

***State of Hawaii  
Department of  
Transportation—  
Highways Division***

*Financial Statements for the Years  
Ended June 30, 2006 and 2005,  
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, 2006 and 2005 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, 2006 and 2005, 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, 2006 and 2005, 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 12 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 February 14, 2007 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*

February 14, 2007

# **STATE OF HAWAII**

## **DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

#### **YEAR ENDED JUNE 30, 2006**

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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, 2006. 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, 2006 by \$5.5 billion. Of this amount, \$368 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 \$134 million. This resulted from an excess of expenses over revenues of \$116 million and a transfer of \$17 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 \$232 million.

#### Governmental Funds Financial Statements

- At June 30, 2006, the Highways Division's Governmental Funds reported a combined ending fund balance of \$372 million. The combined fund balance decreased by \$23 million from the prior year's ending fund balance. Approximately \$3 million of the total fund balance is considered unreserved at June 30, 2006.
- The Highways Division's State Highway Fund, the major operating fund, reported an ending fund balance of \$257 million, of which \$150 million is considered unreserved. There was a \$9 million decrease in fund balance for the year ended June 30, 2006.

### 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 13 to 20 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 37 through 39 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 13 through 20 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 21 and 22 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 23 through 43 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 \$5.5 billion and \$5.6 billion at June 30, 2006 and 2005, respectively.

	2006	2005	2004
<b>ASSETS</b>			
Current and other assets	\$ 437,366,791	\$ 458,567,338	\$ 404,275,851
Capital assets—net	<u>5,434,538,889</u>	<u>5,558,496,473</u>	<u>5,620,354,262</u>
Total assets	<u>\$5,871,905,680</u>	<u>\$6,017,063,811</u>	<u>\$6,024,630,113</u>
<b>LIABILITIES</b>			
Current liabilities	\$ 63,565,416	\$ 60,260,477	\$ 54,539,487
Long-term liabilities	<u>309,502,296</u>	<u>324,462,472</u>	<u>271,133,762</u>
Total liabilities	<u>373,067,712</u>	<u>384,722,949</u>	<u>325,673,249</u>
<b>NET ASSETS</b>			
Invested in capital assets—net of related debt	5,116,016,933	5,266,333,666	5,323,200,439
Restricted	14,295,000	11,800,000	11,385,000
Unrestricted	<u>368,526,035</u>	<u>354,207,196</u>	<u>364,371,425</u>
Total net assets	<u>5,498,837,968</u>	<u>5,632,340,862</u>	<u>5,698,956,864</u>
Total liabilities and net assets	<u>\$5,871,905,680</u>	<u>\$6,017,063,811</u>	<u>\$6,024,630,113</u>

The largest portion of the Highways Division's net assets (93 percent and 94 percent at June 30, 2006 and 2005, respectively) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, infrastructure, and construction in progress), 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 (0.3 percent at June 30, 2006 and 2005) 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.

Capital assets—net decreased by \$124 million from June 30, 2005 to June 30, 2006 and by \$62 million from June 30, 2004 to June 30, 2005 primarily because depreciation expense more than offset additions to construction in progress.



Long-term liabilities decreased by \$15 million from June 30, 2005 to June 30, 2006 primarily due to principal payments on revenue bonds. Long-term liabilities increased from June 30, 2004 to June 30, 2005 by \$53 million primarily due to the issuance of \$184 million of Series 2005 A and B bonds, offset by the redemption of \$129 million of bonds outstanding.

### 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.

	2006	2005	2004
<b>EXPENSES</b>			
Program expenses:			
Operations and maintenance	\$ 143,373,361	\$ 109,483,520	\$ 109,198,974
Administration of Highways Division	25,600,658	28,738,899	13,362,525
Surcharge on gross receipts	7,911,833	7,734,341	7,332,555
Motor Vehicle Safety Office	8,852,745	8,173,097	6,236,527
Capital projects	13,621,234	11,308,652	12,663,523
Depreciation expense	232,285,626	233,759,033	229,478,789
Debt service/interest expense	13,232,173	13,038,937	12,743,501
Total expenses	<u>444,877,630</u>	<u>412,236,479</u>	<u>391,016,394</u>
<b>REVENUES</b>			
Program revenues:			
Charges for services	26,825,112	25,500,311	23,574,730
Operating grants and contributions	43,629,731	65,301,185	50,278,694
Capital grants and contributions	<u>77,405,713</u>	<u>100,179,383</u>	<u>37,394,223</u>
Total program revenues	<u>147,860,556</u>	<u>190,980,879</u>	<u>111,247,647</u>
General revenues:			
Taxes	164,945,006	154,872,126	149,837,470
Interest income	14,191,947	8,780,995	8,570,235
Other	<u>1,416,904</u>	<u>279,232</u>	<u>1,742,870</u>
Total general revenues	<u>180,553,857</u>	<u>163,932,353</u>	<u>160,150,575</u>
Total revenues	<u>328,414,413</u>	<u>354,913,232</u>	<u>271,398,222</u>
DECREASE IN NET ASSETS BEFORE TRANSFERS	(116,463,217)	(57,323,247)	(119,618,172)
TRANSFERS	<u>(17,039,677)</u>	<u>(9,292,755)</u>	<u>(10,987,493)</u>
DECREASE IN NET ASSETS	(133,502,894)	(66,616,002)	(130,605,665)
NET ASSETS—Beginning of year	<u>5,632,340,862</u>	<u>5,698,956,864</u>	<u>5,829,562,529</u>
NET ASSETS—End of year	<u>\$5,498,837,968</u>	<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 45 percent and 54 percent of total revenues in fiscal years 2006 and 2005, respectively. The largest components of program revenues (82 and 87 percent for fiscal years 2006 and 2005, 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 91 percent and 94 percent of general revenues for fiscal years 2006 and 2005, respectively.

The fiscal year 2006 decrease in net assets of \$134 million resulted from the excess of expenses over revenues of \$116 million due primarily to depreciation expense of \$232 million and a transfer out of \$17 million to other State departments for the payment of debt service on general obligation bonds.

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.

The fiscal year 2004 decrease in net assets of \$131 million resulted from the excess of expense over revenues of \$120 million due primarily to depreciation expense of \$229 million and a transfer out of \$11 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, 2006, the Highways Division's Governmental Funds reported combined ending fund balances of \$372 million, representing a decrease of \$24 million from the prior year. Approximately \$3 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.

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*.

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, 2006, the total fund balance of the SHF was \$257 million, of which \$150 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 57 percent of total fund expenditures (including transfers out), while total fund balance represents 98 percent of the same amount.

The fund balance of the Highways Division's SHF decreased by \$9 million in the current year as compared to a \$28 million increase in the prior year. During the current year, the Highways Division collected less revenues and also expended more for operations and maintenance.

At June 30, 2005, the total fund balance of the SHF was \$266 million, of which \$158 million was unreserved. Unreserved fund balance represented 70 percent of total fund expenditures (including transfers out), while total fund balance represented 118 percent of the same amount.

The fund balance of the Highways Division's SHF increased by \$28 million in fiscal year 2005 as compared to a \$13 million increase in fiscal year 2004. During fiscal year 2005, 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 \$24.8 million in fiscal year 2005 to \$28.4 million in fiscal year 2006. 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, 2006, the CPF had a total fund balance of \$114 million, including an unreserved fund deficit of \$147 million. The fund balance of the CPF decreased by \$15 million in fiscal year 2006 as compared to an increase of \$19 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.

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 fiscal year 2004. The change from fiscal year 2004 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 for fiscal year 2006 had total appropriations of approximately \$3.1 million more than the original budget. The total original appropriations were \$189.5 million, while the final appropriations were \$192.6 million. The increase in budgeted revenues was the result of higher expected rental motor and tour vehicle surcharge taxes, offset by lower expected fuel taxes. The actual revenues on a budgetary basis were \$11.6 million higher than the final budget, primarily due to an increase in taxes.

Expenditures on the budgetary actual basis for fiscal year 2006 were \$9.5 million lower than the final budgeted amounts. The difference was due primarily to lower than budgeted administrative expenses, including debt service on general obligation bonds.

The final amended State Highway Fund budget for fiscal year 2005 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 for fiscal year 2005 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, 2006 amounts to \$5.434 billion, net of accumulated depreciation of \$3.477 billion. The Highways Division's investment in capital assets as of June 30, 2005 amounted 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 year 2006, the Highways Division put out 12 projects to bid with a contract amount of approximately \$150 million. There were 5 projects on Oahu, 3 projects on Maui, (includes Molokai and Lanai), and 4 projects on Kauai.

During fiscal year 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, 2006, the Highways Division had \$261 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 2006, with construction expected to start in fiscal year 2007.

At June 30, 2005, the Highways Division had \$224 million in contracts encumbered in the Capital Projects Fund. Such amount represented 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, 2006, \$295 million in Highway Revenue Bonds were outstanding, compared to \$310 million as of June 30, 2005 and \$257 million as of June 30, 2004. The increase in bonds payable from June 30, 2004 to June 30, 2005 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, 2006, \$81 million in State of Hawaii General Obligation Bonds were outstanding, compared to \$95 million as of June 30, 2005 and \$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 years ended June 30, 2006 and 2005 amounted to \$17 million and \$9 million, respectively, and the amounts were 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

JUNE 30, 2006

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	\$ 232,730,274	\$ -	\$ 153,274,797	\$ 386,005,071	\$ -	\$ 386,005,071
Receivables—net of allowance for doubtful accounts:						
Due from U.S. Government (Note 5)	6,698,815		6,883,379	13,582,194		13,582,194
Due from Capital Projects Fund	32,444,617			32,444,617	(32,444,617)	-
Due from City and Counties	6,068,848			6,068,848		6,068,848
Land parcels held for sale	1,408,650			1,408,650		1,408,650
Prepaid expenses	263,451		106,762	370,213		370,213
Restricted cash:						
Revenue bond debt service (Note 9)		21,342,965		21,342,965		21,342,965
Security deposits	6,345,181			6,345,181		6,345,181
Bond issue costs—net of accumulated amortization (Note 9)				-	1,686,069	1,686,069
Other assets				-	557,600	557,600
Capital assets—net of accumulated depreciation (Note 7)				-	5,434,538,889	5,434,538,889
<b>TOTAL ASSETS</b>	<u>\$ 285,959,836</u>	<u>\$ 21,342,965</u>	<u>\$ 160,264,938</u>	<u>\$ 467,567,739</u>	<u>\$ 5,404,337,941</u>	<u>\$ 5,871,905,680</u>

(Continued)

# STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

## GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS AS OF JUNE 30, 2006

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		
LIABILITIES:						
Accounts payable	\$ 3,838,454	\$ -	\$ 3,495,268	\$ 7,333,722	\$ -	\$ 7,333,722
Accrued payroll	3,140,888			3,140,888		3,140,888
Contracts payable:						
Current portion	8,499,924		5,256,074	13,755,998		13,755,998
Retained percentage	3,562,423		4,829,102	8,391,525		8,391,525
Payable from restricted assets:						
Matured bonds and interest payable (Notes 8 and 9)		21,342,965		21,342,965		21,342,965
Security deposits	6,345,181			6,345,181		6,345,181
Due to State Highway Fund			32,444,617	32,444,617	(32,444,617)	-
Other liabilities	3,255,137			3,255,137		3,255,137
Long-term liabilities (Note 8):						
Due within one year:						
Workers' compensation payable (Note 16)				-	752,786	752,786
Accrued vacation payable				-	2,723,276	2,723,276
Due after one year:						
Workers' compensation payable (Note 16)				-	3,878,261	3,878,261
Accrued vacation payable				-	7,563,737	7,563,737
Revenue bonds payable (Notes 8 and 9)				-	294,584,236	294,584,236
Total liabilities	<u>28,642,007</u>	<u>21,342,965</u>	<u>46,025,061</u>	<u>96,010,033</u>	<u>277,057,679</u>	<u>373,067,712</u>
FUND BALANCES / NET ASSETS (Note 11):						
Fund Balances:						
Reserved for encumbrances	105,681,327		261,501,278	367,182,605	(367,182,605)	
Reserved for prepaid expenses	263,451		106,762	370,213	(370,213)	
Reserved for land parcels held for sale	1,408,650			1,408,650	(1,408,650)	
Unreserved, reported in State Highway Fund	149,964,401			149,964,401	(149,964,401)	
Unreserved, reported in Capital Projects Fund (Note 18)			(147,368,163)	(147,368,163)	147,368,163	
Total fund balances	<u>257,317,829</u>		<u>114,239,877</u>	<u>371,557,706</u>	<u>(371,557,706)</u>	
Net Assets:						
Invested in capital assets—net of related debt				-	5,116,016,933	5,116,016,933
Restricted for revenue bonds				-	14,295,000	14,295,000
Unrestricted				-	368,526,035	368,526,035
Total net assets					<u>5,498,837,968</u>	<u>5,498,837,968</u>
TOTAL LIABILITIES AND FUND BALANCES / NET ASSETS	<u>\$ 285,959,836</u>	<u>\$ 21,342,965</u>	<u>\$ 160,264,938</u>	<u>\$ 467,567,739</u>	<u>\$ 5,404,337,941</u>	<u>\$ 5,871,905,680</u>

See notes to financial statements.

(Concluded)

# STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

## GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS

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			Adjustments (Note 11)	Government-wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund		
<b>LIABILITIES:</b>					
Accounts payable	\$ 3,137,241	\$ -	\$ 2,176,398	\$ -	\$ 5,313,639
Accrued payroll	2,907,198				2,907,198
Contracts payable:					
Current portion	8,082,375		10,915,540		18,997,915
Retained percentage	3,542,498		6,454,278		9,996,776
Payable from restricted assets:					
Matured bonds and interest payable (Notes 8 and 9)		17,307,241			17,307,241
Security deposits	5,232,620				5,232,620
Due to State Highway Fund			21,770,974	(21,770,974)	
Other liabilities	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	<u>23,407,020</u>	<u>17,307,241</u>	<u>41,317,190</u>	<u>302,691,498</u>	<u>384,722,949</u>
<b>FUND BALANCES / NET ASSETS (Note 11):</b>					
Fund Balances:					
Reserved for encumbrances	106,252,170		223,764,724	(330,016,894)	
Reserved for prepaid expenses	1,818,933		1,106,150	(2,925,083)	
Unreserved, reported in State Highway Fund	158,244,252			(158,244,252)	
Unreserved, reported in Capital Projects Fund (Note 18)			(95,899,505)	95,899,505	
Total fund balances	<u>266,315,355</u>		<u>128,971,369</u>	<u>(395,286,724)</u>	
<b>Net Assets:</b>					
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				<u>5,632,340,862</u>	<u>5,632,340,862</u>
<b>TOTAL LIABILITIES AND FUND BALANCES / NET ASSETS</b>	<u>\$ 289,722,375</u>	<u>\$ 17,307,241</u>	<u>\$ 170,288,559</u>	<u>\$ 5,539,745,636</u>	<u>\$ 6,017,063,811</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  
YEAR ENDED JUNE 30, 2006**

	<b>Governmental Funds</b>					<b>Government-wide Statement of Activities</b>
	<b>State Highway Fund</b>	<b>Debt Service Fund</b>	<b>Capital Projects Fund</b>	<b>Total</b>	<b>Adjustments (Note 11)</b>	
<b>EXPENDITURES / EXPENSES:</b>						
Operations and maintenance:						
Oahu highways and services	\$ 74,918,495	\$ -	\$ -	\$ 74,918,495	\$ (13,838,716)	\$ 61,079,779
Hawaii highways and services	20,126,032			20,126,032	(148,872)	19,977,160
Maui highways and services	14,042,501			14,042,501		14,042,501
Kauai highways and services	9,730,420			9,730,420	(8,579)	9,721,841
Molokai highways and services	1,900,350			1,900,350		1,900,350
Lanai highways and services	1,097,581			1,097,581		1,097,581
Pass through for County highways and services	35,554,149			35,554,149		35,554,149
Administration of Highways Division	30,465,251			30,465,251	(4,864,593)	25,600,658
Surcharge on gross receipts (Note 13)	7,911,833			7,911,833		7,911,833
Motor Vehicle Safety Office	8,852,745			8,852,745		8,852,745
Capital projects			103,522,121	103,522,121	(89,900,887)	13,621,234
Depreciation expense				-	232,285,626	232,285,626
Debt service:						
Principal payment (Note 9)		14,295,000		14,295,000	(14,295,000)	-
Interest expense (Note 9)		14,095,926		14,095,926	(863,753)	13,232,173
Total expenditures / expenses	<u>204,599,357</u>	<u>28,390,926</u>	<u>103,522,121</u>	<u>336,512,404</u>	<u>108,365,226</u>	<u>444,877,630</u>
<b>PROGRAM REVENUES:</b>						
Charges for services:						
Vehicle registration fees (Note 4)	21,043,927			21,043,927		21,043,927
Other fees and permits (Note 4)	3,665,702			3,665,702		3,665,702
Penalties and fines (Note 4)	1,136,961			1,136,961		1,136,961
Rentals	978,522			978,522		978,522
Operating grants and contributions (Note 5)	43,629,731			43,629,731		43,629,731
Capital grants and contributions (Note 5)			77,405,713	77,405,713		77,405,713
Total program revenues	<u>70,454,843</u>		<u>77,405,713</u>	<u>147,860,556</u>		<u>147,860,556</u>
NET PROGRAM EXPENSE (Forward)	<u>(134,144,514)</u>	<u>(28,390,926)</u>	<u>(26,116,408)</u>	<u>(188,651,848)</u>	<u>(108,365,226)</u>	<u>(297,017,074)</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  
YEAR ENDED JUNE 30, 2006**

	<b>Governmental Funds</b>				<b>Adjustments (Note 11)</b>	<b>Government-wide Statement of Activities</b>
	<b>State Highway Fund</b>	<b>Debt Service Fund</b>	<b>Capital Projects Fund</b>	<b>Total</b>		
NET PROGRAM EXPENSE (Forwarded)	\$ (134,144,514)	\$ (28,390,926)	\$ (26,116,408)	\$ (188,651,848)	\$ (108,365,226)	\$ (297,017,074)
GENERAL REVENUES:						
Taxes (Note 4):						
Fuel taxes	82,852,986			82,852,986		82,852,986
Rental motor and tour vehicle surcharge taxes	50,581,945			50,581,945		50,581,945
Vehicle weight taxes	31,510,075			31,510,075		31,510,075
Interest income	14,191,947			14,191,947		14,191,947
Non-imposed fringe benefits (Note 6)	1,416,904			1,416,904		1,416,904
Total general revenues	180,553,857			180,553,857		180,553,857
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	46,409,343	(28,390,926)	(26,116,408)	(8,097,991)	(108,365,226)	(116,463,217)
OTHER FINANCING SOURCES (USES) (Note 10):						
Transfers in	1,408,650	28,390,926	11,384,916	41,184,492	(41,184,492)	-
Transfers out	(56,815,519)			(56,815,519)	56,815,519	-
Total other financing sources (uses)	(55,406,869)	28,390,926	11,384,916	(15,631,027)	15,631,027	-
DEFICIENCY OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES (Note 11)	(8,997,526)	-	(14,731,492)	(23,729,018)	(92,734,199)	(116,463,217)
TRANSFERS OUT (Note 10)					(17,039,677)	(17,039,677)
CHANGE IN NET ASSETS (Note 11)					(109,773,876)	(133,502,894)
FUND BALANCES / NET ASSETS:						
Beginning of year	266,315,355		128,971,369	395,286,724	5,237,054,138	5,632,340,862
End of year	\$ 257,317,829	\$ -	\$ 114,239,877	\$ 371,557,706	\$ 5,127,280,262	\$ 5,498,837,968

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  
YEAR ENDED JUNE 30, 2005**

	<b>Governmental Funds</b>					<b>Government-wide Statement of Activities</b>
	<b>State Highway Fund</b>	<b>Debt Service Fund</b>	<b>Capital Projects Fund</b>	<b>Total</b>	<b>Adjustments (Note 11)</b>	
<b>EXPENDITURES / EXPENSES:</b>						
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>
<b>PROGRAM REVENUES:</b>						
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  
YEAR ENDED JUNE 30, 2005**

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

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) YEAR ENDED JUNE 30, 2006

	Original Budget	Final Budget	Budgetary Actual	Variance
REVENUES:				
Fuel taxes	\$ 84,162,880	\$ 81,924,000	\$ 82,852,986	\$ 928,986
Vehicle weight taxes	28,220,639	29,280,000	30,740,563	1,460,563
Rental motor and tour vehicle surcharge tax	42,665,514	46,962,276	50,581,945	3,619,669
Vehicle registration fees	19,753,472	19,753,472	20,765,665	1,012,193
Interest income	10,900,000	10,900,000	14,165,650	3,265,650
Enforcement fee	1,369,215	1,369,215	1,304,386	(64,829)
Vehicle registration penalties	1,059,400	1,059,400	1,104,524	45,124
Commercial drivers license fee	368,202	368,000	465,125	97,125
Rentals	850,000	850,000	978,522	128,522
Other	<u>211,200</u>	<u>211,200</u>	<u>1,328,025</u>	<u>1,116,825</u>
Total revenues	<u>189,560,522</u>	<u>192,677,563</u>	<u>204,287,391</u>	<u>11,609,828</u>
EXPENDITURES:				
Operations and maintenance:				
Oahu highways and services	74,037,884	79,293,326	78,313,806	979,520
Hawaii highways and services	25,735,257	21,835,257	20,606,051	1,229,206
Maui highways and services	17,506,124	17,342,124	16,492,302	849,822
Kauai highways and services	11,740,850	13,235,580	12,167,451	1,068,129
Molokai highways and services	4,536,206	4,401,206	4,267,082	134,124
Lanai highways and services	918,193	416,156	340,748	75,408
Administration of Highways Division including debt service (Note 10)	71,622,334	61,392,927	55,489,178	5,903,749
State of Hawaii surcharge on gross receipts	6,848,422	6,848,422	7,911,834	(1,063,412)
Motor Vehicle Safety Office	<u>5,924,225</u>	<u>5,830,225</u>	<u>5,435,735</u>	<u>394,490</u>
Total expenditures	<u>218,869,495</u>	<u>210,595,223</u>	<u>201,024,187</u>	<u>9,571,036</u>
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	<u>\$ (29,308,973)</u>	<u>\$ (17,917,660)</u>	<u>\$ 3,263,204</u>	<u>\$ 21,180,864</u>

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) YEAR ENDED JUNE 30, 2005

	Original Budget	Final Budget	Budgetary Actual	Variance
REVENUES:				
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	<u>224,000</u>	<u>211,200</u>	<u>1,864,367</u>	<u>1,653,167</u>
Total revenues	<u>182,203,726</u>	<u>185,813,530</u>	<u>190,437,919</u>	<u>4,624,389</u>
EXPENDITURES:				
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	<u>7,237,771</u>	<u>7,009,045</u>	<u>6,327,650</u>	<u>681,395</u>
Total expenditures	<u>169,165,857</u>	<u>154,394,805</u>	<u>146,618,748</u>	<u>7,776,057</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ 13,037,869</u>	<u>\$ 31,418,725</u>	<u>\$ 43,819,171</u>	<u>\$ 12,400,446</u>

See notes to financial statements.

# STATE OF HAWAII

## DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

### NOTES TO FINANCIAL STATEMENTS

#### YEARS ENDED JUNE 30, 2006 AND 2005

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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, 2006.

**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 \$6,345,181 and \$5,232,620 at June 30,

2006 and 2005, respectively. (The deposits were received on the Highways Division's contracts with third parties.)

The State has an established policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Section 36-21, Hawaii Revised Statutes, authorizes the State to invest in obligations of the State, the U.S. Treasury, agencies and instrumentalities, certificates of deposit, and bank repurchase agreements.

At June 30, 2006 and 2005, information relating to individual 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. A portion of the bank balances is covered by federal deposit insurance, or by collateral held by the State Treasury, or by the State's fiscal agents in the name of the State. Other bank balances are held by fiscal agents in the State's name for the purpose of satisfying outstanding bond obligations. Accordingly, these deposits are exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. For demand or checking accounts and 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 use of daily available bank balances to determine collateral requirements results in the available balances being under-collateralized at various times during the fiscal year. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State. The State also requires that no more than 60% of the State's total funds available for deposit and on deposit in the State Treasury may be deposited in any one financial institution.

***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:

Class of Assets	Estimated Useful Lives	Capitalization Threshold
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 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 adopted this Statement effective July 1, 2005. The adoption of this Statement did not have a significant impact on the financial statements.

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of other postemployment benefits ("OPEB") expense and related liabilities (assets), note disclosures, and if applicable, required supplementary information in the financial reports of state and local governmental employers. The Statement requires systematic, accrual-basis measurement and recognition of OPEB expense over a period that approximates employees' years of service, and provides information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2006. Management has not completed its determination of the impact on the financial statements once the provisions of this Statement are implemented.

In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Legislation, an amendment of GASB Statement No. 34*. This Statement established and modifies requirements related to restrictions of net assets resulting from enabling legislation. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2005. Adoption of this Statement did not have an effect on the June 30, 2006 financial statements.

In July 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2005. Management has not yet completed its determination of the impact on the financial statements once the provisions of this Statement are implemented.

### **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 (\$212,945,270) and the MVSO (\$5,924,225).

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:

	2006	2005
Excess of revenues over expenditures, non-GAAP budgetary basis	\$ 3,263,204	\$ 43,819,171
Federal grants-in-aid	43,629,731	65,301,185
Operating transfers out to State of Hawaii for debt service	17,039,677	9,292,755
Pass through expenditures for county projects	(26,706,439)	(26,528,719)
Other adjustments to modified accrual basis of accounting	<u>9,183,170</u>	<u>(12,654,406)</u>
Excess of revenues over expenditures, GAAP basis	<u>\$ 46,409,343</u>	<u>\$ 79,229,986</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, 2006 and 2005, 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	5.3 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 \$25 per vehicle, of which \$5 is earmarked for deposit into the Emergency Medical Services (“EMS”) special fund. During the years ended June 30, 2006 and 2005, the Highways Division collected \$4,595,407 and \$3,599,470, respectively. All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2006 and 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 twenty-five-passenger carrier vehicle and \$15 a month for tour vehicles categorized as an eight to twenty-five-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, 2006 and 2005, 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, 2006 and 2005, expenditures of approximately \$5,445,000 and \$5,300,000, 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, 2006 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, 2006, 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 \$1,416,904 and \$279,232 for fiscal years 2006 and 2005, respectively, have been reported as revenues and expenditures.

## 7. CAPITAL ASSETS

Changes in capital assets during the years ended June 30, 2006 and 2005 were as follows:

	Balance July 1, 2005	Additions	Deductions	Transfers	Balance June 30, 2006
<b>Capital assets not being depreciated:</b>					
Land	\$ 421,179,556	\$ 772,240	\$ (1,408,650)	\$ -	\$ 420,543,146
Construction in progress	144,571,209	105,245,917		(60,156,785)	189,660,341
Infrastructure	<u>712,200,763</u>			<u>7,242,588</u>	<u>719,443,351</u>
Total	<u>1,277,951,528</u>	<u>106,018,157</u>	<u>(1,408,650)</u>	<u>(52,914,197)</u>	<u>1,329,646,838</u>
<b>Capital assets being depreciated:</b>					
Land improvements	2,215,473				2,215,473
Buildings and improvements	21,765,545	224,944		3,827,532	25,818,021
Vehicles and equipment	47,173,609	3,493,591	(1,648,038)		49,019,162
Infrastructure	<u>7,456,102,116</u>			<u>49,086,665</u>	<u>7,505,188,781</u>
Total	7,527,256,743	3,718,535	(1,648,038)	52,914,197	7,582,241,437
Less accumulated depreciation	<u>(3,246,711,798)</u>	<u>(232,285,626)</u>	<u>1,648,038</u>		<u>(3,477,349,386)</u>
Capital assets being depreciated—net	<u>4,280,544,945</u>	<u>(228,567,091)</u>	<u>-</u>	<u>52,914,197</u>	<u>4,104,892,051</u>
Total capital assets	<u>\$ 5,558,496,473</u>	<u>\$(122,548,934)</u>	<u>\$ (1,408,650)</u>	<u>\$ -</u>	<u>\$ 5,434,538,889</u>

	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>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>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>(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>

## 8. GENERAL LONG-TERM LIABILITIES

Changes in general long-term liabilities during the years ended June 30, 2006 and 2005 were as follows:

	Balance June 30, 2005	Increase	Decrease	Balance June 30, 2006	Due Within One Year	Due After One Year
Accrued workers' compensation	\$ 4,631,047	\$ 752,786	\$ (752,786)	\$ 4,631,047	\$ 752,786	\$ 3,878,261
Accrued vacation	10,088,436	3,779,425	(3,580,848)	10,287,013	2,723,276	7,563,737
Revenue bonds	<u>321,542,989</u>		<u>(12,663,753)</u>	<u>308,879,236</u>	<u>14,295,000</u>	<u>294,584,236</u>
	<u>\$ 336,262,472</u>	<u>\$ 4,532,211</u>	<u>\$ (16,997,387)</u>	<u>\$ 323,797,296</u>	<u>\$ 17,771,062</u>	<u>\$ 306,026,234</u>
	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>



## 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 4.5% 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, 2006:

<b>Series</b>	<b>Interest Rate</b>	<b>Final Maturity Date (July 1)</b>	<b>Original Amount of Issue</b>	<b>Outstanding Amount</b>
1996	3.8% - 6.0%	2016	\$ 55,000,000	\$ 8,500,000
1998	4.5% - 5.5%	2018	94,920,000	35,340,000
2000	4.4% - 5.5%	2020	50,000,000	10,660,000
2001	3.8% - 5.4%	2022	70,000,000	22,085,000
2003	2.0% - 5.25%	2013	44,940,000	37,105,000
2005	3.0% - 5.25%	2025	<u>183,915,000</u>	<u>183,915,000</u>
			<u>\$498,775,000</u>	297,605,000
		Add unamortized premium		17,960,928
		Less deferred loss on defeasance		(6,686,692)
		Less current portion		<u>(14,295,000)</u>
		Noncurrent portion		<u>\$294,584,236</u>

The approximate maturities for revenue bonds, including interest of \$127,138,289 (debt service fund of \$7,047,963 and general long-term debt of \$120,083,326) in each of the next five years and thereafter are as follows:

<b>Years Ending June 30</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2007	\$ 14,295,000	\$ 13,825,383	\$ 28,120,383
2008	14,885,000	13,242,228	28,127,228
2009	15,495,000	12,597,053	28,092,053
2010	16,150,000	11,880,394	28,030,394
2011	16,935,000	11,156,285	28,091,285
2012-2016	96,605,000	43,515,631	140,120,631
2017-2021	93,100,000	17,853,859	110,953,859
2022-2026	<u>30,140,000</u>	<u>3,060,456</u>	<u>33,200,456</u>
Total	<u>\$297,605,000</u>	<u>\$127,131,289</u>	<u>\$424,736,289</u>

In 2006, \$28,390,926 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of \$14,295,000 and interest of \$14,095,926.

## 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)					Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total	Adjustments	
2006						
Funding of highway capital projects	\$ (11,384,916)	\$ -	\$ 11,384,916	\$ -	\$ -	\$ -
Reimbursement to State for debt service on general obligation bonds	(17,039,677)			(17,039,677)	17,039,677	-
Land parcels held for sale	1,408,650			1,408,650	(1,408,650)	-
Funding of revenue bond debt service	(28,390,926)	28,390,926		-		-
	<u>\$ (55,406,869)</u>	<u>\$ 28,390,926</u>	<u>\$ 11,384,916</u>	<u>\$ (15,631,027)</u>	<u>\$ 15,631,027</u>	<u>\$ -</u>
2005						
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>

### 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, 2006 are as follows:

<b>Years Ending June 30</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
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	10,091,760	1,060,325	11,152,085
2012-2016	21,648,501	1,439,186	23,087,687
2017-2021	<u>2,875,295</u>	<u>67,125</u>	<u>2,942,420</u>
Total	<u>\$ 81,247,468</u>	<u>\$ 11,330,098</u>	<u>\$ 92,577,566</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 \$13,413,344 and \$5,081,794 for principal and \$3,626,333 and \$4,210,961 for interest for the years ended June 30, 2006 and 2005, 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, 2006 and 2005:

	2006	2005
Total Governmental Funds fund balances	\$ 371,557,706	\$ 395,286,724
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.	5,434,538,889	5,558,496,473
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.	1,686,069	1,915,565
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	(10,287,013)	(10,088,436)
Accrued workers' compensation	(4,631,047)	(4,631,047)
Revenue bonds payable	(294,584,236)	(309,742,989)
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
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.	557,600	1,031,900
Total government-wide net assets	<u>\$5,498,837,968</u>	<u>\$5,632,340,862</u>

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

	2006	2005
Governmental Funds change in fund balances	\$ (23,729,018)	\$ 46,904,124
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 \$107,555,801 and \$168,747,864, offset by depreciation expense of \$232,285,626 and \$233,759,033 in 2006 and 2005.	(124,729,825)	(65,011,169)
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.	14,295,000	11,800,000
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 \$0 in 2006 and \$18,156,367 in 2005, offset by amortization expense of \$1,823,564 and \$867,950 in 2006 and 2005.	1,705,907	(201,203,417)
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 \$0 in 2006 and \$7,439,199 in 2005, offset by amortization expense of \$842,154 and \$863,737 in 2006 and 2005.	(842,154)	136,983,265
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 \$0 in 2006 and \$1,581,758 in 2005, offset by amortization expense of \$229,495 and \$576,446 in 2006 and 2005.	<u>(229,496)</u>	<u>1,005,312</u>
Subtotal (Forwarded)	(133,529,586)	(69,521,885)

(Continued)

	2006	2005
Subtotal (Forwarded)	\$ (133,529,586)	\$ (69,521,885)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in Governmental Funds.	297,940	
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>(271,248)</u>	<u>2,905,883</u>
Government-wide change in net assets	<u>\$ (133,502,894)</u>	<u>\$ (66,616,002)</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 2006, 2005, and 2004 was approximately \$5,753,000, \$3,578,000, and \$3,348,000, 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 2006 and 2005 aggregated approximately \$2,807,000 and \$2,803,000, 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 \$7,912,000 and \$7,734,000 in fiscal years 2006 and 2005, respectively.

The Highways Division is assessed a percentage of the cost of the general administration expenses of the Department. During fiscal years 2006 and 2005, the assessments amounted to approximately \$5,438,000 and \$5,455,000, respectively. During fiscal years 2006 and 2005, respectively, the Highways Division received assessment refunds from the Department amounting to approximately \$961,000 and \$865,000, resulting in a net general administration expense of approximately \$4,477,000 and \$4,590,000.

## 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:

**Years Ending  
June 30**

2007	\$ 956,632
2008	956,632
2009	956,632
2010	956,632
2011	956,632
2012-2016	4,783,160
2017-2019	<u>2,152,422</u>
Total	<u>\$ 11,718,742</u>

The total rental expenditures during fiscal years 2006 and 2005 for operating leases were approximately \$1,225,000 and \$1,292,000, 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:

**Years Ending  
June 30**

2007	\$ 308,792
2008	308,792
2009	308,792
2010	308,792
2011	308,792
2012-2016	1,543,960
2017-2021	1,464,710
2022-2026	1,385,460
2027-2031	749,960
2032-2036	404,154
2037-2041	386,100
2042-2044	<u>61,765</u>
Total	<u>\$ 7,540,069</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 \$557,600 at June 30, 2006. 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, 2006 aggregated approximately \$21,391,000.

## **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, 2006.

## **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, 2006, the Capital Projects Fund had an unreserved deficit balance of \$147,368,163. The Highways Division intends to take corrective action to eliminate this deficit balance.

## **19. SUBSEQUENT EVENT**

On October 15, 2006, an earthquake with a magnitude of 6.7 occurred approximately north-northwest of Kailua-Kona on the island of Hawaii. The earthquake and its subsequent aftershocks caused significant damage to certain capital assets of the Highways Division. As of the date of this report, management cannot reasonably estimate the amount or the extent of damage caused by the earthquake. Management is in the process of investigating whether the costs of repairing the assets can be covered by the State of Hawaii's property insurance policy or paid from disaster relief assistance from the Federal Emergency Management Agency.

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