



*State of Hawaii  
Department of  
Transportation—  
Highways Division*

*Financial Statements as of and for the  
Years Ended June 30, 2005 and 2004,  
and Independent Auditors' Report*

*Submitted by  
The Auditor  
State of Hawaii*

**STATE OF HAWAII  
DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION**

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## INDEPENDENT AUDITORS' REPORT

The Auditor  
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Highways Division, Department of Transportation, State of Hawaii ("Highways Division"), as of June 30, 2005 and 2004 and for the years then ended, listed in the foregoing table of contents. These financial statements are the responsibility of the Highways Division's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Highways Division's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Highways Division at June 30, 2005 and 2004, and the respective changes in financial position and the respective budgetary comparison for the State Highway Fund for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the financial statements of the Highways Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Highways Division. They do not purport to, and do not, present the financial position of the State of Hawaii as of June 30, 2005 and 2004, and the changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 4 through 11 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Highways Division's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated March 17, 2006 on our consideration of the Highways Division's internal control over financial reporting and on our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche LLP*

March 17, 2006

# STATE OF HAWAII

## DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

### MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEAR ENDED JUNE 30, 2005

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The following Management's Discussion and Analysis ("MD&A") of the Highways Division, Department of Transportation, State of Hawaii ("Highways Division") activities and financial performance provides the reader with an introduction and overview to the financial statements of the Highways Division for the year ended June 30, 2005. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Territorial Highway Department was created by the Territorial Legislature on April 24, 1925 by Act 78 to qualify Hawaii for participation in the Federal-Aid Program. The purpose of the Federal-Aid Program was to ensure the development of an integrated network of highways in the United States. Congress defined that the Federal government would provide the funds for construction on a matching contribution basis while the State or its political subdivisions would administer the highway.

The Department of Transportation was created in 1959 by the Hawaii State Government Reorganization Act. In creating the new department, the legislature transferred the responsibilities of the old Highway Department to the Highways Division of the new Department of Transportation.

The mission of the Highways Division is to facilitate the rapid, safe, and economical movement of people and goods within the State by providing, maintaining, and operating land transportation facilities and support services. The major goals of the Highways Division are to plan, design, construct, and maintain highway facilities. In addition, the Highways Division, together with the Statewide Transportation Planning Office, implements innovative and diverse approaches to congestion management to increase the efficiency of the transportation system.

The Highways Division is managed by the Highways Division Administrator. Each island in the system is managed by a district manager with the exception of the Maui District, which includes the islands of Molokai and Lanai. The Staff Services Office, headed by the Administrative Services Officer, is responsible for personnel, budget, procurement, financial management, method, standards and evaluation functions of the Highways Division. Other major functional operations within the Highways Division include Engineering Services Office, Landscape Services Office, Motor Vehicle Safety Office, Planning Branch, Design Branch, Rights-of-Way Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, and Traffic Branch.

### FINANCIAL HIGHLIGHTS

#### Government-wide Financial Statements

- The assets of the Highways Division exceeded its liabilities at June 30, 2005 by \$5.6 billion. Of this amount, \$354 million is considered unrestricted and may be used to meet the Highways Division's ongoing obligations.
- The current year change in net assets was a decrease of \$67 million. This resulted from an excess of expenses over revenues of \$57 million and a transfer of \$9 million to other State departments for debt

service payments on general obligation bonds. The excess of expenses over revenues was significantly impacted by depreciation expense of \$234 million.

#### Governmental Funds Financial Statements

- At June 30, 2005, the Highways Division's Governmental Funds reported a combined ending fund balance of \$395 million. The combined fund balance increased by \$47 million from the prior year's ending fund balance. Approximately \$62 million of the total fund balance is considered unreserved at June 30, 2005.
- The Highways Division's State Highway Fund, the major operating fund, reported an ending fund balance of \$266 million, of which \$158 million is considered unreserved. There was a \$28 million increase in fund balance for the year ended June 30, 2005.

### OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Highways Division's basic financial statements. The Highways Division's basic financial statements consist of three sections: 1) government-wide financial statements, 2) Governmental Funds financial statements, 3) notes to the financial statements. These sections are described below:

#### Government-wide Financial Statements

The government-wide statements report information about the Highways Division as a whole in a manner similar to private-sector business. The statements provide both long-term and short-term information about the Highways Division's overall financial status. They are prepared using the economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses connected with the fiscal year, regardless of when cash is received or paid. The government-wide financial statements include the following two statements:

1. The *Statement of Net Assets* presents all of the Highways Division's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Highways Division's net assets are an indicator of whether its financial health is improving or deteriorating.
2. The *Statement of Activities* presents information showing how the Highways Division's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods.

The Highways Division's activities are considered governmental activities, and are primarily funded by taxes, charges for services, and intergovernmental revenues.

The government-wide financial statements can be found to the right of the "Adjustments" column, immediately following the Governmental Funds financial statements on pages 12 to 21 of this report.

## **Governmental Funds Financial Statements**

A *fund* is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Highways Division, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the Highways Division are considered Governmental Funds.

The Governmental Funds financial statements focus on near-term inflows and outflows of *spendable resources*, as well as on the *balances of spendable resources* available at the end of the fiscal year. Governmental Funds financial statements are prepared using the current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Highways Division's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Highways Division.

Because the focus of Governmental Funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for Governmental Funds with similar information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Highways Division's near-term financing decisions. A reconciliation to facilitate this comparison between Governmental Funds financial statements and government-wide financial statements is included on pages 38 through 40 of this report (see Note 11).

The Highways Division has three Governmental Funds, all of which are considered major funds for presentation purposes. That is, each major fund is presented in a separate column in the Governmental Funds balance sheet and in the Governmental Funds statement of revenues, expenditures, and changes in fund balances. The Highways Division's three Governmental Funds are the State Highway Fund (a Special Revenue Fund), the Debt Service Fund, and the Capital Projects Fund.

The basic Governmental Funds financial statements can be found to the left of the "Adjustments" column of the government-wide financial statements on pages 12 through 21 of this report.

### **Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis)**

The Governmental Funds financial statements are followed by a budgetary comparison statement, which compares the State Highway Fund's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual State Highway Fund revenues and expenditures compared to the State Highway Fund revenues and expenditures prepared for budgetary purposes is included in Note 3 to the financial statements.

The Statement of Revenues and Expenditures—Budget and Actual—State Highway Fund (Non-GAAP Budgetary Basis) can be found on pages 22 and 23 of this report.

## **Notes to the Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the Governmental Funds financial statements. The notes to the financial statements can be found on pages 24 through 44 of this report.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Highways Division's financial position. The Highways Division's assets exceeded liabilities by \$5.6 billion and \$5.7 billion at June 30, 2005 and 2004, respectively.

	2005	2004
<b>ASSETS</b>		
Current and other assets	\$ 458,567,338	\$ 404,275,851
Capital assets—net	<u>5,558,496,473</u>	<u>5,620,354,262</u>
Total assets	<u>\$6,017,063,811</u>	<u>\$6,024,630,113</u>
<b>LIABILITIES</b>		
Current liabilities	\$ 60,260,477	\$ 54,539,487
Long-term liabilities	<u>324,462,472</u>	<u>271,133,762</u>
Total liabilities	<u>384,722,949</u>	<u>325,673,249</u>
<b>NET ASSETS</b>		
Invested in capital assets—net of related debt	5,266,333,666	5,323,200,439
Restricted	11,800,000	11,385,000
Unrestricted	<u>354,207,196</u>	<u>364,371,425</u>
Total net assets	<u>5,632,340,862</u>	<u>5,698,956,864</u>
Total liabilities and net assets	<u>\$6,017,063,811</u>	<u>\$6,024,630,113</u>

The largest portion of the Highways Division's net assets (94 percent and 93 percent at June 30, 2005 and 2004, respectively) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Highways Division's net assets (0.2 percent at June 30, 2005 and 2004) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for payment of the Highways Division's revenue bond debt service. The remaining balance of unrestricted net assets may be used to meet the Highways Division's on-going obligations to citizens and creditors.



## Statement of Activities

The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the Highways Division's net assets changed during the year.

	2005	2004
<b>EXPENSES</b>		
Program expenses:		
Operations and maintenance	\$ 109,483,520	\$ 109,198,974
Administration of Highways Division	28,738,899	13,362,525
Surcharge on gross receipts	7,734,341	7,332,555
Motor Vehicle Safety Office	8,173,097	6,236,527
Capital projects	11,308,652	12,663,523
Depreciation expense	233,759,033	229,478,789
Debt service/interest expense	<u>13,038,937</u>	<u>12,743,501</u>
Total expenses	<u>412,236,479</u>	<u>391,016,394</u>
<b>REVENUES</b>		
Program revenues:		
Charges for services	25,500,311	23,574,730
Operating grants and contributions	65,301,185	50,278,694
Capital grants and contributions	<u>100,179,383</u>	<u>37,394,223</u>
Total program revenues	<u>190,980,879</u>	<u>111,247,647</u>
General revenues:		
Taxes	154,872,126	149,837,470
Interest income	8,780,995	8,570,235
Other	<u>279,232</u>	<u>1,742,870</u>
Total general revenues	<u>163,932,353</u>	<u>160,150,575</u>
Total revenues	<u>354,913,232</u>	<u>271,398,222</u>
DECREASE IN NET ASSETS BEFORE TRANSFERS	(57,323,247)	(119,618,172)
TRANSFERS	<u>(9,292,755)</u>	<u>(10,987,493)</u>
DECREASE IN NET ASSETS	(66,616,002)	(130,605,665)
NET ASSETS—Beginning of year	<u>5,698,956,864</u>	<u>5,829,562,529</u>
NET ASSETS—End of year	<u>\$5,632,340,862</u>	<u>\$5,698,956,864</u>

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 54 percent and 41 percent of total revenues in fiscal years 2005 and 2004, respectively. The largest components of program revenues (87 and 79 percent for fiscal years 2005 and 2004, respectively) resulted from operating and capital grants and contributions from the Federal Highway Administration for the maintenance and construction of roads and other infrastructure.

Revenues not classified as program revenues are considered general revenues and comprise primarily taxes and interest earnings. Taxes represented 94 percent of general revenues for both fiscal years 2005 and 2004.

The fiscal year 2005 decrease in net assets of \$67 million resulted from the excess of expenses over revenues of \$57 million due primarily to depreciation expense of \$234 million and a transfer out of \$9 million to other State departments for the payment of debt service on general obligation bonds.

## **FINANCIAL ANALYSIS OF THE HIGHWAYS DIVISION'S GOVERNMENTAL FUNDS**

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

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

At June 30, 2005, the Highways Division's Governmental Funds reported combined ending fund balances of \$395 million, representing an increase of \$47 million from the prior year. Approximately \$62 million of this amount constitutes *unreserved fund balance*, which is available for spending in the coming year. The remainder of fund balance is *reserved* to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

The *State Highway Fund* ("SHF") is the major operating fund of the Highways Division. The State imposes taxes, fees, and charges relating to the operation and use of motor vehicles on the public highways of the State. These funds are deposited into the State Highway Fund established under Section 248-8, HRS. Monies deposited in the SHF are used for acquisition, planning, design, construction, operation, repair, and maintenance of the State Highway System.

The current taxes, fees, and charges deposited to the SHF consist of: (1) the highway fuel taxes; (2) vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees, and charges accounted for most of the receipts of the State Highway Fund. Other sources of revenues include interest earnings on monies previously credited to the SHF, vehicle weight tax penalties, certain rental income from State Highway System properties, passenger motor vehicle inspection charges, overweight permits, sales of surplus lands, commercial license fees, and other miscellaneous revenues.

At June 30, 2005, the total fund balance of the SHF was \$266 million, of which \$158 million was unreserved. As a measure of the SHF's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures (including transfers out). Unreserved fund balance represents 70 percent of total fund expenditures (including transfers out), while total fund balance represents 118 percent of the same amount.

The fund balance of the Highways Division's SHF increased by \$28 million in the current year as compared to a \$13 million increase in the prior year. During the current year, the Highways Division collected more revenues but also expended more for operations and maintenance.

The *Debt Service Fund* ("DSF") is used to track the revenue bond debt service for the Highways Division. Debt service requirements are transferred from the State Highway Fund. Debt service expense increased slightly from \$24.5 million in fiscal year 2004 to \$24.8 million in fiscal year 2005. The increase resulted from

a decrease in current year principal and interest payments, offset by \$1.4 million in additional funds the Highways Division paid for the refunding bond issuance.

The *Capital Projects Fund* (“CPF”) accounts for the Highways Division’s capital improvements program. At June 30, 2005, the CPF had a total fund balance of \$129 million, including an unreserved fund deficit of \$96 million. The fund balance of the CPF increased by \$19 million in fiscal year 2005 as compared to a decrease of \$15.8 million in the prior year. The change from the prior year was due primarily to the issuance of \$60 million in revenue bonds in fiscal year 2005 to fund new projects.

## **STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS**

The final amended State Highway Fund budget had total appropriations of approximately \$3.6 million more than the original budget. The total original appropriations were \$182.2 million, while the final appropriations were \$185.8 million. The increase in budgeted revenues was the result of higher expected interest income. The actual revenues on a budgetary basis were \$4.6 million higher than the final budget, primarily due to an increase in vehicle weight taxes.

Expenditures on the budgetary actual basis were \$7.8 million lower than the final budgeted amounts. The difference was due primarily to significant repairs and maintenance work that was budgeted being deferred into future periods.

## **CAPITAL ASSET AND DEBT ADMINISTRATION**

### **Capital Assets**

The Highways Division’s investment in capital assets as of June 30, 2005 amounts to \$5.558 billion, net of accumulated depreciation of \$3.247 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During fiscal 2005, the Highways Division put out 116 projects to bid with a contract amount of approximately \$168 million. There were 72 projects on Oahu, 16 projects on Hawaii, 14 projects on Maui, (includes Molokai and Lanai), and 14 projects on Kauai.

At June 30, 2005, the Highways Division had \$224 million in contracts encumbered in the Capital Projects Fund. Such amount represents some projects still in the in-house planning stage, and some contracts awarded in fiscal year 2005, with construction expected to start in fiscal year 2006.

Additional information on the Highways Division’s capital assets can be found in Note 7 to the attached financial statements.

### **Long-Term Debt**

As of June 30, 2005, \$310 million in Highway Revenue Bonds were outstanding, compared to \$257 million as of June 30, 2004. The increase in bonds payable was primarily the result of the issuance of \$184 million in Series 2005 A and B bonds. \$60 million in Series A bonds were issued to fund capital projects. \$124 million in Series B bonds were issued to refund \$129 million in bonds outstanding, to take advantage of favorable interest rates, and to reduce future debt service.

See Note 9 for additional information on Highway Revenue Bonds.

As of June 30, 2005, \$95 million in State of Hawaii General Obligation Bonds were outstanding, compared to \$104 million as of June 30, 2004. These bonds are considered general obligations of the State, and not the Highways Division. Accordingly, no amounts are recorded by the Highways Division for these liabilities. The Highways Division makes debt service payments to repay principal and interest on these amounts. The payments for the fiscal year ended June 30, 2005 amounted to \$9 million, and the amount was recorded as an other financing use and transfer out in the financial statements.

See Note 10 for further information on general obligation bonds.

The Highways Division's revenue bond rating by Moody's Investors Service, Inc., Standard & Poor's Corporation, and Fitch IBCA, Inc. are "Aa3," "AA," and "AA-," respectively.

Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies, and assumptions of its own. There is no assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward, suspended, or withdrawn entirely by the rating agencies if, in the judgment of such rating agencies, circumstances so warrant. The State undertakes no responsibility to oppose any such revision, suspension, or withdrawal.

Additional information on the Highways Division's long-term debt can be found in Note 9 to the attached financial statements.

#### **REQUEST FOR INFORMATION**

This financial report is designed to provide a general overview of the Highways Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Gerald Dang, Administrative Services Officer, State of Hawaii, Department of Transportation, Highways Division, 869 Punchbowl Street, Honolulu, Hawaii, 96813.

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS  
AS OF JUNE 30, 2005**

ASSETS	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
Cash with Director of Finance, State of Hawaii	\$ 247,208,957	\$ -	\$ 164,051,058	\$ 411,260,015	\$ -	\$ 411,260,015
Receivables—net of allowance for doubtful accounts:						
Due from U.S. Government (Note 5)	7,759,124		5,131,351	12,890,475	72,672	12,963,147
Due from Capital Projects Fund	21,770,974			21,770,974	(21,770,974)	
Due from City and Counties	5,931,767			5,931,767		5,931,767
Prepaid expenses	1,818,933		1,106,150	2,925,083		2,925,083
Restricted cash:						
Revenue bond debt service (Note 9)		17,307,241		17,307,241		17,307,241
Security deposits	5,232,620			5,232,620		5,232,620
Bond issue costs—net of accumulated amortization (Note 9)				-	1,915,565	1,915,565
Other assets				-	1,031,900	1,031,900
Capital assets—net of accumulated depreciation (Note 7)				-	5,558,496,473	5,558,496,473
<b>TOTAL ASSETS</b>	<u>\$ 289,722,375</u>	<u>\$ 17,307,241</u>	<u>\$ 170,288,559</u>	<u>\$ 477,318,175</u>	<u>\$ 5,539,745,636</u>	<u>\$ 6,017,063,811</u>

(Continued)

# STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

## GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS AS OF JUNE 30, 2005

LIABILITIES AND FUND BALANCES / NET ASSETS	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
LIABILITIES:						
Accounts payable	\$ 3,137,241	\$ -	\$ 2,176,398	\$ 5,313,639	\$ -	\$ 5,313,639
Accrued payroll	2,907,198			2,907,198		2,907,198
Contracts payable:						
Current portion	8,082,375		10,915,540	18,997,915		18,997,915
Retained percentage	3,542,498		6,454,278	9,996,776		9,996,776
Payable from restricted assets:						
Matured bonds and interest payable (Notes 8 and 9)		17,307,241		17,307,241		17,307,241
Security deposits	5,232,620			5,232,620		5,232,620
Due to State Highway Fund			21,770,974	21,770,974	(21,770,974)	
Other liabilities	505,088			505,088		505,088
Long-term liabilities (Note 8):						
Due within one year:						
Workers' compensation payable (Note 16)				-	1,130,606	1,130,606
Accrued vacation payable				-	2,431,861	2,431,861
Due after one year:						
Workers' compensation payable (Note 16)				-	3,500,441	3,500,441
Accrued vacation payable				-	7,656,575	7,656,575
Revenue bonds payable (Notes 8 and 9)				-	309,742,989	309,742,989
Total liabilities	23,407,020	17,307,241	41,317,190	82,031,451	302,691,498	384,722,949
FUND BALANCES / NET ASSETS (Note 11):						
Fund Balances:						
Reserved for encumbrances	106,252,170		223,764,724	330,016,894	(330,016,894)	
Reserved for prepaid expenses	1,818,933		1,106,150	2,925,083	(2,925,083)	
Unreserved, reported in State Highway Fund	158,244,252			158,244,252	(158,244,252)	
Unreserved, reported in Capital Projects Fund (Note 18)			(95,899,505)	(95,899,505)	95,899,505	
Total fund balances	266,315,355		128,971,369	395,286,724	(395,286,724)	
Net Assets:						
Invested in capital assets—net of related debt				-	5,266,333,666	5,266,333,666
Restricted for revenue bonds				-	11,800,000	11,800,000
Unrestricted				-	354,207,196	354,207,196
Total net assets					5,632,340,862	5,632,340,862
<b>TOTAL LIABILITIES AND FUND BALANCES / NET ASSETS</b>	<b>\$ 289,722,375</b>	<b>\$ 17,307,241</b>	<b>\$ 170,288,559</b>	<b>\$ 477,318,175</b>	<b>\$ 5,539,745,636</b>	<b>\$ 6,017,063,811</b>

See notes to financial statements.

(Concluded)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS  
AS OF JUNE 30, 2004**

ASSETS	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
Cash with Director of Finance, State of Hawaii	\$ 225,668,403	\$ -	\$ 131,055,275	\$ 356,723,678	\$ -	\$ 356,723,678
Receivables—net of allowance for doubtful accounts:						
Due from U.S. Government (Note 5)	8,680,294		4,801,238	13,481,532	72,672	13,554,204
Due from Capital Projects Fund	12,363,332			12,363,332	(12,363,332)	-
Due from City and Counties	5,386,574			5,386,574		5,386,574
Land parcels held for sale	57,300			57,300		57,300
Prepaid expenses	1,622,664		2,109,848	3,732,512		3,732,512
Restricted cash:						
Revenue bond debt service (Note 9)		18,191,464		18,191,464		18,191,464
Security deposits	5,349,027			5,349,027		5,349,027
Bond issue costs—net of accumulated amortization (Note 9)				-	910,253	910,253
Other assets				-	370,839	370,839
Capital assets—net of accumulated depreciation (Note 7)				-	5,620,354,262	5,620,354,262
<b>TOTAL</b>	<u>\$ 259,127,594</u>	<u>\$ 18,191,464</u>	<u>\$ 137,966,361</u>	<u>\$ 415,285,419</u>	<u>\$ 5,609,344,694</u>	<u>\$ 6,024,630,113</u>

(Continued)

# STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

## GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS AS OF JUNE 30, 2004

LIABILITIES AND FUND BALANCES / NET ASSETS	Governmental Funds				Adjustments (Note 11)	Government-wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total		
<b>LIABILITIES:</b>						
Accounts payable	\$ 2,012,280	\$ -	\$ 190,693	\$ 2,202,973	\$ -	\$ 2,202,973
Accrued payroll	2,419,263			2,419,263		2,419,263
Contracts payable:						
Current portion	7,168,390		7,479,184	14,647,574		14,647,574
Retained percentage	3,022,244		7,648,331	10,670,575		10,670,575
Payable from restricted assets:						
Matured bonds and interest payable (Notes 8 and 9)		18,191,464		18,191,464		18,191,464
Security deposits	5,349,027			5,349,027		5,349,027
Due to State Highway Fund			12,363,332	12,363,332	(12,363,332)	
Other liabilities	1,058,611			1,058,611		1,058,611
Long-term liabilities (Note 8):						
Due within one year:						
Workers' compensation payable (Note 16)				-	1,330,124	1,330,124
Accrued vacation payable				-	2,702,086	2,702,086
Due after one year:						
Workers' compensation payable (Note 16)				-	3,300,923	3,300,923
Accrued vacation payable				-	6,477,792	6,477,792
Revenue bonds payable (Notes 8 and 9)				-	257,322,837	257,322,837
Total liabilities	<u>21,029,815</u>	<u>18,191,464</u>	<u>27,681,540</u>	<u>66,902,819</u>	<u>258,770,430</u>	<u>325,673,249</u>
<b>FUND BALANCES / NET ASSETS (Note 11):</b>						
Fund Balances:						
Reserved for encumbrances	105,667,081		222,457,348	328,124,429	(328,124,429)	
Reserved for prepaid expenses	1,622,664		2,109,848	3,732,512	(3,732,512)	
Reserved for land parcels held for sale	57,300			57,300	(57,300)	
Unreserved, reported in State Highway Fund	130,750,734			130,750,734	(130,750,734)	
Unreserved, reported in Capital Projects Fund (Note 18)			(114,282,375)	(114,282,375)	114,282,375	
Total fund balances	<u>238,097,779</u>		<u>110,284,821</u>	<u>348,382,600</u>	<u>(348,382,600)</u>	
Net Assets:						
Invested in capital assets, net of related debt					5,323,200,439	5,323,200,439
Restricted for revenue bonds					11,385,000	11,385,000
Unrestricted					364,371,425	364,371,425
Total net assets					<u>5,698,956,864</u>	<u>5,698,956,864</u>
<b>TOTAL LIABILITIES AND FUND BALANCES / NET ASSETS</b>	<u>\$ 259,127,594</u>	<u>\$ 18,191,464</u>	<u>\$ 137,966,361</u>	<u>\$ 415,285,419</u>	<u>\$ 5,609,344,694</u>	<u>\$ 6,024,630,113</u>

See notes to financial statements.

(Concluded)



**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2005**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
EXPENDITURES / EXPENSES:						
Operations and maintenance:						
Oahu highways and services	\$ 65,208,126	\$ -	\$ -	\$ 65,208,126	\$ (22,463,730)	\$ 42,744,396
Hawaii highways and services	19,511,693			19,511,693	(1,213,732)	18,297,961
Maui highways and services	10,743,083			10,743,083		10,743,083
Kauai highways and services	7,402,342			7,402,342	(15,368)	7,386,974
Molokai highways and services	990,339			990,339		990,339
Lanai highways and services	2,792,048			2,792,048		2,792,048
Pass through for County highways and services	26,528,719			26,528,719		26,528,719
Administration of Highways Division	26,420,075			26,420,075	2,318,824	28,738,899
Surcharge on gross receipts (Note 13)	7,734,341			7,734,341		7,734,341
Motor Vehicle Safety Office	8,173,097			8,173,097		8,173,097
Capital projects			162,593,705	162,593,705	(151,285,053)	11,308,652
Depreciation expense				-	233,759,033	233,759,033
Debt service:						
Principal payment (Note 9)		11,800,000		11,800,000	(11,800,000)	-
Interest expense (Note 9)		13,043,150		13,043,150	(4,213)	13,038,937
Total expenditures / expenses	<u>175,503,863</u>	<u>24,843,150</u>	<u>162,593,705</u>	<u>362,940,718</u>	<u>49,295,761</u>	<u>412,236,479</u>
PROGRAM REVENUES:						
Charges for services:						
Vehicle registration fees (Note 4)	20,626,282			20,626,282		20,626,282
Other fees and permits (Note 4)	3,004,636			3,004,636		3,004,636
Penalties and fines (Note 4)	1,196,311			1,196,311		1,196,311
Rentals	673,082			673,082		673,082
Operating grants and contributions (Note 5)	65,301,185			65,301,185		65,301,185
Capital grants and contributions (Note 5)			100,179,383	100,179,383		100,179,383
Total program revenues	<u>90,801,496</u>		<u>100,179,383</u>	<u>190,980,879</u>		<u>190,980,879</u>
NET PROGRAM EXPENSE (Forward)	<u>(84,702,367)</u>	<u>(24,843,150)</u>	<u>(62,414,322)</u>	<u>(171,959,839)</u>	<u>(49,295,761)</u>	<u>(221,255,600)</u>

(Continued)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2005**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
NET PROGRAM EXPENSE (Forwarded)	\$ (84,702,367)	\$ (24,843,150)	\$ (62,414,322)	\$ (171,959,839)	\$ (49,295,761)	\$ (221,255,600)
GENERAL REVENUES:						
Taxes (Note 4):						
Fuel taxes	80,913,323			80,913,323		80,913,323
Rental motor and tour vehicle surcharge taxes	43,949,575			43,949,575		43,949,575
Vehicle weight taxes	30,009,228			30,009,228		30,009,228
Interest income	8,780,995			8,780,995		8,780,995
Non-imposed fringe benefits (Note 6)	279,232			279,232		279,232
Total general revenues	163,932,353			163,932,353		163,932,353
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	79,229,986	(24,843,150)	(62,414,322)	(8,027,486)	(49,295,761)	(57,323,247)
OTHER FINANCING SOURCES (USES) (Note 10):						
Transfers in		24,843,150	218,947,872	243,791,022	(243,791,022)	-
Transfers out	(51,012,410)		(137,847,002)	(188,859,412)	188,859,412	-
Total other financing sources (uses)	(51,012,410)	24,843,150	81,100,870	54,931,610	(54,931,610)	-
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES (Note 11)	28,217,576	-	18,686,548	46,904,124	(104,227,371)	(57,323,247)
TRANSFERS OUT (Note 10)					(9,292,755)	(9,292,755)
CHANGE IN NET ASSETS (Note 11) (Forward)					(113,520,126)	(66,616,002)

(Continued)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2005**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
CHANGE IN NET ASSETS (Forwarded)					\$ (113,520,126)	\$ (66,616,002)
FUND BALANCES / NET ASSETS:						
Beginning of year	<u>238,097,779</u>	<u>                    </u>	<u>110,284,821</u>	<u>348,382,600</u>	<u>5,350,574,264</u>	<u>5,698,956,864</u>
End of year	<u>\$ 266,315,355</u>	<u>\$ -</u>	<u>\$ 128,971,369</u>	<u>\$ 395,286,724</u>	<u>\$ 5,237,054,138</u>	<u>\$ 5,632,340,862</u>

See notes to financial statements.

(Concluded)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2004**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
<b>EXPENDITURES / EXPENSES:</b>						
Operations and maintenance:						
Oahu highways and services	\$ 52,397,959	\$ -	\$ -	\$ 52,397,959	\$ (6,274,149)	\$ 46,123,810
Hawaii highways and services	21,929,361			21,929,361	(44,661)	21,884,700
Maui highways and services	9,084,490			9,084,490	(1,840)	9,082,650
Kauai highways and services	10,909,179			10,909,179	(602,587)	10,306,592
Molokai highways and services	778,236			778,236		778,236
Lanai highways and services	722,164			722,164		722,164
Pass through for County highways and services	20,300,822			20,300,822		20,300,822
Administration of Highways Division	22,768,226			22,768,226	(9,405,701)	13,362,525
Surcharge on gross receipts (Note 13)	7,332,555			7,332,555		7,332,555
Motor Vehicle Safety Office	6,236,527			6,236,527		6,236,527
Capital projects			86,449,226	86,449,226	(73,785,703)	12,663,523
Depreciation expense				-	229,478,789	229,478,789
Debt service:						
Principal payment (Note 9)		11,385,000		11,385,000	(11,385,000)	-
Interest expense (Note 9)		13,149,808		13,149,808	(406,307)	12,743,501
Total expenditures / expenses	<u>152,459,519</u>	<u>24,534,808</u>	<u>86,449,226</u>	<u>263,443,553</u>	<u>127,572,841</u>	<u>391,016,394</u>
<b>PROGRAM REVENUES:</b>						
Charges for services:						
Vehicle registration fees (Note 4)	19,688,218			19,688,218		19,688,218
Other fees and permits (Note 4)	2,002,899			2,002,899		2,002,899
Penalties and fines (Note 4)	1,081,897			1,081,897		1,081,897
Rentals	801,716			801,716		801,716
Operating grants and contributions (Note 5)	50,206,022			50,206,022	72,672	50,278,694
Capital grants and contributions (Note 5)			37,394,223	37,394,223		37,394,223
Total program revenues	<u>73,780,752</u>		<u>37,394,223</u>	<u>111,174,975</u>	<u>72,672</u>	<u>111,247,647</u>
NET PROGRAM EXPENSE (Forward)	<u>(78,678,767)</u>	<u>(24,534,808)</u>	<u>(49,055,003)</u>	<u>(152,268,578)</u>	<u>(127,500,169)</u>	<u>(279,768,747)</u>

(Continued)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2004**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
NET PROGRAM EXPENSE (Forwarded)	\$ (78,678,767)	\$ (24,534,808)	\$ (49,055,003)	\$ (152,268,578)	\$ (127,500,169)	\$ (279,768,747)
GENERAL REVENUES:						
Taxes (Note 4):						
Fuel taxes	79,606,595			79,606,595		79,606,595
Rental motor and tour vehicle surcharge taxes	41,413,782			41,413,782		41,413,782
Vehicle weight taxes	28,817,093			28,817,093		28,817,093
Interest income	8,570,235			8,570,235		8,570,235
Gain on sale of capital assets				-	1,621,422	1,621,422
Non-imposed fringe benefits (Note 6)	79,648			79,648		79,648
Other	41,800			41,800		41,800
Total general revenues	158,529,153			158,529,153	1,621,422	160,150,575
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	79,850,386	(24,534,808)	(49,055,003)	6,260,575	(125,878,747)	(119,618,172)
OTHER FINANCING SOURCES (USES) (Note 10):						
Transfers in	1,978,000	24,534,808	33,304,958	59,817,766	(59,817,766)	-
Transfers out	(68,827,259)			(68,827,259)	68,827,259	-
Total other financing sources (uses)	(66,849,259)	24,534,808	33,304,958	(9,009,493)	9,009,493	-
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES (Note 11)	13,001,127	-	(15,750,045)	(2,748,918)	(116,869,254)	(119,618,172)
TRANSFERS OUT (Note 10)					(10,987,493)	(10,987,493)
CHANGE IN NET ASSETS (Note 11) (Forward)					(127,856,747)	(130,605,665)

(Continued)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2004**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
CHANGE IN NET ASSETS (Forwarded)					\$ (127,856,747)	\$ (130,605,665)
FUND BALANCES / NET ASSETS:						
Beginning of year	<u>225,096,652</u>	<u>                    </u>	<u>126,034,866</u>	<u>351,131,518</u>	<u>5,478,431,011</u>	<u>5,829,562,529</u>
End of year	<u>\$ 238,097,779</u>	<u>\$ -</u>	<u>\$ 110,284,821</u>	<u>\$ 348,382,600</u>	<u>\$ 5,350,574,264</u>	<u>\$ 5,698,956,864</u>

See notes to financial statements.

(Concluded)

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES AND EXPENDITURES—  
BUDGET AND ACTUAL—STATE HIGHWAY FUND (NON-GAAP BUDGETARY BASIS)  
FOR THE YEAR ENDED JUNE 30, 2005**

	<b>Original Budget</b>	<b>Final Budget</b>	<b>Budgetary Actual</b>	<b>Variance</b>
<b>REVENUES:</b>				
Fuel taxes	\$ 80,402,661	\$ 80,800,694	\$ 80,913,323	\$ 112,629
Vehicle weight taxes	27,666,622	27,803,585	30,828,052	3,024,467
Rental motor and tour vehicle surcharge tax	42,242,058	42,034,988	43,949,575	1,914,587
Vehicle registration fees	19,365,679	19,461,549	20,237,728	776,179
Interest income	8,600,000	11,900,000	8,780,763	(3,119,237)
Enforcement fee	1,357,136	1,357,136	1,719,832	362,696
Vehicle registration penalties	1,144,936	1,043,744	1,034,091	(9,653)
Commercial drivers license fee	350,634	350,634	437,106	86,472
Rentals	850,000	850,000	673,082	(176,918)
Other	224,000	211,200	1,864,367	1,653,167
<b>Total revenues</b>	<b>182,203,726</b>	<b>185,813,530</b>	<b>190,437,919</b>	<b>4,624,389</b>
<b>EXPENDITURES:</b>				
Operations and maintenance:				
Oahu highways and services	43,535,244	44,035,244	42,275,790	1,759,454
Hawaii highways and services	19,415,583	19,415,583	17,812,519	1,603,064
Maui highways and services	15,121,304	14,994,588	14,647,129	347,459
Kauai highways and services	10,840,562	10,700,557	9,263,324	1,437,233
Molokai highways and services	3,621,281	3,367,905	2,913,156	454,749
Lanai highways and services	295,413	496,540	403,492	93,048
Administration of Highways Division including debt service (Note 10)	63,079,449	48,356,093	45,241,347	3,114,746
State of Hawaii surcharge on gross receipts	6,019,250	6,019,250	7,734,341	(1,715,091)
Motor Vehicle Safety Office	7,237,771	7,009,045	6,327,650	681,395
<b>Total expenditures</b>	<b>169,165,857</b>	<b>154,394,805</b>	<b>146,618,748</b>	<b>7,776,057</b>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	<b>\$ 13,037,869</b>	<b>\$ 31,418,725</b>	<b>\$ 43,819,171</b>	<b>\$ 12,400,446</b>

See notes to financial statements.

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION,  
HIGHWAYS DIVISION**

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES AND EXPENDITURES—  
BUDGET AND ACTUAL—STATE HIGHWAY FUND (NON-GAAP BUDGETARY BASIS)  
FOR THE YEAR ENDED JUNE 30, 2004**

	Original Budget	Final Budget	Budgetary Actual	Variance
<b>REVENUES:</b>				
Fuel taxes	\$ 74,617,223	\$ 74,557,721	\$ 79,606,595	\$ 5,048,874
Vehicle weight taxes	25,696,751	26,461,279	27,392,695	931,416
Rental motor and tour vehicle surcharge tax	38,401,573	38,401,573	41,413,782	3,012,209
Vehicle registration fees	18,206,189	18,424,710	19,173,940	749,230
Interest income	12,900,000	12,900,000	8,569,226	(4,330,774)
Enforcement fee	1,461,014	1,461,014	1,231,247	(229,767)
Vehicle registration penalties	1,202,475	1,098,763	1,028,320	(70,443)
Commercial drivers license fee	333,937	244,454	189,002	(55,452)
Rentals	850,000	850,000	801,716	(48,284)
Other	<u>2,675,000</u>	<u>2,625,000</u>	<u>6,434,703</u>	<u>3,809,703</u>
 Total revenues	 <u>176,344,162</u>	 <u>177,024,514</u>	 <u>185,841,226</u>	 <u>8,816,712</u>
<b>EXPENDITURES:</b>				
Operations and maintenance:				
Oahu highways and services	44,368,085	44,368,085	40,674,569	3,693,516
Hawaii highways and services	19,238,820	19,238,820	16,285,941	2,952,879
Maui highways and services	14,931,134	14,231,451	14,025,155	206,296
Kauai highways and services	11,214,239	11,214,239	11,219,489	(5,250)
Molokai highways and services	1,007,378	1,274,818	808,475	466,343
Lanai highways and services	3,497,446	3,230,006	3,203,059	26,947
Administration of Highways Division including debt service (Note 10)	61,160,646	50,131,283	44,960,889	5,170,394
State of Hawaii surcharge on gross receipts	5,699,695	6,078,065	8,180,494	(2,102,429)
Motor Vehicle Safety Office	<u>7,378,563</u>	<u>7,205,197</u>	<u>4,554,219</u>	<u>2,650,978</u>
 Total expenditures	 <u>168,496,006</u>	 <u>156,971,964</u>	 <u>143,912,290</u>	 <u>13,059,674</u>
 EXCESS OF REVENUES OVER EXPENDITURES	 <u>\$ 7,848,156</u>	 <u>\$ 20,052,550</u>	 <u>\$ 41,928,936</u>	 <u>\$ 21,876,386</u>

See notes to financial statements.



# STATE OF HAWAII

## DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

### NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

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#### 1. REPORTING ENTITY

Act 1, Session Laws of Hawaii (“SLH”), Second Special Session 1959, the Hawaii State Government Reorganization Act of 1959 (“Act”), established the Department of Transportation (“Department”) whose function is to establish, maintain, and operate transportation facilities of the State of Hawaii (“State”), including highways, airports, harbors, and such other transportation facilities and activities as may be authorized by law. The Department’s activities are carried out through three primary operating divisions: Airports, Harbors, and Highways (“Highways Division”). Through the Highways Division, the Department has general supervision of the management and maintenance of the State Highways System and the location, design, and construction of new highways and facilities. The Highways Division provides supervision to assure completion of State highway contracts in accordance with plans and specifications.

Taxes, fees, and charges authorized and collected relating to the operation and use of motor vehicles on public highways of the State are deposited into the State Highway Fund, and expenditures for purposes of the Act are made from the State Highway Fund.

The State Highway Fund also includes the Motor Vehicle Safety Office (“MVSO”). MVSO was originally established as the Highway Safety Coordinator’s Office to implement the 1967 Hawaii Highway Safety Act. It was reorganized by the 1977 State Legislature to encompass the additional duty of the safety of operations of heavy motor vehicles. The MVSO is assigned as a staff office under the Highways Division.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Financial Statement Presentation***—The Highways Division’s financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (“GASB”) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

***Governmental Funds Financial Statements***—The accounts of the Highways Division are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures. Governmental resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. For financial reporting purposes, the Highways Division includes all funds that are controlled by or dependent on the Highways Division’s administrative head. Control by or dependence on the Highways Division was determined on the basis of statutory authority and monies flowing through the Highways Division to each fund or account.

Governmental Funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Highways Division considers all revenues reported in the Governmental Funds to be

available if the revenues are collected within 90 days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditures in Governmental Funds. Proceeds of general long-term debt are reported as other financing sources.

A description of the funds administered by the Highways Division and included in the Governmental Funds financial statements follows:

**State Highway Fund:** The State Highway Fund generally accounts for revenues and expenditures for highway operations and maintenance and administration.

The State Highway Fund is a special revenue fund of the State established by Section 248-8, Hawaii Revised Statutes (“HRS”). All fuel taxes collected under Section 243-4, HRS except county fuel taxes, aviation fuel taxes, and taxes on fuel sold for use by small boats are deposited in the State Highway Fund.

Section 248-9, HRS provides that monies in the State Highway Fund shall be expendable by the Department of Transportation for the design, construction, reconstruction, repair and maintenance, and for acquisition of rights-of-way for public highways included in the State Highways System established under Section 264-41, HRS.

**Debt Service Fund:** The Debt Service Fund accounts for the Highways Division’s financial resources obtained and used for the payment of principal and interest on State of Hawaii Highway Revenue Bonds.

**Capital Projects Fund:** The Capital Projects Fund accounts for the Highways Division’s construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts (SLH) through June 30, 2005.

**Government-wide Financial Statements**—The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. The effect of interfund activity has been removed from these financial statements.

**Statement of Net Assets:** The statement of net assets includes all capital assets and long-term liabilities that are excluded from the Governmental Funds financial statements. The net assets are reported in three categories: invested in capital assets, net of related debt; restricted; and unrestricted.

**Statement of Activities:** The statement of activities reports expenses and revenues in a format that focuses on the cost of the Highways Division’s program. Revenues are classified as either program revenues or general revenues. Program revenues include charges paid by users, as well as capital or operating grants. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

**Cash**—Cash reported in the balance sheet/statement of net assets includes cash in the State Treasury, including deposits received and held for others in the amount of \$5,232,620 and \$5,349,027 at June 30,

2005 and 2004, respectively. (The deposits were received on the Highways Division's contracts with third parties.)

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

At June 30, 2005 and 2004, cash in the State Treasury consisted of cash deposited in approximately 20 bank accounts, time certificates of deposit, money market accounts, repurchase agreements, and U.S. Government securities with original maturities of three months or less. Information relating to the bank balances, insurance, and collateral of cash deposits was not available since such information is determined on a statewide basis, and not for individual departments or divisions.

Bank deposits of the State are covered by federal deposit insurance or by collateral held either by the State Treasury or by the State's fiscal agent in the name of the State. For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on the daily available bank balances to limit its exposure to custodial credit risk (the risk that in the event of a bank failure, the State's deposits may not be returned to it.) The use of daily available bank balances to determine collateral requirements results in the available balances being undercollateralized at various times during the year.

**Receivables**—Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the credit worthiness of the tenants and others doing business with the Highways Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected.

**Prepaid Expenses**—Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses in both Governmental Funds and government-wide financial statements.

**Restricted Assets**—Restricted assets consist of monies and other resources, the use of which is legally restricted. Restricted assets account for the principal and interest amounts accumulated to make debt service payments on the Highways Division's revenue bonds and also include security deposits from third parties.

**Capital Assets**—Capital assets, which include land and improvements, buildings and improvements, vehicles and equipment, infrastructure (i.e., roads, bridges, tunnels), and construction in progress, are reported in the government-wide statement of net assets. Such assets are recorded at cost or at estimated fair market value at the date of donation. Capital outlays are recorded as expenditures of the State Highway Fund or Capital Projects Fund in the Governmental Funds and as assets in the government-wide statement of net assets to the extent the capitalization threshold is met. Capital assets are depreciated by the straight-line method over their estimated useful lives as follows:

<b>Class of Assets</b>	<b>Estimated Useful Lives</b>	<b>Capitalization Threshold</b>
Land improvements	20 years	\$100,000
Buildings	45 years	100,000
Building improvements	20 years	100,000
Vehicles and equipment	5-10 years	5,000
Infrastructure	13-46 years	100,000

Disposals of assets are recorded by removing the costs and related accumulated depreciation from the accounts with a resulting gain or loss.

Repairs and maintenance, and minor replacements, renewals, and betterments are charged against operations. Major replacements, renewals, and betterments are capitalized.

**Accrued Vacation and Compensatory Pay**—The Highways Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences, in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 or 96 hours per calendar year, depending on the date of hire. Accumulation of such vacation is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment.

**Long-Term Obligations**—In the government-wide statement of net assets, long-term debt and other long-term obligations are reported as liabilities. Bond premiums, issuance costs, and loss on refunding are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium and loss on refunding. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the Governmental Funds financial statements, bond premiums and issuance costs are recognized during the current period. The face amount of debt and any related premium are reported as other financing sources. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

**Encumbrances**—The Highways Division’s accounting procedures provide for the recording of commitments as encumbrances at the time contracts are awarded and executed. Purchase orders issued for materials, supplies, and services chargeable to annual appropriations for operating costs, which are outstanding at the end of the year, are also encumbered. Encumbrances are recorded as a reservation of fund balance in the Governmental Funds balance sheet. The related expenditure is reported in the period in which the liability is incurred. Encumbrances are not recognized in the government-wide statement of net assets.

**Employees’ Retirement System**—The Highways Division’s contributions to the Employees’ Retirement System of the State of Hawaii (“ERS”) are based on the current contribution rate determined by the State

Department of Budget and Finance. The Highways Division's policy is to fund its required contribution each pay period.

**Risk Management**—The Highways Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The Highways Division is self-insured for workers' compensation as discussed in Note 16. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

**Use of Estimates**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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.

**New Accounting Pronouncements**—In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The Highways Division adopted this Statement effective July 1, 2004. This Statement did not have a significant impact on the financial statements.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. Statement No. 42 establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The Highways Division will adopt this Statement effective July 1, 2005. Management believes that the adoption of this Statement will not have a significant impact on the financial statements.

In July 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*. Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits, expenditures, and related liabilities. The Highways Division will adopt this Statement effective July 1, 2007. Management has not yet completed its analysis of the impact that the implementation of this Statement will have on the financial statements.

### **3. BUDGETS AND BUDGETARY ACCOUNTING**

**State Highway Fund**—In the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis), amounts reflected as original and amended budgeted revenues are the official estimates as compiled by the State Department of Budget and Finance at the time of budget consideration and adoption by the State Legislature. Revenues received from federal grants-in-aid are not included in the statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis) since such grants are normally reimbursements of costs incurred on approved projects.

In the case of expenditures, the original and amended budgeted amounts reflected on the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 2004 (Act 41, SLH 2004)—authorizations for expenditures for operating purposes for the Highways Division (\$161,928,086) and the MVS0 (\$7,237,771).

Appropriations are made and expenditures are controlled at the program level reflected in the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis). State Highway Fund appropriations lapse at year-end.

With reference to the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis), budget and actual amounts for expenditures include encumbrances and exclude expenditures charged to prior years' appropriations and unbudgeted federally funded expenditures.

The reconciliation of the budgetary actual excess of revenues over expenditures as shown on the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis) to the Governmental Funds statement of revenues, expenditures, and changes in fund balances—State Highway Fund is as follows:

	2005	2004
Excess of revenues over expenditures, non-GAAP budgetary basis	\$ 43,819,171	\$ 41,928,936
Federal grants-in-aid	65,301,185	50,206,022
Operating transfers out to State of Hawaii for debt service	9,292,755	10,987,493
Pass through expenditures for county projects	(26,528,719)	(20,300,822)
Other adjustments to modified accrual basis of accounting	<u>(12,654,406)</u>	<u>(2,971,243)</u>
Excess of revenues over expenditures, GAAP basis	<u>\$ 79,229,986</u>	<u>\$ 79,850,386</u>

**Capital Projects Fund**—Excess Capital Projects Fund appropriations lapse after completion of the project, which is generally two or three years subsequent to appropriation. Funds appropriated as part of a qualified federal award program do not lapse.

#### 4. TAX AND FEE REVENUES

**State Fuel Tax**—The primary source of revenues for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For the years ended June 30, 2005 and 2004, the tax imposed on each gallon of fuel was as follows:

Gasoline	16 cents
Diesel Fuel:	
Non-highway use	1 cent
Highway use	16 cents
Liquefied Petroleum Gas:	
Non-highway use	1 cent
Highway use	11 cents

**Vehicle Weight Tax and Penalties**—The vehicle weight tax was 0.75-1.25 cent per pound of net vehicle weight (depending upon the weight of the vehicle) to a maximum of \$150 per vehicle.

**Rental Motor Vehicle Surcharge Tax**—The rental motor vehicle surcharge tax was \$3 a day or any portion of a day that a rental motor vehicle is rented or leased.

**Vehicle Registration Fee**—The vehicle registration fee was increased from \$20 to \$25 per vehicle pursuant to Act 158 SLH 2004. The incremental \$5 is earmarked for deposit into the Emergency Medical Services (“EMS”) special fund. During the year ended June 30, 2005, the Highways Division collected \$3,599,470. All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2005.

**Tour Vehicle Surcharge Tax**—The tour vehicle surcharge tax was \$65 a month for tour vehicles categorized by the Public Utilities Commission as an over seventeen-passenger carrier vehicle and \$15 a month for tour vehicles categorized as an eight to seventeen-passenger carrier vehicle.

**Other Taxes and Fees**—The motor carrier safety inspection fee was \$1.50 per vehicle every six months.

## **5. FEDERAL GRANTS-IN-AID**

The Highways Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration (“FHWA”) through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2005 and 2004, the receivable from the U.S. Government is comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement. At June 30, 2005 and 2004, expenditures of approximately \$5,300,000 and \$4,484,000, respectively, were not recorded as receivables and as federal grants-in-aid revenue, pending qualification for reimbursement by the Highways Division. In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO’s matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Costs reimbursement by the FHWA and National Highway Traffic Safety Administration (“NHTSA”) are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Highways Division for economy, efficiency, and program results. The Highways Division’s management believes that any federal aid received as of June 30, 2005 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Highways Division at June 30, 2005, or the results of operations of such funds for the year then ended.

## **6. NON-IMPOSED FRINGE BENEFITS**

Payroll fringe benefit costs of employees of the Highways Divisions are assumed by the State and are not charged to the Highways Division operating funds. These costs totaling \$279,232 and \$79,648 for fiscal years 2005 and 2004, respectively, have been reported as revenues and expenditures.

## 7. CAPITAL ASSETS

Changes in capital assets during the years ended June 30, 2005 and 2004 were as follows:

	Balance July 1, 2004	Additions	Deductions	Transfers	Balance June 30, 2005
<b>Capital assets not being depreciated:</b>					
Land	\$ 419,887,997	\$ 1,291,559	\$ -	\$ -	\$ 421,179,556
Construction in progress	167,763,635	167,829,458		(191,021,884)	144,571,209
Infrastructure	<u>687,375,625</u>	<u>                    </u>		<u>24,825,138</u>	<u>712,200,763</u>
Total	<u>1,275,027,257</u>	<u>169,121,017</u>		<u>(166,196,746)</u>	<u>1,277,951,528</u>
<b>Capital assets being depreciated:</b>					
Land improvements	2,215,473				2,215,473
Buildings and improvements	12,884,560			8,880,985	21,765,545
Vehicles and equipment	45,512,549	2,780,227	(1,119,167)		47,173,609
Infrastructure	<u>7,298,786,355</u>	<u>                    </u>	<u>                    </u>	<u>157,315,761</u>	<u>7,456,102,116</u>
Total	7,359,398,937	2,780,227	(1,119,167)	166,196,746	7,527,256,743
Less accumulated depreciation	<u>(3,014,071,932)</u>	<u>(233,759,033)</u>	<u>1,119,167</u>	<u>                    </u>	<u>(3,246,711,798)</u>
Capital assets being depreciated—net	<u>4,345,327,005</u>	<u>(230,978,806)</u>	<u>-</u>	<u>166,196,746</u>	<u>4,280,544,945</u>
Total capital assets	<u>\$ 5,620,354,262</u>	<u>\$ (61,857,789)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,558,496,473</u>



	(As Restated) Balance July 1, 2003	Additions	Deductions	Transfers	Balance June 30, 2004
<b>Capital assets not being depreciated:</b>					
Land	\$ 419,229,647	\$ 658,350	\$ -	\$ -	\$ 419,887,997
Construction in progress	166,574,746	86,098,944		(84,910,055)	167,763,635
Infrastructure	<u>675,570,142</u>			<u>11,805,483</u>	<u>687,375,625</u>
Total	<u>1,261,374,535</u>	<u>86,757,294</u>		<u>(73,104,572)</u>	<u>1,275,027,257</u>
<b>Capital assets being depreciated:</b>					
Land improvements	2,062,485	152,988			2,215,473
Buildings and improvements	12,353,920	530,640			12,884,560
Vehicles and equipment	43,308,123	3,986,194	(1,781,768)		45,512,549
Infrastructure	<u>7,225,681,783</u>			<u>73,104,572</u>	<u>7,298,786,355</u>
Total	7,283,406,311	4,669,822	(1,781,768)	73,104,572	7,359,398,937
Less accumulated depreciation	<u>(2,786,018,333)</u>	<u>(229,478,789)</u>	<u>1,425,190</u>		<u>(3,014,071,932)</u>
Capital assets being depreciated—net	<u>4,497,387,978</u>	<u>(224,808,967)</u>	<u>(356,578)</u>	<u>73,104,572</u>	<u>4,345,327,005</u>
Total capital assets	<u>\$ 5,758,762,513</u>	<u>\$(138,051,673)</u>	<u>\$ (356,578)</u>	<u>\$ -</u>	<u>\$ 5,620,354,262</u>

## 8. GENERAL LONG-TERM LIABILITIES

Changes in general long-term liabilities during the years ended June 30, 2005 and 2004 were as follows:

	Balance June 30, 2004	Increase	Decrease	Balance June 30, 2005	Due Within One Year	Due After One Year
Accrued workers' compensation	\$ 4,631,047	\$ 1,130,606	\$ (1,130,606)	\$ 4,631,047	\$ 1,130,606	\$ 3,500,441
Accrued vacation	9,179,878	3,815,937	(2,907,379)	10,088,436	2,431,861	7,656,575
Revenue bonds	<u>268,707,837</u>	<u>194,632,168</u>	<u>(141,797,016)</u>	<u>321,542,989</u>	<u>11,800,000</u>	<u>309,742,989</u>
	<u>\$ 282,518,762</u>	<u>\$ 199,578,711</u>	<u>\$(145,835,001)</u>	<u>\$ 336,262,472</u>	<u>\$ 15,362,467</u>	<u>\$ 320,900,005</u>

	Balance June 30, 2003	Increase	Decrease	Balance June 30, 2004	Due Within One Year	Due After One Year
Accrued workers' compensation	\$ 4,631,047	\$ 1,036,959	\$ (1,036,959)	\$ 4,631,047	\$ 1,330,124	\$ 3,300,923
Accrued vacation	9,376,158	2,824,942	(3,021,222)	9,179,878	2,702,086	6,477,792
Revenue bonds	<u>279,749,144</u>	<u>                    </u>	<u>(11,041,307)</u>	<u>268,707,837</u>	<u>11,385,000</u>	<u>257,322,837</u>
	<u>\$ 293,756,349</u>	<u>\$ 3,861,901</u>	<u>\$ (15,099,488)</u>	<u>\$ 282,518,762</u>	<u>\$ 15,417,210</u>	<u>\$ 267,101,552</u>

## 9. REVENUE BONDS

In 1993, the Director issued the *Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Highway Revenue Bonds* ("Certificate"). Subsequent issues of revenue bonds were covered by supplemental certificates to the original 1993 Certificate.

These revenue bonds are payable solely from, and collateralized solely by, the revenues held in the State Highway Fund consisting primarily of highway fuel taxes, vehicle registration fees, vehicle weight taxes, rental motor vehicle and tour vehicle surcharge taxes, and interest earnings on monies previously credited to the State Highway Fund. The proceeds of the revenue Bonds are used to finance certain highway capital improvement projects and other related projects for the State Highways System.

On September 1, 1996, the Highways Division issued \$55,000,000 in State of Hawaii Highway Revenue Bonds, Series 1996 ("1996 Bonds"). The 1996 Bonds bear interest at rates ranging from 3.8% to 6.0% and mature in increasing annual installments through 2016. The 1996 Bonds maturing on and after July 1, 2006 are subject to redemption at the option of the State at prices ranging from 102% to 100% plus accrued interest.

On July 1, 1998, the Highways Division issued \$94,920,000 in State of Hawaii Highway Revenue Bonds, Series 1998 ("1998 Bonds"). The 1998 Bonds bear interest at rates ranging from 4.0% to 5.5% and mature in annual installments through 2018. The 1998 Bonds maturing on and after July 1, 2009 through July 1, 2016 are subject to redemption at the option of the State on and after July 1, 2008 at prices ranging from 101% to 100% plus accrued interest.

On October 1, 2000, the Highways Division issued \$50,000,000 in State of Hawaii Highway Revenue Bonds, Series 2000 ("2000 Bonds"). The 2000 Bonds bear interest at rates ranging from 4.4% to 5.5% and mature in annual installments through 2020. The 2000 Bonds maturing on and after July 1, 2011 through July 1, 2020 are subject to redemption at the option of the State after July 1, 2010 at a price of 100% plus accrued interest.

On October 3, 2001, the Highways Division issued \$70,000,000 in State of Hawaii Highway Revenue Bonds, Series 2001 ("2001 Bonds"). The 2001 Bonds bear interest at rates ranging from 3.8% to 5.4% and mature in annual installments through 2022. The 2001 Bonds maturing on and after July 11, 2011 are subject to redemption at the option of the State at a redemption of 100% plus accrued interest. These bonds were issued at a premium of \$2,787,593, which will be amortized over the life of the bonds using the effective interest method.

On April 15, 2003, the Highways Division issued \$44,940,000 in State of Hawaii Highway Revenue Bonds, Series 2003 ("Refunding Series of 2003") with interest rates ranging from 2.00% to 5.25% to refund \$45,350,000 of its outstanding 1993 Bonds with interest rates ranging from 2.6% to 5.0%. The net proceeds of \$46,749,377 (after payment of \$452,013 in underwriting fees, insurance, and other costs), along with an additional \$519,500 from the Highways Revenue Fund were deposited in an

irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the 1993 Bonds. On July 1, 2003, the refunded bonds were redeemed at a price of 102%. As a result, the refunded portion of the 1993 Bonds is considered to be defeased and the liability for those bonds has been removed from the financial statements.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$1,399,377. This difference, reported in the accompanying financial statements as a deduction from Highways revenue bonds, is being charged to operations over the next 21 years. The Highways Division in effect reduced its aggregate debt service payments by approximately \$4,165,000 over the next 21 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$3,687,000.

On February 20, 2005, the Highways Division issued \$60,000,000 in State of Hawaii Revenue Bonds Series A (“2005A Bonds”). The 2005A Bonds bear interest at rates ranging from 3.0% to 5.0% and mature in annual installments through 2025. The 2005A Bonds maturing on and after July 1, 2016 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of \$3,155,926, which will be amortized over the life of the bonds using the effective interest method.

On February 20, 2005, the Highways Division issued \$123,915,000 in State of Hawaii Revenue Bonds Series B (“Refunding Series 2005B”) with interest rates ranging from 3.0% to 5.25% to refund \$128,705,000 of outstanding bonds (“refunded bonds”) with interest rates ranging from 4.95% to 5.6% comprised of the following:

<b>Series</b>	<b>Interest Rate</b>	<b>Principal Refunded</b>
1996	5.25% - 5.6%	\$26,135,000
1998	5.0% - 5.25%	30,275,000
2000	4.95% - 5.5%	31,340,000
2001	5.25% - 5.375%	40,955,000

The net proceeds of \$137,847,002 (after payment of \$1,581,758 in underwriting fees, insurance, and other costs), along with an additional \$1,401,015 from the Highways Revenue Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the refunded bonds. As a result, the refunded portion of the bonds is considered to be defeased and the liability for those portions of the bonds has been removed from the financial statements.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$7,439,199. This difference, reported in the accompanying financial statements as a deduction from Highways revenue bonds, is being charged to operations over the next 17 years. The Highways Division in effect reduced its aggregate debt service payments by approximately \$12,042,000 over the next 17 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$8,944,000.

The following is a summary of highways system revenue bonds issued and outstanding at June 30, 2005:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1996	6.00%	2010	\$ 55,000,000	\$ 8,500,000
1998	4.5% - 5.5%	2018	94,920,000	38,920,000
2000	4.4% - 5.5%	2020	50,000,000	12,515,000
2001	3.8% - 5.4%	2022	70,000,000	24,490,000
2003	2.0% - 5.25%	2014	44,940,000	41,065,000
2005	3.0% - 5.25%	2026	<u>183,915,000</u>	<u>183,915,000</u>
			<u>\$498,775,000</u>	309,405,000
			Add unamortized premium	19,666,835
			Less deferred loss on defeasance	(7,528,846)
			Less current portion	<u>(11,800,000)</u>
			Noncurrent portion	<u>\$309,742,989</u>

The approximate maturities for revenue bonds, including interest of \$139,686,488 (debt service fund of \$5,507,241 and general long-term debt of \$134,179,247) in each of the next five years and thereafter are as follows:

Years Ending June 30	Principal	Interest	Total
2006	\$ 11,800,000	\$ 12,555,200	\$ 24,355,200
2007	14,295,000	13,825,383	28,120,383
2008	14,885,000	13,242,227	28,127,227
2009	15,495,000	12,597,053	28,092,053
2010	16,150,000	11,880,394	28,030,394
2011-2015	92,260,000	47,846,844	140,106,844
2016-2020	102,760,000	22,882,556	125,642,556
2021-2025	37,290,000	4,756,256	42,046,256
2026	<u>4,470,000</u>	<u>100,575</u>	<u>4,570,575</u>
Total	<u>\$ 309,405,000</u>	<u>\$ 139,686,488</u>	<u>\$ 449,091,488</u>

In 2005, \$25,074,710 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of \$11,800,000 and interest of \$13,274,704.

## 10. OTHER FINANCING SOURCES AND USES / TRANSFERS

Operating transfers, accounted for in the Governmental Funds statement of revenues, expenditures, and changes in fund balances as other financing sources and uses, and on the government-wide statement of net assets as transfers, are summarized as follows:

Description	Transfers In (Out)				Adjustments	Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total		
<b>2005</b>						
Funding of highway capital projects	\$ (16,876,505)	\$ -	\$ 16,876,505	\$ -	\$ -	\$ -
Proceeds from issuance of revenue bonds			183,915,000	183,915,000	(183,915,000)	-
Premiums from issuance of revenue bonds			18,156,367	18,156,367	(18,156,367)	-
Payments to refunded bond escrow agent			(137,847,002)	(137,847,002)	137,847,002	-
Reimbursement to State for debt service on general obligation bonds	(9,292,755)			(9,292,755)		(9,292,755)
Funding of revenue bond debt service	(24,843,150)	24,843,150		-		-
Gain on sale of property				-		-
	<u>\$ (51,012,410)</u>	<u>\$ 24,843,150</u>	<u>\$ 81,100,870</u>	<u>\$ 54,931,610</u>	<u>\$ (64,224,365)</u>	<u>\$ (9,292,755)</u>
<b>2004</b>						
Funding of highway capital projects	\$ (33,304,958)	\$ -	\$ 33,304,958	\$ -	\$ -	\$ -
Reimbursement to State for debt service on general obligation bonds	(10,987,493)			(10,987,493)		(10,987,493)
Funding of revenue bond debt service	(24,534,808)	24,534,808		-		-
Gain on sale of property	1,978,000			1,978,000	(1,978,000)	-
	<u>\$ (66,849,259)</u>	<u>\$ 24,534,808</u>	<u>\$ 33,304,958</u>	<u>\$ (9,009,493)</u>	<u>\$ (1,978,000)</u>	<u>\$ (10,987,493)</u>

### Funding of Highway Capital Projects

Funding of highway capital projects by the State Highway Fund is recognized when received by the Capital Projects Fund.

### Reimbursement to State for Debt Service

Allocated portions of the State's general obligation bonds have been designated by the Director of Finance, State of Hawaii, to be reimbursed from the State Highway Fund. The proceeds from these bonds are related to the above funds transferred from the State to the Highways Division for highway capital projects. These bonds are the obligations of the State and are not included in these financial statements. The amount of the Highways Division's reimbursement to the State for debt service is primarily determined by the Director of Finance, State of Hawaii.

The annual amounts required to amortize the designated portions of general obligation bonds as of June 30, 2005 are as follows:

<b>Years Ending June 30</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2006	\$ 13,413,344	\$ 3,626,333	\$ 17,039,677
2007	14,202,572	3,167,796	17,370,368
2008	14,413,816	2,483,310	16,897,126
2009	11,294,925	1,786,968	13,081,893
2010	6,720,599	1,325,388	8,045,987
2011-2015	29,499,475	2,410,300	31,909,775
2016-2020	5,113,405	156,008	5,269,413
2021	<u>2,674</u>	<u>134</u>	<u>2,808</u>
Total	<u>\$94,660,810</u>	<u>\$ 14,956,237</u>	<u>\$ 109,617,047</u>

Debt service reimbursements are accounted for as expenditures of the “Administration of Highways Division” program on the Governmental Funds statement of revenues and expenditures—budget and actual—State Highway Fund (non-GAAP budgetary basis) and are accounted for as “Operating transfers out” of the State Highway Fund on the Governmental Funds statement of revenues, expenditures, and changes in fund balances. Reimbursement payments consisted of \$5,081,794 and \$6,292,045 for principal and \$4,210,961 and \$4,695,448 for interest for the years ended June 30, 2005 and 2004, respectively.

**11. RECONCILIATIONS OF GOVERNMENTAL FUNDS AND GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The following schedule reconciles the Governmental Funds fund balances to the government-wide net assets at June 30, 2005 and 2004:

	2005	2004
Total Governmental Funds fund balances	\$ 395,286,724	\$ 348,382,600
Amounts reported as net assets for government-wide reporting are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the Governmental Funds financial statements.	5,558,496,473	5,620,354,262
Bond issuance costs and losses related to bond refunding are recorded as expenditures in Governmental Funds financial statements when the costs are first incurred. However, in the government-wide financial statements, such amounts are recorded as a deferred charge and amortized over the life of the related bonds.	1,915,565	1,863,637
Long-term liabilities are not due and payable in the current period and therefore are not reported in the Governmental Funds financial statements:		
Accrued vacation	(10,088,436)	(9,179,878)
Accrued workers' compensation	(4,631,047)	(4,631,047)
Revenue bonds payable	(309,742,989)	(258,276,221)
Revenues and the related receivables from government contracts are recorded on the modified accrual basis for Governmental Funds financial statements and on the accrual basis for government-wide financial statements.	72,672	72,672
Deposits made with the court for parcels of land in condemnation proceedings do not provide current financial resources and therefore are not reported in the fund financial statements.	<u>1,031,900</u>	<u>370,839</u>
Total government-wide net assets	<u>\$5,632,340,862</u>	<u>\$5,698,956,864</u>

The following schedule reconciles the Governmental Funds change in fund balances to the government-wide change in net assets:

	<b>2005</b>	<b>2004</b>
Governmental Funds change in fund balances	\$ 46,904,124	\$ (2,748,918)
Amounts reported for governmental activities in the statement of net assets are different because:		
Governmental Funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This amount includes the adjustment for capital outlay of \$168,747,864 and \$90,194,582, offset by depreciation expense of \$233,759,033 and \$229,478,789 in 2005 and 2004.	(65,011,169)	(139,284,207)
Repayment of bond principal is reported as an expenditure in the Governmental Funds, but the repayment reduces long-term liabilities in the statement of net assets.	11,800,000	11,385,000
Bond proceeds provide current financial resources and are recorded as other financing sources in the Governmental Funds. However, issuing debt and the related original issue premium increases long-term liabilities in the statement of net assets. This amount includes premiums of \$18,156,367 in 2005, offset by amortization expense of \$867,950 and \$823,813 in 2005 and 2004.	(201,203,417)	823,813
Payments made to defease bonds use current financial resources and are recorded as other financing uses in the Governmental Funds. However, these payments decrease long-term liabilities recorded in the statement of net assets. The loss on refunding is deferred and amortized over the life of the bond. The amounts include a deferred loss of \$7,439,199 in 2005, offset by amortization expense of \$863,737 and \$417,506 in 2005 and 2004.	136,983,265	(417,506)
Bond issue costs are reported as expenditures in the governmental funds as they require the use of current financial resources. However, in the statement of activities, these expenses are deferred and amortized to expense over the remaining life of the related bond. This amount includes bond issue costs of \$1,581,758, offset by amortization expense of \$576,446 and \$276,015 in 2005 and 2004.	<u>1,005,312</u>	<u>(276,015)</u>
Subtotal (Forwarded)	(69,521,885)	(130,517,833)

(Continued)



	2005	2004
Subtotal (Forwarded)	\$ (69,521,885)	\$(130,517,833)
Government Funds report the full amount of the proceeds from the sale of capital assets as revenues. However, in the statement of activities, a gain or loss from the disposal of capital assets is reported only to the extent of the difference between the selling price and the carrying value of the asset disposed.		(356,578)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in Governmental Funds.		72,672
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in Governmental Funds.	<u>2,905,883</u>	<u>196,074</u>
Government-wide change in net assets	<u>\$ (66,616,002)</u>	<u>\$(130,605,665)</u>
		(Concluded)

## 12. PENSION INFORMATION

### Employees' Retirement System ("ERS")

All full-time employees of the Highways Division are eligible to participate in the ERS, a cost-sharing multiple-employer public employee retirement system established to administer a pension benefit program for all state and county employees. The ERS was established by Chapter 88 of the HRS and is governed by a Board of Trustees. All contributions, benefits, and eligibility requirements are established by Chapter 88 of the HRS and can be amended by legislative action.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute. In the contributory plan, employees may elect normal retirement at age 55 with five years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by state statute to contribute 7.8% of their salary to the plan; the Highways Division is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early

retirement. The Highways Division is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

The Highways Division's contribution to the ERS for fiscal years 2005, 2004, and 2003 was approximately \$3,578,000, \$3,348,000, and \$3,009,000, respectively, and represented the required contributions for each year. Actual contributions paid by the Highways Division equal contributions required by the ERS.

The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS, 201 Merchant Street, Suite 1400, Honolulu, Hawaii, 96813 or by calling (808) 586-1660.

### **Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits to all qualified employees. For employees hired before July 1, 1996, the Highways Division pays the entire monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than 10 years of credited service. For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the Highways Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Highways Division pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium.

Contributions are based upon negotiated collective bargaining agreements and are limited by state statute to the actual cost of benefit coverage. Such contributions are financed on a pay-as-you-go basis. The amounts allocated to the Highways Division for the fiscal years 2005 and 2004 aggregated approximately \$2,803,000 and \$2,714,000, respectively.

## **13. TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES**

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged, or encumbered, for the payment of bonds and interest during the year. The assessments amounted to approximately \$7,734,000 and \$8,180,000 in fiscal years 2005 and 2004, respectively.

The Highways Division is assessed a percentage of the cost of the general administration expenses of the Department. During fiscal years 2005 and 2004, the assessments amounted to approximately \$5,455,000 and \$4,888,000, respectively. During fiscal years 2005 and 2004, respectively, the Highways Division received assessment refunds from the Department amounting to approximately \$865,000 and \$315,000, resulting in a net general administration expense of approximately \$4,590,000 and \$3,706,000.

## **14. OPERATING LEASES**

### **Rental Expenditures**

The Highways Division leases office and baseyard space under various long-term operating lease agreements expiring at various dates through fiscal year 2019 and beyond. Rental expenditures are

recorded based on the terms of the lease agreements. Scheduled minimum rental payments for succeeding fiscal years ending June 30 are as follows:

<b>Years Ending June 30</b>	
2006	\$ 956,632
2007	956,632
2008	956,632
2009	956,632
2010	956,632
2011-2015	4,783,160
2016-2019	<u>3,188,773</u>
 Total	 <u>\$12,755,093</u>

The total rental expenditures during fiscal years 2005 and 2004 for operating leases were approximately \$1,292,000 and \$1,351,000, respectively.

### **Rental Revenues**

The Highways Division also leases various Highways Division-owned properties under noncancelable long-term lease agreements that expire through fiscal year 2044. Scheduled minimum revenues for succeeding fiscal years ending June 30 are as follows:

<b>Years Ending June 30</b>	
2006	\$ 306,872
2007	306,872
2008	306,872
2009	306,872
2010	306,872
2011-2015	1,534,360
2016-2020	1,486,810
2021-2025	1,375,860
2026-2030	933,860
2031-2035	400,926
2036-2040	376,500
2041-2044	<u>135,625</u>
 Total	 <u>\$7,778,301</u>

## **15. COMMITMENTS**

### **Condemnation Proceedings**

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways Division to compensate the existing property owner for the fair market value of the real property. Prior to the determination of the fair market value, the Highways Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$1,031,900 at June 30, 2005. Such funds

deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Highways Division.

### **Deferred Compensation Plan**

The State established a deferred compensation plan (“plan”) in accordance with Section 457 of the Internal Revenue Code, which enables State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, as well as property and rights purchased with those amounts and income attributable to those amounts, are held in trust by third-party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the plan are not reflected in the State or Highways Division financial statements.

### **Sick Pay**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, a state employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credits in the ERS. Accumulated sick leave at June 30, 2005 aggregated approximately \$21,758,000.

## **16. RISK MANAGEMENT**

### **Property and Liability Insurance**

The State maintains certain insurance coverages to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies.

### **Workers’ Compensation**

The State is self-insured for workers’ compensation. Accordingly, the Highways Division is liable for 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 and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims include the effects of specific incremental claim adjustment expenses, salvage and subrogation, and other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. The workers’ compensation reserve amounted to \$4,631,047 at June 30, 2005.

## **17. CONTINGENT LIABILITIES AND OTHER**

### **Litigation**

The State is the defendant in lawsuits seeking damages allegedly related to State highways and highway construction contracts. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Highways Division's financial position. In addition, the State has not determined whether the ultimate liabilities, if any, will be imposed on the State Highway Fund. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

## **18. DEFICIT BALANCE**

At June 30, 2005, the Capital Projects Fund had an unreserved deficit balance of \$95,899,505. The Highways Division intends to take corrective action to eliminate this deficit balance.

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