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# **A Study of Special Fund Assessments and Reimbursements**

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

**THE AUDITOR**  
STATE OF HAWAII

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Hawaii

Submitted by

**THE AUDITOR**  
STATE OF HAWAII

Report No. 94-17  
November 1994

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## Foreword

This report was prepared in response to the Supplemental Appropriations Act of 1994, which directed the State Auditor to conduct a study of assessments imposed on special funds to reimburse the state general fund.

We wish to acknowledge the cooperation and assistance extended to us by the officials and staff of the Department of Budget and Finance and others whom we contacted during the course of our study.

Marion M. Higa  
State Auditor

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# Table of Contents

## Chapter 1 Introduction

Objectives of the Study .....	2
Scope and Methodology .....	2

## Chapter 2 Findings and Recommendations

Summary of Findings .....	3
Imposing Assessments On Special Funds Is Appropriate .....	3
Assessment Formulas Should Be Reviewed .....	4
Assessments Should Apply to All Funds .....	7
All Departments Should Comply With Chapter 36 .....	8
Recommendations .....	8

Responses of the Affected Agencies .....	11
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# Chapter 1

## Introduction

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The Supplemental Appropriations Act of 1994 directs the State Auditor to study assessments imposed on special funds to reimburse the state general fund. Unless exempted, special funds are annually assessed for two kinds of expenses incurred by state government in maintaining those funds. The two kinds of expenses are: (1) government-wide central services expenses, and (2) administrative expenses of the department that houses the fund. The assessments are made through transfers to the state general fund.

Assessments for central services expenses are authorized under Section 36-27, Hawaii Revised Statutes (HRS), which directs the director of finance to deduct 5 percent of all receipts from each special fund to defray these costs. In addition, Sections 36-28, 36-28.5, and 36-29, HRS, authorize the director of finance to deduct 5 percent of the net revenues from the State Highway Fund, the Airport Revenue Fund, and the Harbor Special Fund, respectively. The reimbursement for departmental administrative expenses is stipulated in Section 36-30, HRS, which requires each special fund to be responsible for its proportionate share of the administrative expenses of the department in which the fund is located.

The statute on assessments for central services expenses was enacted in 1955. The requirement to reimburse the general fund for departmental expenses was imposed in 1964. But the Department of Budget and Finance (B&F) required few special funds to pay the assessments until recently. Prior to FY1992-93, only 20 funds were assessed for central services and departmental administrative expenses. In FY1991-92, an estimated \$17.5 million in assessments was transferred to the general fund. In 1993, B&F identified and assessed 58 additional special funds. The amount transferred to the general fund increased by \$10 million to an estimated total of \$27 million for FY1992-93.

Since the initial statute, over 20 special funds have been statutorily exempted from the central services assessment, the departmental administrative assessment, or both. Currently, 78 other special funds are assessed fees. In addition, revolving funds and trust funds are not subject to the two types of assessments.

The law does not define “central services expenses.” However, a recent study conducted for B&F itemized some of these expenses. They include but are not limited to cash management and debt management

services by B&F, and accounting, building maintenance, and payroll services by the Department of Accounting and General Services (DAGS).

The Financial Administration Division of B&F is responsible for the Chapter 36 assessments. The division notifies the departments with special funds that they are responsible for paying the two assessments to the general fund. It also reviews and monitors the status of the assessments. The departments generally transfer the assessments through journal vouchers processed by DAGS.

Section 7(7) of the Supplemental Appropriations Act of 1994 (Act 252) directed the State Auditor to conduct a study of the special fund assessment requirements of Sections 36-27, 36-28, 36-28.5, 36-29, and 36-30, HRS. Several issues prompted the Legislature to request this study. They included: (1) more proposals to exempt special funds from the two assessment requirements, (2) a federal agency review of the central services assessment against the Airport Revenue Fund in the Department of Transportation, and (3) a concern that the two assessments may have a negative impact upon the programs operated by the special funds.

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## **Objectives of the Study**

1. Determine whether the rationale as well as the size of the current assessment fee and reimbursement requirement in Chapter 36 are appropriate.
2. Determine the impact of the assessment fee and reimbursement requirement upon the special funds and the general fund.
3. Make recommendations based upon the findings in these areas.

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## **Scope and Methodology**

We interviewed administrators and analysts of B&F and staff of departments with special funds subject to the assessments. We reviewed applicable statutes, departmental correspondence, reports, departmental worksheets, and journal vouchers. We also reviewed similar statutory requirements in other states.

Our work was performed from June 1994 through September 1994 in accordance with generally accepted government auditing standards.



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# Chapter 2

## Findings and Recommendations

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This chapter presents our findings and recommendations on the appropriateness of the assessments for central services costs and departmental administrative costs under Chapter 36. These assessments affect 78 special funds in 12 departments of the Executive Branch, the University of Hawaii, and the Judiciary.

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### Summary of Findings

1. It is appropriate to assess special funds for central services expenses and departmental administrative expenses.
2. The formulas for calculating both the central services assessment and the departmental reimbursement need to be reviewed.
3. The assessments should be applied consistently to all special funds. No special fund should be exempted. Revolving funds and trust funds should also be subject to the assessments.
4. The Department of Budget and Finance (B&F) has made reasonable efforts to ensure departmental compliance with Chapter 36. All departments are cooperating except for the Department of Hawaiian Home Lands, which is not complying.

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### Imposing Assessments On Special Funds Is Appropriate

Imposing assessments under Sections 36-27 through 36-30, HRS is appropriate. Special funds are financing mechanisms created outside the general fund to support specific activities or programs. They are designed to be self-sustaining. This means that charges to users of the activities or programs should be sufficient to cover all costs. These costs include central services expenses and departmental administrative expenses that special funds do not pay for directly. Unless these costs are included, users are not paying for the full costs of services provided under the special fund.

It is appropriate for special funds to reimburse the general fund for the costs incurred by general-funded central services agencies such as B&F or the Department of Accounting and General Services (DAGS). It is also appropriate that special funds pay for departmental administrative costs associated with the day-to-day administration of special funds.

All special funds incur central services expenses and departmental expenses that are being paid for from general fund revenues. Central services costs include such items as cash and debt management services provided by B&F and accounting, building maintenance, and payroll services provided by DAGS. These costs should not have to be absorbed by the general fund.

Individual departments also incur administrative costs on behalf of special funds. Examples of such expenses include administrative staff salaries, building and grounds maintenance, utilities, and general office expenses. Departments should not be expected to assume these overhead costs generated by special funds.

Hawaii's assessment requirements are not unique. Other states have adopted similar requirements and the practice is allowed by the federal government on federal grants and contracts. Other states such as Arkansas, South Dakota, Oregon, North Dakota, and Idaho also charge for central services expenses.

***Special funds can anticipate and budget for assessments***

In reviewing the budgets for several special funds and interviewing program managers and department fiscal staff, we found that the assessments had no significant impact on the activities and programs financed by special funds, especially when the departments have prepared for the assessments.

Departments with special funds are able to budget for the Chapter 36 requirements. As long as they receive notice that special funds are subject to the assessments, they are able to plan for them.

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**Assessment Formulas Should Be Reviewed**

The formulas for calculating the amounts special funds owe for central services expenses and departmental administrative expenses should be reviewed. Neither formula is linked to actual costs. In addition, the actual costs of central services expenses and departmental administrative expenses have not been formally determined. B&F should establish defensible formulas for both assessments.

***Central services formula can be challenged***

The formula for the central services fee assessment has no logical or mathematical basis. It was set arbitrarily by Act 247 in 1955. As originally drafted, Act 247 would have set the assessment at 10 percent of receipts of the special funds. A 5 percent figure was eventually chosen. Neither the 10 percent nor the 5 percent figure had any clear rationale. B&F states that the 5 percent figure is "a reasonable surcharge rate." However, the formula is not linked to actual costs and B&F has no clear estimate of what central services costs might be.



**Formula is not linked to actual costs**

The formula is not based upon the actual cost of services that central governmental agencies provide to the special funds. Instead, the formula is tied to special fund revenues. Since the assessment is based upon receipts, the amount of the assessment becomes larger as the fund generates more revenue.

Increased revenues do not necessarily result in an increase in central services costs. The cost of processing a transaction generally does not change with the size of the transaction. For example, the same amount of paperwork is required to process one check or one receipt of \$50,000 as is required to process one check or one receipt of \$5. Yet the current formula would assess one special fund \$2,500 and the other 25 cents for central services expenses.

**No estimate of central services expenses is available**

B&F has no estimate of the central services costs incurred by special funds. The department contracted with a consultant who estimated total central services costs of state government to be \$188 million. The consultant's study extended to attributing central services costs to departments but not to special funds.

**Other states have lower assessments**

Other states that charge for central services expenses deduct a smaller proportion than does Hawaii. Arkansas deducts between 1 1/2 percent and 3 percent of net revenues of special funds collected by state departments and agencies. Arkansas has determined that the cost of central services is not less than 3 percent of the revenues. Idaho uses a schedule in which the proportion deducted ranges from 1/10 of 1 percent to 3 percent of the revenues depending on the amount received by each special fund.

**Assessments can be based on other methods**

B&F should establish a more defensible assessment formula. It should ensure a logical, systematic, mathematical, or scientific basis for determining the assessment figure. The amount reimbursed should be approximately equal to a reasonable estimate of central services costs associated with the special funds.

A full cost allocation study would determine the actual central services costs associated with the special funds. Should such a study prove to be unfeasible, other methods of determining costs can be used. B&F annually prepares a Statewide Cost Allocation Plan (SWCAP) that identifies and recovers allowable costs associated with federal grants and contracts. This plan could substitute for a full cost allocation study

even though the SWCAP does not reflect full central services costs since federal guidelines disallow some costs. However, estimates could be made of these disallowed costs.

### **Guidelines are inconsistent**

In addition to the questionable formula, departments are confused about how the central services fee assessment should be calculated. Current B&F guidelines are contradictory. One document asserts that the fee assessment should be based on *all receipts* of special funds. Another document, however, indicates departments can apply the 5 percent figure against *net receipts*.

B&F has allowed some departments to use net receipts when calculating the amount owed for the central services fee assessment. Other departments, such as the Department of Land and Natural Resources and the Department of Agriculture, use gross receipts.

The official B&F position is that the assessment should be based upon all receipts. Under Sections 36-28 to 36-29, only the three special funds in the Department of Transportation may adjust their receipts before applying the 5 percent formula. B&F should issue clear and consistent guidelines on this issue.

### **Calculation of departmental administrative costs needs review**

The methodology for calculating the departmental reimbursement under Section 36-30, HRS is also questionable. It is not based on a reliable estimate of departmental administrative costs for special funds.

Section 36-30 states that each special fund is responsible for its pro rata share of the administrative expenses incurred by a department for the special fund. The statute identifies the pro rata share as “that proportion of the administrative expenses of the department...which the expenditures of the special fund bear to the total expenditures of the department....” The statute allows credit for any administrative expenses already paid from the special fund. The statute also allows other “adjustments as may be necessary to achieve an equitable apportionment.” However, the statute does not specify what kinds of adjustments may be made.

The statute also allows the director of finance to determine the amount to be charged to each special fund. Currently, B&F allows departments to calculate the amount without questioning the figures. B&F should establish consistent guidelines for special funds to follow in calculating the reimbursements. Without guidelines, departments may overcharge or undercharge.



Neither B&F nor the various departments have attempted to accurately calculate or to estimate departmental administrative costs associated with the special funds. A reasonable estimate of such costs should be determined either informally or through a cost study.

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## **Assessments Should Apply to All Funds**

Although the law is supposed to apply to all special funds, it has been watered down by exempting certain special funds. We believe that the law should apply consistently to all special funds since they all incur central services and departmental costs. In addition, revolving funds and trust funds should also be assessed for such costs.

### ***Exemptions have no basis***

There is no compelling reason for exempting any special fund from the two assessments. Such exemptions have diluted the original intent of the Legislature to defray the cost of providing support services to the special funds. Since all special funds incur central services and departmental administrative costs, all should pay for their share of these expenses.

The law as enacted in 1955 did not specifically exempt any special fund. Currently, 21 funds are specifically exempted from the central services fee assessments in Section 36-27 and 19 special funds are exempted from the departmental administrative reimbursements in Section 36-30.

Some statutes establishing special funds also exempt them from the assessments. This has resulted in inconsistencies. For example, the Hilo Hospital and Maui Memorial Hospital special funds were exempted under a pilot project established by Act 223, SLH 1990, as amended by Act 187, SLH 1992. Other community hospitals, however, were required to pay the assessments.

Each year, amendments to existing statutes or new statutes provide for additional exemptions. We found no underlying support or reasoning for these exemptions.

### ***Revolving funds and trust funds should also be assessed***

Approximately 65 revolving funds and numerous trust funds operate in the executive branch of state government. Both revolving and trust funds incur central services costs and departmental overhead costs. There is no reason for the State or the departments to absorb these costs.

Revolving funds and trust funds should not be exempted from the requirement to pay their share of central services costs and departmental expenses. If the two assessments were applied to the approximately 65 revolving funds, approximately \$18 million annually would be transferred from the revolving funds to the general fund.



The only two funds that should be exempted are the Employees' Retirement System and the Unemployment Insurance Trust Fund. The two funds already pay for all their overhead expenses. B&F and DAGS invoice the two funds for services rendered.

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## **All Departments Should Comply With Chapter 36**

B&F has made reasonable efforts to ensure that departments make the required transfers in compliance with Chapter 36. It appears to have identified all special funds that are subject to the Chapter 36 requirements. It has notified departments responsible for the reimbursements. When a department fails to transfer moneys to the general fund, B&F formally notifies the department that it needs to comply with the requirements.

In 1993, several departments or offices, such as the Department of Health and the Housing Finance and Development Corporation, were late in paying their FY1992-93 assessments. However, they are currently trying to pay what is due. The Department of Hawaiian Home Lands, however, does not intend to comply. It has contended that its special funds are actually trust funds and exempt from the assessments. We note that the department's funds are not officially considered trust funds.

### ***The Department of Hawaiian Home Lands is not in compliance***

The Department of Hawaiian Home Lands' special funds are not exempt from Sections 36-27 and 36-30. The department operates five special funds that are subject to the Chapter 36 requirements: (1) Hawaiian Home Operating Fund, (2) Hawaiian Home Administration Account, (3) Hawaiian Home Receipts Fund, (4) Hawaiian Home Trust Fund, and (5) Native Hawaiian Rehabilitation Fund. While the Hawaiian Home Trust Fund's name implies that it is a trust fund, the fund was established as a special fund under the Hawaiian Homes Commission Act.

To date the Department of Hawaiian Home Lands has not remitted the two assessments for the five special funds under its control. The department owes an estimated \$1 million for central services costs for FY1992-93. The department should pay the assessments.

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## **Recommendations**

1. The Legislature should consider amending Sections 36-27 and 36-30, Hawaii Revised Statutes to:
  - a. Remove all exemptions of special funds from the statutory assessments for central services and departmental administrative costs, and

- b. Include all revolving and trust funds other than those that already pay all of their operating costs.
- 2. The Legislature should also amend statutes establishing special, revolving, and trust funds to remove their specific exemptions from Sections 36-27 and 30-30, HRS.
- 3. The Department of Budget and Finance should establish a sound methodology for reasonably estimating central services expenses and departmental costs associated with the special funds, trust funds, and revolving funds.
- 4. The Department of Budget and Finance should develop clear and consistent guidelines for calculating reimbursements to the general fund.
- 5. The Department of Hawaiian Home Lands should be required to transfer past due assessments to the general fund.



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## Responses of the Affected Agencies

### Comments on Agency Responses

We transmitted a draft of this report to the Department of Budget and Finance and the Department of Hawaiian Home Lands on October 20, 1994. A copy of the transmittal letter to the Department of Budget and Finance is included as Attachment 1. A similar letter was sent to the Department of Hawaiian Home Lands. The responses from the Department of Budget and Finance and the Department of Hawaiian Home Lands are included as Attachments 2 and 3, respectively.

The Department of Budget and Finance concurs with the two recommendations specifically directed at it. The department will review the current assessment formulas and evaluate the options in pursuing alternative formulas. The department will also review its current guidelines for calculating reimbursements to the general fund and discuss those guidelines with the departments to ensure clarity and consistency in the reimbursement calculations.

The Department of Hawaiian Home Lands does not agree with our finding that its five special funds are subject to the assessments under Sections 36-27 and 36-30, HRS. The department argues that the five funds are not subject to the assessments because: (1) the assessments violate the provisions of the Hawaiian Homes Commission Act, 1920, as amended (HHCA), the Admission Act, and the Hawaii State Constitution; (2) the funds are trust funds to be used exclusively for the benefit of native Hawaiians, the beneficiaries of the Hawaiian Home Lands Trust; and (3) any transfer to the General Fund contradicts the intent of Article XII, Section 1 of the State Constitution. The department has requested an Executive Order suspending the application of the two assessments against its funds. We believe the department's funds should be subject to the assessments.



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

October 20, 1994

**COPY**

The Honorable Eugene S. Imai  
Director of Finance  
Department of Budget and Finance  
250 South Hotel Street  
No. 1 Capital District Building  
Honolulu, Hawaii 96813

Dear Mr. Imai:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *A Study of Special Fund Assessments and Reimbursements*. We ask that you telephone us by Monday, October 24, 1994 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 Thursday, November 3, 1994.

The Department of Hawaiian Home Lands has 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 final form.

Sincerely,

A handwritten signature in cursive script, reading 'Marion M. Higa'.

Marion M. Higa  
State Auditor

Enclosures

JOHN WAIHEE  
GOVERNOR



ATTACHMENT 2

EUGENE S. IMAI  
DIRECTOR

BARBARA KIM STANTON  
DEPUTY DIRECTOR

CELIA L. JACOBY  
DEPUTY DIRECTOR

EMPLOYEES' RETIREMENT SYSTEM  
HAWAII INC  
HAWAII PUBLIC EMPLOYEES HEALTH FUND  
HOUSING FINANCE AND DEVELOPMENT  
CORPORATION  
OFFICE OF THE PUBLIC DEFENDER  
PUBLIC UTILITIES COMMISSION  
RENTAL HOUSING TRUST FUND COMMISSION

STATE OF HAWAII  
DEPARTMENT OF BUDGET AND FINANCE  
P.O. BOX 150  
HONOLULU, HAWAII 96810-0150

ADMINISTRATIVE AND RESEARCH OFFICE  
BUDGET, PROGRAM PLANNING AND  
MANAGEMENT DIVISION  
FINANCIAL ADMINISTRATION DIVISION  
INFORMATION AND COMMUNICATION  
SERVICES DIVISION

RECEIVED  
Nov 1 1 42 PM '94  
OFFICE OF THE AUDITOR  
STATE OF HAWAII

October 28, 1994

Ms. Marion Higa  
State Auditor  
Office of the Auditor  
465 S. King Street, Rm. 500  
Honolulu, Hawaii 96813

Dear Ms. Higa:

Thank you for the opportunity to review and respond to the report, A Study of Special Fund Assessments and Reimbursements prepared by your office. We appreciate your recognition of our continuous efforts to ensure that departments effect the statutorily mandated transfers of special fund assessments for reimbursements of central service costs and administrative expenses. Our comments to your report will be limited to the two recommendations specifically directed at the Department of Budget and Finance.

Recommendation #3: The Department of Budget and Finance should establish a sound methodology for reasonably estimating central services expenses and departmental costs associated with the special funds, trust funds, and revolving funds.

Comment: We concur. We shall review the current level of assessment established by the Legislature and evaluate the options identified in your report to determine the effectiveness and cost-benefit of pursuing an alternate method.

Ms. Marion Higa  
October 28, 1994  
Page 2

Recommendation #4: The Department of Budget and Finance should develop clear and consistent guidelines for calculating reimbursements to the general fund.

Comment: We concur. We will be reviewing the present guidelines and will be discussing them with the departments at an upcoming special funds workshop that we have scheduled to ensure clarity and consistency in reimbursement calculations.

Again, we would like to thank you for the opportunity to provide our comments on the study. We affirm our commitment to ensuring statutory compliance regarding special fund assessments and will continue to enforce such compliance in the event that statutory revisions are effected by the Legislature. As we had already scheduled a workshop on special funds for all departments on November 29, 1994, we are especially pleased that the report will be released in time for us to be able to share your observations and suggestions with all departments at the workshop.

Sincerely,



EUGENE S. IMAI  
Director of Finance



JOHN WAIHEE  
GOVERNOR  
STATE OF HAWAII



HOALIKU L. DRAKE  
CHAIRMAN  
HAWAIIAN HOMES COMMISSION

STATE OF HAWAII  
DEPARTMENT OF HAWAIIAN HOME LANDS

P. O. BOX 1879  
HONOLULU, HAWAII 96805

October 31, 1994

Ms. Marion M. Higa  
State Auditor  
State of Hawaii  
465 South King Street, Room 500  
Honolulu, Hawaii 96813

RECEIVED  
Nov 1 11 34 AM '94  
OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Ms. Higa:

We have reviewed the draft of "A Study of Special Fund Assessments and Reimbursements" and ask that these comments be included in your report.

The draft states the reason the Department of Hawaiian Home Lands (DHHL) has not paid assessments is that DHHL considered its special funds to be trust funds. This is not the primary reason DHHL has not paid the assessment. It was one of several reasons given your staff.

HRS Section 36-27 requires the Director of Finance, "from time to time" to deduct five per cent of all receipts of each special fund, except for those special funds specifically exempted, and to transfer the deducted amount to the State General Fund. This transfer is to cover central service expenses.

Similarly, HRS Section 36-30 requires each special fund (except those specifically exempted) to reimburse the General Fund for a pro rata share of departmental administrative expenses.

The Director of Finance has determined that the following DHHL funds are subject to assessment:

Hawaiian Home Operating Fund  
Hawaiian Home Administration Account  
Hawaiian Home Receipts Fund  
Hawaiian Home Trust Fund  
Native Hawaiian Rehabilitation Fund



We believe the funds identified above are not subject to assessment because: (1) The assessments violate provisions of the Hawaiian Homes Commission Act, 1920, as amended (HHCA), the Admission Act, and the Hawaii State Constitution; (2) the funds are trust funds to be used exclusively for the benefit of native Hawaiians, the beneficiaries of the Hawaiian Home Lands Trust; and, (3) any transfer to the General Fund contradicts the intent of Article XII, Section 1 of the State Constitution.

#### The Admission Act

Section 4 of the Admission Act required the State of Hawaii to adopt the HHCA as a provision of its constitution and stipulated the following conditions of the compact between the United States and Hawaii:

"§4. As a compact with the United States relating to the management and disposition of the Hawaiian home lands, the Hawaiian Homes Commission Act, 1920, as amended, shall be adopted as a provision of the Constitution of said State, as provided in section 7, subsection (b) of this Act, subject to amendment or repeal only with the consent of the United States, and in no other manner; Provided, That (1) sections 202, 213, 219, 220, 222, 224, and 225 and other provisions relating to administration, and paragraph (2) of section 204, sections 206 and 212, and other provisions relating to the powers and duties of officers other than those charged with the administration of said Act, may be amended in the constitution, or in the manner required for State legislation, but the Hawaiian home-loan fund, the Hawaiian home-operating fund, and the Hawaiian home-development fund shall not be reduced or impaired by any such amendment, whether made in the constitution or in the manner required for State legislation, and the encumbrances authorized to be placed on Hawaiian home lands by officers other than those charged with the administration of said Act, shall not be increased, except with the consent of the United States; (2) that any amendment to increase the benefits to lessees of Hawaiian home lands may be made in the constitution, or in the manner required for State legislation, but the qualifications of lessees shall not be changed except with the consent of the United States; and (3) that all proceeds and income from the "available lands", as defined by said Act, shall be used only in carrying out the provisions of said Act." (Emphasis added)

#### The Hawaii State Constitution

Section 1 of Article XI adopted the HHCA as a provision of the Constitution, subject to amendment or repeal only in the manner provided by Congress. Section 2 accepted as a compact with the United States the trust responsibilities.

"Section 1. Anything in this constitution to the contrary notwithstanding, the Hawaiian Homes Commission Act, 1920, enacted by the Congress, as the same has been or may be amended prior to the admission of the State, is hereby adopted as a law of the State, subject to amendment or repeal by the legislature, provided, that, if and to the extent that the United States shall so require, said law shall be subject to amendment or repeal only with the consent of the United States and in no other manner, provided, further, that, if the United States shall have been provided or shall provide that particular provisions or types of provisions of said Act may be amended in the manner required for ordinary state legislation, such provisions or types of provisions may be so amended. The proceeds and income from Hawaiian home lands shall be used only in accordance with the terms of such Act, and the legislature may, from time to time, make additional sums available for the purposes of said Act by appropriating the same in the manner provided by law. (Emphasis added)

Section 2. The State and its people do hereby accept, as a compact with the United States, or as conditions or trust provisions imposed by the United States, relating to the management and disposition of the Hawaiian home lands, the requirement that Section 1 hereof be included in this constitution, in whole or in part, it being intended that the Act or Acts of Congress pertaining thereto shall be definitive of the extent and nature of such compact, conditions or trust provisions, as the case may be. The State and its people do further agree and declare that the spirit of the Hawaiian Homes Commission Act looking to the continuance of the Hawaiian homes projects for the further rehabilitation of the Hawaiian race shall be faithfully carried out."

The Constitutional Convention of 1978 amended the above provisions and renumbered Article XI as Article XII. Section 1 reads as follows:

"Section 1. Anything in this constitution to the contrary notwithstanding, the Hawaiian Homes Commission Act, 1920, enacted by the Congress, as the same has been or may be amended prior to the admission of the State, is hereby adopted as a law of the State, subject to amendment or repeal by the legislature; provided that if and to the extent that the United States shall so require, such law shall be subject to amendment or repeal only with the consent of the United States and in no other manner; provided further that if the United States shall have been provided or shall provide that particular provisions or types of provisions of such Act may be amended in the manner required for ordinary state legislation, such provisions or types of provisions may be so amended. The



proceeds and income from Hawaiian home lands shall be used only in accordance with the terms and spirit of such Act. The legislature shall make sufficient sums available for the following purposes: (1) development of home, agriculture, farm and ranch lots; (2) home, agriculture, aquaculture, farm and ranch loans; (3) rehabilitation projects to include, but not limited to, educational, economic, political, social and cultural processes by which the general welfare and conditions of native Hawaiians are thereby improved; (4) the administration and operating budget of the department of Hawaiian home lands; in furtherance of (1), (2), (3) and (4) herein, by appropriating the same in the manner provided by law.

Thirty percent of the state receipts derived from the leasing of cultivated sugarcane lands under any provision of law or from water licenses shall be transferred to the native Hawaiian rehabilitation fund, section 213 of the Hawaiian Homes Commission Act, 1920, for the purposes enumerated in that section. Thirty percent of the state receipts derived from the leasing of lands cultivated as sugarcane lands on the effective date of this section shall continue to be so transferred to the native Hawaiian rehabilitation fund whenever such lands are sold, developed, leased, utilized, transferred, set aside or otherwise disposed of for purposes other than the cultivation of sugarcane. There shall be no ceiling established for the aggregate amount transferred into the native Hawaiian rehabilitation fund." (Emphasis added)

#### Constitutional Requirement: Legislative Appropriations to DHHL

From its beginning through 1987, with the exception of certain years during the Territorial period, the Hawaiian Homes program did not receive any external funding for administrative and operating expenses. The program was dependent upon general leasing revenues and a pro rata share of receipts from the leasing of sugarcane lands and water licenses for all of its administrative and operating costs, although appropriations were made to capitalize home loans funds and for infrastructure development, including water system improvements.

In 1978 the State Constitution was amended to address this deficiency. Language that previously read that "the legislature may from time to time make additional sums available [to the department]..." was replaced by the following provision:

"The legislature shall make sufficient sums available for the following purposes: (1) development of home, agriculture, farm and ranch lots; (2) home, agriculture, aquaculture, farm and ranch loans; (3) rehabilitation projects to include, but not limited to, educational, economic, political, social and cultural processes by which the general welfare and conditions

of native Hawaiians are thereby improved: (4) the administration and operating budget of the department of Hawaiian home lands; in furtherance of (1), (2), (3), and (4) herein, by appropriating the same in the manner provided by law." (Article XII, Section 1) (Emphasis added)

The Committee on Hawaiian Affairs of the 1978 Constitutional Convention included the following comments in its Standing Committee Report No. 56:

"It is clear to your Committee that the intent and spirit of the Act would be better served by releasing the department of its present burden to generate revenues through the general leasing of its lands. Your Committee decided that through legislative funding this dilemma would be resolved. In that manner more lands could be made available to the intended beneficiaries." (Convention Documents, Hawaii Constitutional Convention of 1978, p.632).

The Federal-State Task Force on the HHCA in 1983 recommended that the State, through its executive and legislative branches, implement the mandate of Article XII of the State Constitution to provide adequate funding for the administration and operation of DHHL and for rehabilitation projects.

Despite the constitutional amendment and the Task Force recommendation the department did not receive any external funding for administrative costs until the fiscal year beginning July 1, 1988, when the legislature, acting upon the Executive Budget recommendation, appropriated \$972,803 from the State General Fund to finance 49, or half, of DHHL's 98 permanent positions. In 1989 more than \$6 million was appropriated from the General Fund for the 1989-1991 biennium period to fund the 98 permanent positions and associated expenses for those positions. Temporary positions and other operating costs, however, had to be financed from DHHL funds.

Today, General Fund support has declined to about 21% of total operating costs. To levy an assessment on DHHL funds in order to reimburse the General Fund violates the spirit and intent of the 1978 constitutional amendments. More General Funds should be provided DHHL, rather than assessing DHHL funds to pay the General Fund!

#### DHHL Funds as "Trust Funds"

HRS Section 37-62 defines "Special funds" to mean "funds which are dedicated or set aside by law for a specified object or purpose, but excluding revolving funds and trust funds." "Trust fund" means a fund "in which designated persons or classes of persons have a vested beneficial interest or equitable ownership, or which was created or established by a gift, grant, contribution, devise or bequest that limits the use of the fund to designated objects or purposes." Although Section 213 of the HHCA refers to the five



funds covered by this discussion as "special funds," they are in fact "trust funds" because, as assets of the Hawaiian Home Lands Trust, they can be used only in the interest of the beneficiaries of the trust. The funds are discussed below.

#### Hawaiian Home Operating Fund

The Hawaiian Home-Development Fund (established in 1941) and the Hawaiian Home-Operating Fund (established in 1948) were merged into one fund, the Hawaiian Home Operating Fund, in 1986. This fund is used for operational costs not provided by the Hawaiian Home Administration Account or other funds, as well as for development expenses.

The major source of funding has been from the quarterly transfers from the Hawaiian Home Receipts Fund and transfers from the Revenue Bond Special Fund via the Administration Account.

There are two portions in this fund: (1) operating portion, and (2) development portion. Section 4 of the Admission Act expressly provides that the predecessors of this fund, the Hawaiian Home-Operating Fund and the Hawaiian Home-Development Fund, "shall not be reduced or impaired" by any amendment to the HHCA. Any special assessment by state law would reduce or impair this fund and in so doing violate this provision of the Admission Act.

#### Hawaiian Home Administration Account

The Hawaiian Home Administration Account was established in 1941. The entire receipts from any leasing or other disposition of "available lands" shall be deposited into this account. Any interest or other earnings arising out of investments from this fund are to be credited to this fund. The monies are to be expended by the department for salaries and all other administrative expenses of the department, excluding capital improvements, in the absence of general funds appropriated for operating and administrative costs.

Receipts of this fund are from general leases, licenses, revocable permits, rights of entry, and other dispositions of Hawaiian home lands. Any assessment on this fund would violate the provisions in the Admission Act and the Constitution stipulating that all proceeds and income from "available lands," as defined by the HHCA, "shall be used only in carrying out the provisions of said Act."

As an aside, in Fiscal Year 1993 DHHL received \$9,722,400 for past rent and interest for Hawaiian home lands that had been set aside by executive actions for public purposes. This compensation was paid as part of the Governor's efforts to make the trust whole. It would be contrary to that effort (and ironic) to levy a 5% assessment on that sum, which represents a remedial action to correct a past wrong.

### Hawaiian Home Receipts Fund

All interest monies from loans or investments received by the department from any fund (except the borrowed money loans in the Hawaiian Home General Loan Fund, the Hawaiian Home Loan Fund, the Hawaiian Home Administration Account and the Native Hawaiian Rehabilitation Fund) are deposited into this fund. In essence, the fund is to serve as a clearing account. At the end of each quarter, all monies in this fund may be transferred to the Hawaiian Home Operating Fund, the Hawaiian Home Administration Account, the Hawaiian Home Trust Fund, the Hawaiian Home Loan Fund, or the Hawaiian Home General Loan Fund as authorized by the Commission or in accordance with the formula in rules adopted by the department, if the Commission does not act on transfers.

Monies of this fund are disbursed to other funds that are used exclusively for specific purposes. Technically, as a clearing account, this is not a "special fund" since it does not have a special object or purpose. It would be inappropriate to levy an assessment on a temporary holding account.

### Hawaiian Home Trust Fund

Except for gifts, bequests, and other moneys given for designated purposes, monies deposited into this fund are available for transfers into any other fund or account authorized by the Act or for any public purpose to further the purposes of the Act. Public purpose includes using the Hawaiian Home Trust Fund as a reserve for loans insured or guaranteed by the FHA, VA, or any other federal agency authorized to insure or guarantee loans. A deposit in the amount of \$850,000 is held in the Hawaiian Home Trust Fund as a reserve for loans insured by FHA.

This is a trust fund and not a special fund, particularly when gifts, bequests, and other moneys given for designated purposes are deposited in this fund.

### Native Hawaiian Rehabilitation Fund

Thirty percent of the state receipts, derived from lands cultivated and previously cultivated as sugar-cane lands and from water licenses, are deposited into this fund which was established by the 1978 State Constitutional Amendment. The money is to be used for "the purposes enumerated" in Section 213 of the HHCA. Section 213(i) states in pertinent part:

"(i) Native Hawaiian rehabilitation fund. Pursuant to Article XII, Section 1, of the State Constitution, thirty per cent of the state receipts, derived from lands previously cultivated as sugarcane lands under any other



provision of law and from water licenses, shall be deposited into this fund. The department shall use this money solely for the rehabilitation of native Hawaiians which shall include, but not be limited to, the educational, economic, political, social, and cultural processes by which the general welfare and conditions of native Hawaiian are thereby improved and perpetuated.

Any payment of principal, interest, or other earnings arising out of the loan or investment of money from this fund shall be credited to and deposited into this fund." (Emphasis added)

### Conclusion

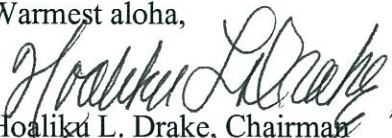
Prior to statehood no assessment was made on DHHL funds. It is only since 1964 that the assessment was imposed, first, on the Hawaiian Home Administration Account.

The DHHL strongly believes that any assessment on DHHL's funds: (1) would violate provisions of the HHCA, the Admission Act, and the Hawaii State Constitution; (2) are inappropriate in light of the fact that DHHL funds are assets of the Hawaiian Home Lands Trust, can be used only in the interest of beneficiaries of the Trust, and are not special funds as defined by HRS Section 36-62; and, (3) would contradict the intent of the drafters of the 1978 constitutional amendments to ensure that sufficient State General Funds are made available to DHHL to relieve it of its reliance on generating income to cover administrative and operating costs.

Your draft report fails to mention that HRS Section 36-31(a) provides that if any transfer to the General Fund would result in the loss of Federal funds, or would be in violation of the Constitution or any law of the United States, the Governor shall issue an Executive Order suspending the application of HRS Sections 36-27, 36-29, and 36-30 to the special fund affected, in whole or in part. The DHHL has requested that an Executive Order be issued.

We would be pleased to provide any further information you may require or to meet with you and your staff to discuss the reasons why DHHL has not paid the assessment.

Warmest aloha,

  
Hoalika L. Drake, Chairman  
Hawaiian Homes Commission