A STUDY OF THE
STATE HIGHWAY SPECIAL FUND

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

Submitted by

Legislative Auditor
State of Hawaii

March 1971

TABLE OF CONTENTS

FOREWORD

This report is the result of our examination of the State highway finances. The study was conducted pursuant to a request by the House of Representatives of the Fifth State Legislature.

Our study focused on the solvency of the State highway special fund and on fiscal problems and issues related to the State highway program.

I wish to acknowledge the excellent assistance and cooperation extended to my staff by the personnel of the State department of transportation.

Clinton T. Tanimura
Legislative Auditor

Chapter 1

INTRODUCTION

The State Legislature has expressed concern over financing of the highway system in the State. Of special interest was the ability of the State highway special fund to meet increasing financial requirements of the State highway program. The House of Representatives of the Fifth State Legislature thus requested the legislative auditor by House Resolution No. 20, 1969, to conduct an audit of the highway program, including its financing. This study is in response to that request.

Objectives of the Study

Our study had the following objectives:

1. To determine the financial status of the State highway special fund for the biennium 1971–73 and the subsequent fiscal years 1973–74 to 1976–77.

2. To identify issues and problems related to fiscal management of the program.

Organization of Report

This report is organized into three chapters: this chapter of introduction, chapter 2 covering the status of the State highway special fund, and chapter 3 which discusses some selected problems.

Chapter 2

STATUS OF STATE HIGHWAY SPECIAL FUND

Our examination reveals that the State highway special fund will be able to meet the State's highway financial requirements through fiscal year 1973, given the present sources of funds and operating practices (table 2.1a). It further reveals that, if certain steps are taken, resources can be increased (without an increase in highway taxes) and expenditures reduced (without curtailing anticipated projects) to enable the State highway special fund to meet the State's highway financial requirements through fiscal year 1975 (table 2.1b).

Revenue

As noted on table 2.1a, the highway special fund's sources of revenue are fuel taxes and other sundry revenues. Other sundry revenues include receipts from the sale of remnant land and improvements and from rentals of buildings.

There are, however, additional sources from which revenue can be realized by the special fund, if the State would take affirmative actions. These sources are noted on table 2.1b. They are: (1) reimbursements from the federal government for expenditures advanced by the highway special fund and (2) interest earnings on the highway special fund balance. The nature of these sources and the actions required to realize revenue from these sources are as follows.

Reimbursements from federal government. There is currently a potential for recovering some $8,925,000 for the special fund from the federal government. This sum is recoverable by the end of fiscal year 1971–72. It represents the federal government's share of the expenses incurred and paid for by the State special fund for highway projects, and is composed of the following reimbursable amounts:

. As yet unclaimed amount for expenditures advanced by the special fund prior to January 1, 1969	$2,034,000
. Amount claimed for reimbursement but withheld by the federal government	1,391,000
. Amount anticipated as increased federal participation by the redesignation of Lunalilo Freeway as an interstate project	5,500,000
Total	$8,925,000

Status of State Highway Special Fund
For Fiscal Years 1971–72 to 1976–77
(in thousand $)

Table 2.1 a

	1971–72	1972–73	1973–74	1974–75	1975–76	1976–77
Estimated Revenues						
Fuel tax and sundry revenues	14,180	15,020	15,910	16,795	17,710	18,645
Estimated Expenditures						
Operating	13,948	15,202	19,553	22,225	24,561	27,406
Capital improvements (cash financed)	1,165	803	---	---	---	---
Total Estimated Expenditures	15,113	16,005	19,553	22,225	24,561	27,406
Estimated Surplus [Deficit] for Fiscal Year	[933]	[985]	[3,643]	[5,430]	[6,851]	[8,761]
Estimated Fund Balance [Deficit], end of Fiscal Year	3,024*	2,039	[1,604]	[7,034]	[13,885]	[22,646]

Table 2.1 b

	1971–72	1972–73	1973–74	1974–75	1975–76	1976–77
Estimated Revenues						
Fuel tax and sundry revenues	14,180	15,020	15,910	16,795	17,710	18,645
Federal reimbursements	8,925	---	---	---	---	---
Interest income on highway fund balance	478	689	548	309	---	---
Total Estimated Revenues	23,583	15,709	16,458	17,104	17,710	18,645
Estimated Expenditures						
Operating	13,961	15,267	19,657	22,383	24,742	27,612
Estimated Surplus [Deficit] for Fiscal Year	9,622	442	[3,199]	[5,279]	[7,032]	[8,967]
Estimated Fund Balance [Deficit], end of Fiscal Year	13,579*	14,021	10,822	5,543	[1,489]	[10,456]

*The estimated fund balance at the beginning of fiscal year 1971—72 is $3,957,000.

1. Unclaimed amount for expenditures made prior to January 1, 1969. There is an estimated $3,823,000 collectible from the federal government for expenditures made by the State for highway construction projects prior to January 1, 1969. No claim has as yet been filed by the State department of transportation to recover this amount, although the claimable amount includes expenses incurred as far back as early 1960's. Of the $3,823,000, $2,034,000 is due the highway special fund and $1,789,000 is due the general obligation bond fund.

The State department of transportation has represented that the primary reason why it has not as yet billed the federal government is because it lacks manpower to process the billing documents. It is apparent that the benefits of collecting these federal funds far outweigh the costs that may be entailed in processing the billings.

We recommend that immediate action be taken to bill the federal government for the above amount.

2. Payments withheld by the federal government. The federal government is presently withholding a portion of the amounts claimed by the State department of transportation for reimbursement. As of June 30, 1970, the amount withheld is $4,742,000. Of this sum, $1,391,000 is due the highway special fund. The reason why the federal government is withholding payment is as follows.

Since 1962, the federal government has been urging the State to get on a "current billing" basis. A "current billing" basis is that system whereby the State bills the federal government for the latter's share of highway construction costs as expenditures are made (monthly) and the federal government pays each bill as soon as practicable (usually within five days of the receipt of the bill) without an extensive audit of the vouchers to determine the validity of the bill. To become eligible to be paid on a "current billing" basis, however, the State must develop accounting and fiscal and operational control systems which would insure accuracy of data and propriety of expenditures. Only with such accounting and control systems can the federal government be assured that the bills it gets from the State would be accurate and proper, thus dispensing with the need to audit the vouchers before payment.

In 1967, the State department of transportation engaged the services of a consultant to develop such accounting and control systems. However, the systems have not as yet been fully implemented. It appears that, among other things, written fiscal and operational procedures acceptable to the federal government are still to be completed and internal auditing has yet to commence. Hawaii is but one of four states not yet fully on a "current billing" basis.

Upon the representation of the State department of transportation that the desired accounting and control systems would be developed, the federal government permitted the State to begin "current billings" in January 1969. However, due to the slowness of the State in developing accounting and control systems acceptable to it, the federal government withheld payment of a portion (10% – $2,056,000) of some bills submitted for expenditures made in 1969 and of all bills submitted for expenditures made during January to June 1970 ($2,686,000).[1]

Since January 28, 1971, the federal government has resumed payment on a "current billing" basis on the representation of the State department of transportation that the department would complete the requirements necessary to support the "current billing" practice by May 1, 1971. The federal government, however, will continue to withhold the $2,056,000 withheld from the bills submitted for expenditures made in 1969 and six months' worth of bills which will vary, from time to time, between $2 to $3 million, until the requirements are met.

It is imperative that the department make every effort to meet the necessary requirements of the current billing system, and we recommend that it does so.

3. Increased federal participation on Lunalilo project. The Lunalilo Freeway was originally constructed as a *primary* road, and as such, the federal government paid for about 50% of its construction cost. Over the years, portions of the freeway were re-designated as *interstate highway.* Since federal participation in cases of interstate highway construction is about 90%, upon such re-designation, the State became eligible to receive and did receive additional federal reimbursement to defray a part of the cost of constructing the re-designated portions of the freeway. There are still other portions of the freeway which are eligible to be re-designated as *interstate;* upon such re-designation, the State can receive further, additional reimbursement. It is estimated that as of this date, about $5.5 million is available to the State if the remaining portions of the freeway are re-designated. The State, however, has held off converting these remaining portions from *primary* to *interstate* for the following reason.

The conversion of a *primary* road to *interstate* highway not only makes the State eligible to receive additional federal reimbursement, but it also frees, for matching State input to construct other primary road or roads, that federal assistance amount originally given to construct the converted road. This amount is freed because, upon conversion, the federal government transfers the amount from the State's primary road account to the State's interstate account. However, the freed amount can be used for other primary road project or projects only if the amount is committed (or obligated) for a project or projects simultaneously with the conversion of the primary road to interstate highway.

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[1]In addition to the $4.7 million withheld by the federal government, it is estimated that $2.4 million of reimbursable costs has accrued during the period July to December 1970. Billings for these costs have not been submitted to the federal government as of the writing of this report. What portion of this $2.4 million is due the highway special fund has not been determined. No part of this sum is included in our calculation of "potential, additional resource" for the special fund, inasmuch as if it is received in the current fiscal year it would not affect the special fund balance.

If the remaining portions of the Lunalilo Freeway are re-designated, the sum of $6.4 million will be available for other primary road projects. Although in the past the federal government has permitted the State to convert the freeway to interstate status a portion at a time, it is now insisting that the remainder be converted *in toto*. The State has had difficulty finding a primary road project or projects of a size sufficient to consume the entire $6.4 million which would be freed upon conversion of the remaining portions of the freeway to interstate.

The department of transportation has represented that it has now found a project of sufficient size and that the conversion of the remainder of the freeway will be made by December 31, 1971. This means that the additional $5.5 million in federal reimbursement would be forthcoming in fiscal year 1971–72.

We recommend that the department of transportation take all steps necessary to insure implementation of the federal aid primary road project which will permit the State to collect the $5.5 million.

Interest income on highway fund balances. The State highway fund has had large fund balances over the past few years. It has not, however, derived any significant amount of interest income, although section 38–8, Hawaii Revised Statutes, provides that interest earned on the investment of monies in a special fund shall be credited to such special fund. The interest earning potential of the fund is such that it would significantly increase the ability of the fund to meet future financial requirements. The amount of interest earnings would, of course, depend on the prevailing rate of interest and the amount of funds available for investment. However, we estimate that in fiscal years 1971–72 to 1974–75 the fund can earn interest totaling $2,024,000 (at a 5% rate), to-wit:

Fiscal Year	Amount
1971–72	$478,000
1972–73	689,000
1973–74	548,000
1974–75	309,000

We recommend that the State administration invest the fund balances of the highway special fund and credit the interest earnings thereon to the fund.

Expenditures

The expenditures estimated for the State highway special fund through fiscal year 1976–77 (tables 2.1a and 2.1b) include the costs of administration, highway maintenance, debt service, and cash financed capital improvements. Future cost impact on the State highway special fund is dependent upon the State's highway program and financial plans. Properly constructed program and financial plans in essence indicate the programs, the program costs and the sources of financing anticipated for the future.

Lack of departmental plans. Our efforts to determine the future impact on the State highway special fund were hampered by the lack in the department of transportation of program and financial plans for the State highway program beyond fiscal year 1970–71. *We believe that such plans should be developed by the department and continuously updated, and we so recommend.*

In the absence of program and financial plans, we requested the State department of transportation to develop an expenditure plan[2] for fiscal biennium 1971–73, and, based on the information supplied by the department, we constructed one for fiscal years 1973–74 to 1976–77. The results of these twin efforts are noted in table 2.2.

The effect of the expenditure plan on the State highway special fund is noted in the "summary" at the bottom of table 2.2. The figures therein opposite "highway fund" are the figures which appear as "total estimated expenditures" on table 2.1a. The "total estimated expenditures" on table 2.1b differ slightly from those shown on table 2.1a. The reason for this difference and the assumptions and bases underlying the expenditure plan (table 2.2) for fiscal years 1973–74 to 1976–77 are discussed below.

Operating expenditures. Operating expenditures include the costs of administration and highway maintenance and debt service charges.

1. *Administration and highway maintenance.* Administration expenses include the "overhead" costs of the State department of transportation's administrative and highway divisions, not related to any specific highway project. Maintenance expenses include the costs of ordinary and special maintenance of highways. The costs of both administration and highway maintenance were estimated by the State department of transportation for the entire six-year period, 1971–72 to 1976–77.

2. *Debt service.* Debt service charges include both principal and interest on bonds already issued and those to be issued over the six-year period. The amount of debt service on future issues is dependent on and directly related to the anticipated capital improvement program. The anticipated future capital improvement program is discussed in the next section. Table 2.2 notes what the debt service charges are expected to be over the next six years. The interest rate assumed is 5%.

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[2]We use the term "expenditure plan" to distinguish it from the "program and financial plan" as the latter term is defined in Act 185, SLH 1970. The "expenditure plan," for example, does not attempt to identify the costs by the cost categories enumerated in Act 185; it displays all capital investment costs as "CIP" and all other costs as "operating."

Table 2.2

Expenditure Plan
for Fiscal Years 1967–68 to 1976–77
(in thousand $)

	Actual			Estimate						
	1967–68	1968–69	1969–70	1970–71	1971–72	1972–73	1973–74	1974–75	1975–76	1976–77
Operating Expenditures										
Highway Fund										
Administration and highway maintenance. .	5,383	5,648	6,706	7,776	7,454	7,476	10,399	11,140	11,443	12,932
Debt Service	4,558	4,894	5,119	5,775	6,494	7,726	9,154	11,085	13,118	14,474
General Fund										
Debt Service	1,563	2,276	2,123	2,714	3,012	3,611	4,138	4,863	5,416	5,654
TOTAL OPERATING EXPENDITURES	11,504	12,818	13,948	16,265	16,960	18,813	23,691	27,088	29,977	33,060
Capital Improvement Expenditures										
Highway Fund (Cash financed)	4,825	2,351	2,960	2,575	1,165	803	---	---	---	---
General Fund (Cash financed)	299	1,219	2,700	3,384	1,388	---	---	---	---	---
General Obligation Bond Fund										
Reimbursable from Highway Special Fund	2,979	6,963	6,259	8,394	21,606	23,363	19,600	19,600	19,600	4,100
Non-reimbursable	3,022	3,608	2,414	5,406	11,142	9,481	3,500	3,500	3,500	3,500
Federal Fund	25,810	29,294	32,967	39,749	57,365	66,474	94,173	94,173	94,173	6,408
TOTAL CAPITAL IMPROVEMENT EXPENDITURES	36,935	43,435	47,300	59,508	92,666	100,121	117,273	117,273	117,273	14,008
TOTAL OPERATING AND CAPITAL IMPROVEMENT EXPENDITURES	48,439	56,253	61,248	75,773	109,626	118,934	140,964	144,361	147,250	47,068
Summary of Expenditures by Fund Sources:										
Highway Fund	14,766	12,893	14,785	16,126	15,113	16,005	19,553	22,225	24,561	27,406
General Fund	1,862	3,495	4,823	6,098	4,400	3,611	4,138	4,863	5,416	5,654
General Obligation Bond Fund										
Reimbursable from Highway Special Fund	2,979	6,963	6,259	8,394	21,606	23,363	19,600	19,600	19,600	4,100
Non-reimbursable	3,022	3,608	2,414	5,406	11,142	9,481	3,500	3,500	3,500	3,500
Federal Fund	25,810	29,294	32,967	39,749	57,365	66,474	94,173	94,173	94,173	6,408
TOTAL	48,439	56,253	61,248	75,773	109,626	118,934	140,964	144,361	147,250	47,068

Capital improvement expenditures. Capital improvement expenditures denote the investment cost of constructing roads and highways, whether financed by cash or by bonds. The capital improvements expenditure plan for fiscal years 1971–72 and 1972–73 was constructed by the State department of transportation. Included in the calculation of expenditures are projects authorized in prior years and projects anticipated for the fiscal biennium 1971–73 for which funds were requested in the department's biennial budget submission to the legislature.

The capital improvements expenditure plan for fiscal years 1973–74 to 1976–77 was constructed by this office based on information supplied by the State department of transportation and on certain assumptions made by us, thus:

1. *The projects.* The projects to be undertaken in fiscal years 1973–74 to 1976–77 were determined by following the suggestion of the State department of transportation. The department suggested that the following projects be assumed:

- Completion of the interstate highway system by fiscal year 1975–76, at a total cost of $310.0 million.[3]

- Continued construction of primary and secondary roads in amounts sufficient to secure federal fund matching.

- Construction annually of approximately $3.5 million worth of projects, financed completely by the State.

2. *State's share of the costs of the projects.* The State's share of the costs of the projects identified above was calculated as follows.

- Based on State estimate, it is expected that the federal government would pay for 85% of the interstate highway system, or $263.5 million, and the State 15%, or $46.5 million. Since the department of transportation was unable to furnish data on how interstate highway construction would be programmed over 1974–76, we assumed an equal rate of expenditures over the three-year period. Thus, the State's annual share is $15.5 million in fiscal years 1973–74 to 1975–76.

- Construction of primary and secondary roads in amounts sufficient to secure federal fund matching means the construction of approximately $9.6 million annually, based on an annual federal apportionment of $5.5 million. This means the State pays $4.1 million annually.

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[3]The $310 million plus the $1.8 million projected for fiscal years 1971–72 and 1972–73 equals $311.8 million for the next five-year period (1971–72 to 1975–76). Under federal requirements, the interstate system must be completed by the end of the 1975–76 fiscal year. This means a tremendous amount of highway construction activities in the next five years. Note the comparative construction expenditure data for years prior to 1971–72 in table 2.2.

- Construction annually of approximately $3.5 million worth of projects, financed completely by the State, means State cost of $3.5 million yearly.

3. *Sources of funding the State's share.* Two problems are manifest in determining the funding source for the State's share of construction costs. They are: general fund vs. special highway fund; and cash vs. bond.

The general fund vs. special fund problem was resolved based on the department of transportation's recommendation that all projects not programmed to receive federal aid be funded by the general fund, and all projects programmed to receive federal aid be supported by the highway special fund. Thus, table 2.2 reflects payment out of the highway special fund for the State's share of the interstate highway and primary and secondary road costs and payment out of the general fund of the full cost of the projects to be financed entirely by the State.[4]

The *bond vs. cash problem* was resolved in favor of bond financing. The reasons for this are discussed in chapter 3. Thus, table 2.2 does not reflect cash financing of capital improvements for fiscal years 1973–74 to 1976–77. It assumes that all capital improvements, the State's share of the costs of which is to be supported by the highway special fund, will be constructed by the floating of general obligation bonds, the principal and interest of which will be reimbursed by the highway special fund.

Expenditure difference between table 2.1a and table 2.1b. The difference in the expenditure totals between table 2.1a and table 2.1b is accounted for by the "inter-generation equity" concept discussed in chapter 3. As noted earlier, the expenditure plan for fiscal years 1971–72 and 1972–73 was constructed by the State department of transportation. In its calculation, the department included highway special fund, cash financed projects of $1,165,000 for fiscal year 1971–72 and $803,000 for fiscal year 1972–73 (see table 2.2). The results are reflected in table 2.1a.

A change in financing of these projects from cash to bond, in accordance with the principle of "inter-generation equity" would result in the elimination of "cash financed" capital expenditures in the two fiscal years and the addition of debt service charges in subsequent years. The result of such change in financing is reflected in table 2.1b. To accomplish this, however, the statutes which appropriate moneys for these projects would require amendment, since the statutes as now written provide that the projects are to be cash financed by the State highway special fund.

Summary

In summary, the State highway special fund will remain solvent through fiscal year 1972–73, assuming the present sources of funds and operating practices. Its solvency, however, can be extended through fiscal year 1974–75, provided the State takes affirmative action to collect certain reimbursable amounts from the federal government, earn interest on the special fund balance and finance all highway construction through general obligation bonds.

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[4]We note that the $3.5 million projected to be paid out annually from the general fund during fiscal years 1973–74 to 1976–77 is significantly smaller than the level of general fund support during fiscal years 1968–69 and 1969–70, and the estimated levels during fiscal years 1970–71 to 1972–73, to-wit:

1968–69	1969–70	1970–71	1971–72	1972–73
$4.8 million	$5.1 million	$8.8 million	$12.5 million	$9.5 million

Chapter 3

SOME SELECTED PROBLEMS

In chapter 2 we noted that the department of transportation has no meaningful program and financial plans which project over a period of years the highway programs anticipated, the costs thereof, and the means of financing them. We recommended that the department formulate and continually update such plans. We note here four other program and operational problems relating to the State highway program. They are: (1) the use of cash rather than bond funds to finance capital improvement projects, (2) the failure of the State to maximize federal participation in federal aid projects, (3) the absence in the State department of transportation of sufficient bases for estimating federal-state contributions in paying for federal aid projects, and (4) the differences in the composition and use of the State highway fund and the city and county of Honolulu highway fund.

Cash vs. Bond Financing

A state or local government jurisdiction has two basic choices in financing capital investment facilities, such as highways, when financing is required from its own resources: (1) it can levy taxes, or otherwise raise revenues, to yield the amounts necessary to pay for the capital investment facilities at the time the facilities are designed or constructed; or (2) it can borrow the funds to finance the capital investment and repay principal plus interest in a series of payments in future years.

In the past, the State has partially financed its highway construction programs through the use of cash. In chapter 2 we noted that the State department of transportation has projected the use of $1,963,000 special fund cash for highway construction (table 2.1a) in fiscal years 1971–73. In our development of the expenditure plan for fiscal years 1973–74 to 1976–77, we projected no use of special fund cash for construction purposes and assumed all such construction would be through bond funds.

The principles of public finance indicate that for state and local government, borrowing funds through the issuance of bonds is the appropriate method to finance capital investments. There are two basic reasons why borrowing is the appropriate method:

1. Bond finance provides a more effective means for allocating the costs of capital investments among the beneficiaries of the investments. Capital investments, such as highways, can be expected to provide a stream of benefits extending some years into the future. This means that not only present residents of a state or locality, but future residents as well, will consume the benefits provided by the capital investments. In such cases, the concept of "inter-generation equity" holds that future, as well as present residents, should share the costs of the investments. Bond finance provides the means

through which payments for capital investments can be spread over the life of the investments so as to coincide more closely with the stream and consumption of future benefits.

2. The cost of external resources (borrowing) is generally lower than the cost of internal resources (cash). State and local governments almost always earn more from the short-term liquid securities they hold than they pay on the long-term debt that they owe. This is because their debt pays tax-exempt interest to lenders, whereas their holdings of short-term securities and time deposits pay interest that is taxable to private *but not government* holders. This condition can be interpreted as a national policy of subsidizing borrowing for capital investment projects at the state and local level. Whatever the merits of the policy from a national standpoint, it would be in the financial interest of a particular state or local government to avail itself of the opportunity created by the policy.

There may be constraints, such as legal debt restrictions, which limit the capacity of a state or local government to fully capitalize on borrowing. However, where such constraints do not influence the immediate choice between cash or bonds, borrowing is the appropriate and the preferred method in terms of both equity and economic efficiency.

Maximization of Federal Participation in Federal Aid Project Costs

The State department of transportation is currently not achieving maximum federal participation in federal aid project costs. We were informed that over $225,000 of project costs eligible for federal reimbursement was not collected in fiscal year 1969–70 because the highway division did not properly document these costs. The $225,000 consisted of the following items:

- Approximately $125,000 for vehicle operation expenses
- $50,000 to $100,000 for expenses of the materials testing laboratory
- About $48,000 for computer rental fees.

The department of transportation has blamed the lack of manpower as the cause of its inability to provide the proper documentation to recover all eligible costs. We believe, however, that the personnel effort required would be more than compensated by the additional federal reimbursements. Action now is especially critical because the level of federal aid projects and the consequent eligible costs are expected to increase significantly during the period 1972–1977.

We recommend that the department of transportation take immediate steps to insure proper documentation for project costs eligible for federal reimbursement.

Bases for Estimating State-Federal Contributions in Federal Aid Projects

The department of transportation estimates that the total additional funds necessary in fiscal years 1971–72 to 1975–76 to complete the interstate system is about $311.8 million[1] and that the federal government's share of the total cost will be 85% or about $265.0 million and the State's share 15% or about $46.8 million.[2] This estimate was reportedly made on the basis of past experience. We have reason to doubt whether the estimate is accurate. *First*, the department has not developed any data to support this estimate. *Second*, a subsequent departmental study of the actual State share of interstate system costs over a recent 18-months' span revealed that the State's share of costs was actually about 13.5% rather than 15.0%. The seemingly small difference of 1.5% means a *reduction* of about 10% in the estimated State's share of the costs of the interstate system, or in terms of dollars, from $46.8 to $42.1 million.

A basis for estimating federal-state participation in highway costs is lacking not only for interstate highways but for primary and secondary roads as well. Federal aid for primary and secondary roads is normally considered to be 52.6% of the costs of these projects. The department of transportation, however, has estimated, without documentation, that the federal government's share of the costs of these projects is 45% and the State's share 55%. Under this estimation, State participation in the costs of these projects is about 7.6% higher than intended by the federal government. We believe that the division should conduct a survey to determine the actual share that the State has been paying for primary and secondary road projects.

The failure of the department to develop adequate bases for estimating the federal and State funds necessary to implement federal aid projects is significant in that it appears that it may have overstated the State's share by several million dollars.

We recommend that the division develop and continually update the data necessary to meaningfully estimate federal-state contributions toward project costs.

Differences in the Composition and Use of the State Highway Fund and the City and County of Honolulu Highway Fund

We have reviewed the financial condition of the highway special funds of the counties, but we restrict our discussion here to the city and county of Honolulu. The highway funds of the neighbor island counties are nowhere near supporting highways as self-sustaining enterprises, and the recourse in

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[1]The $311.8 million is $1.8 million more than shown in chapter 2 as the sum total of the interstate program for fiscal years 1973–74 to 1975–76. The additional $1.8 million is projected for fiscal years 1971–72 and 1972–73 per the expenditure plan constructed by the department of transportation for these two fiscal years (see footnote 3, chapter 2).

[2]Although the interstate program is normally considered to be financed on a 90% federal share and a 10% State share basis, in practice the proportions have not been maintained. There are certain costs that the federal government does not participate in, and others where a limit is set on particular cost categories. Therefore, the federal share is generally less than 90% and the State share is generally higher than 10%.

those counties has been to rely on general fund support. In the case of the city and county of Honolulu, the highway special fund is identifiable as a fund in support of a self-financing enterprise, but there are essential differences in the composition and utilization of the fund when compared with the composition and utilization of the State highway fund.

Whereas the State highway fund derives more than 90% of its revenues from fuel taxes, the city highway fund derives 50% of its revenues from motor vehicle fees, 30% from fuel taxes and the remainder from public utility franchise fees and other miscellaneous sources. We are unable to define the rationale upon which revenue sources are assigned to the State as against those assigned to the city. Presumably, the assignment of these sources are a reflection of public policy objectives, but unless the objectives are clarified and made explicit, it is not possible to review rationally the appropriate apportionment of either (1) revenues in support of highways or (2) revenue *sources* in support of highways. This is a matter for legislative clarification or policy formulation.

As to the expenditures from the respective highway funds of the State and the city, the State's expenditures consist primarily of meeting the costs of construction, repair and maintenance of highways whereas the city's expenditures may be expected to be used to meet the costs of a broader scope of present and emerging activities. For example, a significant portion of the city's funds are expected to be expended on buses, mass transit, storm drains, and street improvement districts. Expenditures for these activities are more appropriately characterized as highway-related expenditures rather than highway expenditures, *per se.*

City highway revenues are applied also to expenditures of operating departments, presumably on the basis that such departments are engaged in support of the highway program. For example, the public works department and the planning department derive a portion of their operating revenues from the highway fund. We were unable to determine the current formula, or any other documented basis, upon which highway fund allocations are made to the operating departments. These allocations should be examined by the city and county of Honolulu in the context of the purposes for which the city's highway fund was established.