
Less:		
Harbor capital improvement revenue bond debt service requirements under the 1967 Certificate, including minimum sinking fund payments during the current fiscal year		3,483,513
		$ 28,739,689
Harbor revenue bond debt service requirements under the 1990 Certificate, including minimum sinking fund payments during the current fiscal year		$ 12,202,591
Ratio of net revenues to harbor revenue bond debt service requirements		2.36

Notes

Chapter 2

1. Sections 8.14.08 and 8.14.09, Department of Transportation Departmental Staff Manual.

2. Section 8.10.07, Departmental Staff Manual.

3. Sections 8.2.06.2.1 and 8.2.06.2.2, Departmental Staff Manual.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Transportation on January 17, 1997. A copy of the transmittal to the department is included as Attachment 1. The department's response is included as Attachment 2.

The department agrees with some of our findings. However, the department does not agree that there is serious deficiency or a material weakness in the division's fiscal operations or property management. The department believes that there was a lack of understanding of the functions of the Harbors Division and how it is managed.

The department agrees with our findings relating to controls over cash receipts and billings at three district offices and certain harbors. The department points out that it is taking steps to make needed improvements including the standardization of the application of charges for utilities. We encourage it to continue its corrective efforts.

The department takes particular exception to the material weakness pointed out by Nishihama & Kishida, CPA's, Inc. Although at the same time it agrees that the Harbors Division does not currently provide monthly statements of revenues and expenditures and that financial reporting has benefits. The department points to the financial model it uses to make major decisions. But our reference is to the need for regular and consistent revenue and expenditure information so managers can operate harbor facilities as cost-efficiently as possible all the time. We are pleased to note that the department will now try to provide reports, especially to district offices.

The department also defends its practice of relying on costly outside auditors to prepare audit schedules for the division. It feels this is a better management approach than hiring year-round staff for what it considers temporary work.

We do not feel that spending in excess of $90,000 a year, every year, for preparing audit schedules and other accounting assistance that is more properly the responsibility of the division to be a better management approach. The department needs to reexamine the issue of what tasks should be done by in-house staff and when. Some of the work currently contracted out could be done internally during the year. This situation has existed for a long period of time and was also pointed out to the department in 1994 by KPMG Peat Marwick LLP, another certified public accounting firm.

With respect to the lack of a required property inventory, the department states that it does have an inventory of Harbors Division properties and is taking steps to merge this inventory with a separate tenant list to develop the type of property inventory record required by its own operating manual. It was the absence of such a merged inventory that contributed to a deficiency finding. We are pleased that the department is taking these and other steps to improve revenues to the division.

The department agrees that revocable permits for non-maritime uses are being issued, but believes the current definition of maritime use is too restrictive. Since the definition of maritime use is statutory, the department states that the division is contemplating requesting the Legislature to expand the definition of "maritime uses." The department also provided an explanation of the problems surrounding the inability to resolve the lease arrangement with Honolulu Shipyard. It states that it is trying to do what is best for the State in light of its belief that a rate consistent with surrounding tenants could drive the shipyard out of business. This lease came up for renewal in 1984. The rental amount has remained unchanged since 1975.

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

January 17, 1997

COPY

The Honorable Kazu Hayashida
Director
Department of Transportation
Aliiaimoku Hale
869 Punchbowl Street
Honolulu, Hawaii 96813

Dear Mr. Hayashida:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Harbors Division*. We ask that you telephone us by Tuesday, January 21, 1997, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, January 27, 1997.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

BENJAMIN J. CAYETANO
GOVERNOR

KAZU HAYASHIDA
DIRECTOR

DEPUTY DIRECTORS
JERRY M. MATSUDA
GLENN M. OKIMOTO

RECEIVED
JAN 27 4 19 PM '97
OFC. OF THE AUDITOR
STATE OF HAWAII

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

IN REPLY REFER TO:

HAR-SF 8407.97

January 27, 1997

TO: MARION M. HIGA, STATE AUDITOR
OFFICE OF THE AUDITOR

FROM: KAZU HAYASHIDA
DEPARTMENT OF TRANSPORTATION

SUBJECT: RESPONSE TO THE FINDINGS OF THE FINANCIAL AUDIT OF THE HARBORS DIVISION

Thank you for the opportunity to comment on your audit findings. There are some aspects of the report that we agree upon as indicated to your staff. We have either corrected the problems or have programmed changes to make the corrections. However, in general, we do not agree that there is a serious deficiency or material weakness in the fiscal operations or in the way our properties are managed. Due to the statements made by your auditor, we feel there was a lack of understanding of the functions of the Harbors Division and how it is managed.

THE DIVISION DOES NOT HAVE NEEDED FINANCIAL INFORMATION

The Department agrees that the Harbors Division does not currently provide monthly statements of revenues and expenditures. We also agree that financial reporting has benefits and will try to provide reports, especially to district offices.

However, major decisions of the Harbors Division are based on a multi-year financial model (model) which provides a broad-range evaluation of the division's total financial program. This model is updated at the end of each fiscal year and whenever a major action occurs or is contemplated. These actions include bond sales, tariff changes, inclusion or deletion of major tenants, proposed land purchases, addition of a new harbor such as Kaumalapau to the harbor system and expenditures for catastrophic damages to our facilities. Evaluation is also done, as necessary, when revenues are routinely reviewed for the first and second quarters of the current and prior fiscal years. When any of these happen, the model is updated to determine impacts and to seek financial options for remedies, if needed. In the past year, the model was updated at least six times. The model is also used to assure adequate revenue bond coverage as required by bond covenants. The model has been used recently to evaluate various options for tariff rate increases and impact on future revenues and bond sales.

Other information generated by our fiscal office on an as required basis include furnishing financial data to engineering on various terminal operations to evaluate cost/benefit required to make decisions on major proposed improvements. The fiscal office also provides periodic expenditure statements to districts whenever the fiscal or district office is concerned with the district exceeding budget limits.

DIVISION RELIES ON COSTLY OUTSIDE AUDITORS

A financial audit of the Division by an independent auditor is required by our Bond Covenant. The Division's financial management staff assists by preparing over 100 audit schedules that are required for the audit. The contracted auditing firm is hired for about three months to prepare additional audit schedules and to do the audit. We feel that this is a better management approach rather than hiring year-round staff for temporary work..

The completion of the audit cannot be delayed because it is critical to meeting the State Comptroller's deadline for the submission of audited financial statements which are needed by the Department of Accounting and General Services (DAGS) in the preparation of the State's Comprehensive Annual Financial Report. Also, if the completion of our audited financial statements is delayed we may violate our bond covenants.

DIVISION'S PROPOSED REORGANIZATION MISSES THE MARK

This comment is not applicable since the reorganization is in draft stage and is still under discussion.

PROPERTY INVENTORY

The Property Management Section does have an inventory listing of Harbors Division properties under its jurisdiction set aside by various Governor's Executive Orders containing the total areas, location maps, metes and bounds descriptions and Tax Map Key Nos. It also has a tenants' list identifying all lessees, permittees, licensees, etc., rentals currently paid, areas occupied, purposes, Tax Map Key Nos. and locations. The inventory and the tenants' list need to be merged. A project is currently underway to plot these data on a geographical information system (GIS). As part of the GIS project, the operations and planning personnel are determining what areas are needed for operations and what areas can be rented out to private entities. The Property Management Section recently advertised in the local paper regarding the availability of Harbors Division properties for rent as part of the Division's revenue enhancement efforts. These efforts have generated approximately $10,000.00 per month to date.

REVOCABLE PERMITS-INCONSISTENT USES

The Department agrees that revocable permits for non-maritime uses (under current definition) are being issued. Due to funding constraints or lack of immediate maritime need, portions of the harbor are sometimes left underdeveloped for long periods. Whenever possible, revocable permits are granted for inconsistent uses to generate revenue. These permits are revoked whenever the Division proceeds with plans to develop or lease these areas for maritime use. In some instances, these permits run for fairly long periods. We agree that in these cases, short term leases may be more applicable. The Division is contemplating requesting the legislature to expand the definition of "maritime uses" to better reflect activities within the harbors. Returning these lands to DLNR will prevent use of these areas in the future when needed.

All existing revocable permits issued for inconsistent uses were initially approved by the Board of Land and Natural Resources.

LEASE RENEWAL

Reissue of a long term lease to Honolulu Shipyard has been delayed due to difficulties in negotiating an acceptable lease rent. Due to economic conditions that has placed a hardship on the industry, forcing the shipyard to accept a rate consistent with surrounding tenants could drive it out of business. This would create a hardship to ship and barge owners who may have to go to the West Coast or Far East for repairs. This would in turn affect prices of consumer goods. It is with these thoughts in mind, with the ultimate concern being impact to consumers, that we are working towards a settlement that both parties can accept. Our goal is not only to get the maximum revenue from our properties but more importantly to do what is best for the State.

OVER-THE COUNTER COLLECTIONS ON KAUAI

This deficiency has been corrected.

CONTROLS OVER DEPOSITS

The Districts are restricting the use of manual receipts. This will make it easier to keep numerical control.

INADEQUATE SEGREGATION OF DUTIES

This is a problem in a two person and sometimes one person office due to vacancies. We agree with the finding and will make every effort to separate or initiate management controls over the cash handling and recording duties whenever possible.

INCONSISTENT FEES CHARGED AMONG DISTRICT OFFICES

Each District is unique and that contributes to the different charges for water and electricity. For example, the rate charged the Districts for electricity by the Utility company varies because each island has its own utility company. We will standardize the application of fees.

Thank you again for the opportunity to provide our comments to your report. If you wish to discuss this further, please call Thomas Fujikawa, Division Administrator, at 587-1927.