

*State of Hawaii Department
of Transportation—
Highways Division*

*Financial Statements for the Years
Ended June 30, 2004 and 2003 (Restated)
and Independent Auditors' Report*

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

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INDEPENDENT AUDITORS' REPORT

The Director
Department of Transportation
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, 2004 and 2003 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 opinions 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 opinions.

As discussed in Note 2 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, 2004 and 2003, and the changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2004 and 2003, 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 20, the accompanying 2003 Government-wide Statement of Net Assets and Statement of Activities have been restated for adjustments to capital assets and capital grants.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2005 on our consideration of the Highways Division's internal control over financial reporting and on our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

March 22, 2005

STATE OF HAWAII

DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2004

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, 2004. 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

- Net assets decreased by \$131 million, primarily due to depreciation expense.
- The assets of the Highways Division exceeded its liabilities at June 30, 2004 by \$5.7 billion. Of this amount, \$364 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 \$131 million. This resulted from an excess of expenses over revenues of \$120 million and a transfer of \$11 million to other State departments. The excess of expenses over revenues was significantly impacted by depreciation expense of \$229 million.
- The Statement of Net Assets and the Statement of Activities for the year ended June 30, 2003 have been restated to correct the effect of approximately \$16.4 million in repairs and maintenance work that was inappropriately capitalized as construction in progress, and \$1.3 million of indirect costs that were inadvertently billed to the U.S. Government. See Note 20 for additional information.

Governmental Funds Financial Statements

- At June 30, 2004, the Highways Division's Governmental Funds reported a combined ending fund balance of \$348.4 million. The combined fund balance decreased by \$2.8 million from the prior year's ending fund balance. Approximately \$16.5 million of the total fund balance is considered unreserved at June 30, 2004.
- The Highways Division's State Highway Fund, the major operating fund, reported an ending fund balance of \$238.1 million, of which \$130.7 million is considered unreserved. There was a \$13 million increase in fund balance for the year ended June 30, 2004.

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 and intergovernmental revenues.

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

Governmental Funds Financial Statements

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

The Governmental Funds financial statements focus on near-term inflows and outflows of *spendable resources*, as well as on the *balances of spendable resources* available at the end of the fiscal year. Governmental fund financials 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 assist 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 12 through 21 of this report.

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

The Governmental Funds financial statements are followed by a budgetary comparison schedule. A reconciliation between the actual State Highway Fund revenues and expenditures on the budgetary basis compared to the State Highway Fund revenues and expenditures prepared for budgetary purposes is included in Note 3 to the financial statements.

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

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the Governmental Funds financial statements. The notes to the financial statements can be found on pages 24 through 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 \$5.7 billion and \$5.8 billion at June 30, 2004 and 2003, respectively.

	2004	(As Restated) 2003
ASSETS		
Current and other assets	\$ 404,275,851	\$ 405,022,286
Capital assets, net	<u>5,620,354,262</u>	<u>5,758,762,513</u>
Total assets	<u>\$6,024,630,113</u>	<u>\$6,163,784,799</u>
LIABILITIES		
Current liabilities	\$ 54,539,487	\$ 51,100,921
Long-term liabilities	<u>271,133,762</u>	<u>283,121,349</u>
Total liabilities	<u>325,673,249</u>	<u>334,222,270</u>
NET ASSETS		
Invested in capital assets, net of related debt	5,323,200,439	5,459,907,797
Restricted	11,385,000	8,187,895
Unrestricted	<u>364,371,425</u>	<u>361,466,837</u>
Total net assets	<u>5,698,956,864</u>	<u>5,829,562,529</u>
Total liabilities and net assets	<u>\$6,024,630,113</u>	<u>\$6,163,784,799</u>

The largest portion of the Highways Division's net assets (93 percent and 94 percent at June 30, 2004 and 2003, respectively) reflects its investment in capital assets (e.g., land and land improvements, buildings, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Highways Division's net assets (0.2 and 0.1 percent at June 30, 2004 and 2003, respectively) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for the payment of the Highways Division's revenue bond debt service. The remaining balance of unrestricted net assets may be used to meet the Highways Division's on-going obligations to citizens and creditors.

Statement of Activities

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

	2004	(As Restated) 2003
EXPENSES		
Program expenses:		
Operations and maintenance	\$ 109,198,974	\$ 116,012,786
Administration of Highways Division	13,362,525	22,120,330
Surcharge on gross receipts	7,332,555	5,569,742
Motor Vehicle Safety Office	6,236,527	6,546,238
Capital projects	12,663,523	6,512,300
Depreciation expense	229,478,789	248,555,598
Debt service/interest expense	12,743,501	14,043,592
Loss on disposal		107,144
	<u>391,016,394</u>	<u>419,467,730</u>
Total expenses		
REVENUES		
Program revenues:		
Charges for services	23,574,730	23,685,867
Operating grants and contributions	50,278,694	61,181,926
Capital grants and contributions	37,394,223	68,544,961
	<u>111,247,647</u>	<u>153,412,754</u>
Total program revenues		
General revenues:		
Taxes	149,837,470	140,887,163
Interest income	8,570,235	11,954,041
Other	1,742,870	485,965
	<u>160,150,575</u>	<u>153,327,169</u>
Total general revenues		
Total revenues	<u>271,398,222</u>	<u>306,739,923</u>
DECREASE IN NET ASSETS BEFORE TRANSFERS	(119,618,172)	(112,727,807)
TRANSFERS	<u>(10,987,493)</u>	<u>(17,858,196)</u>
DECREASE IN NET ASSETS	(130,605,665)	(130,586,003)
BEGINNING NET ASSETS	<u>5,829,562,529</u>	<u>5,960,148,532</u>
ENDING NET ASSETS	<u>\$5,698,956,864</u>	<u>\$5,829,562,529</u>

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 41 percent and 50 percent of total revenues in fiscal years 2004 and 2003, respectively. The largest components of program revenues (79 and 85 percent for fiscal years 2004 and 2003, 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 of taxes and interest earnings. Taxes represented 94 and 92 percent of general revenues for fiscal years 2004 and 2003, respectively.

The fiscal year 2004 decrease in net assets of \$130.6 million resulted from the excess of expenses over revenues of \$119.6 million due primarily to depreciation expense of \$229.4 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, 2004, the Highways Division's Governmental Funds reported combined ending fund balances of \$348.4 million, representing a decrease of \$2.8 million from the prior year. Approximately \$16.5 million of this amount constitutes *unreserved fund balance*, which is available for spending in the coming year. The remainder of fund balance is *reserved* to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

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

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

At June 30, 2004, the total fund balance of the SHF was \$238.1 million, of which \$130.7 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 60 percent of total fund expenditures (including transfers out), while total fund balance represents 109 percent of the same amount.

The fund balance of the Highways Division's SHF increased by \$13 million in the current year as compared to a \$27.7 million increase in the prior year. During the current year, the Highways Division collected more revenues but also expended more for operations and maintenance.

The *Debt Service Fund* ("DSF") is used to track the revenue bond debt service for the Highways Division. Debt service requirements are transferred from the State Highway Fund. Decreases in debt service expense from \$24.8 million in fiscal year 2003 to \$24.5 million in fiscal year 2004 are attributable to decreased interest expense.

The *Capital Projects Fund* ("CPF") accounts for the Highways Division's capital improvements program. At June 30, 2004, the CPF had a total fund balance of \$110.3 million, including an unreserved fund deficit of \$114.3 million. The fund balance of the CPF decreased by \$15.8 million in fiscal year 2004 as compared to a decrease of \$38.9 million in the prior year. The change from the prior year was due primarily to increase in contract encumbrances in the current year and to the fact that there was no issuance of revenue bonds in fiscal year 2004.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

Historically, the Department of Transportation, Highways Division financed a major portion of its share of the cost of capital improvement projects using reimbursable general obligation bonds. Beginning in 1993, the State Department of Transportation, Highways Division began financing the projects through revenue bonds, secured by a first pledge of revenues deposited into the State Highway Fund. Approximately 44% of these revenues are derived from state highway fuel taxes. The balance consists primarily of vehicle registration fees (10%), weight taxes (16%), and surcharges for rental and tour vehicles (23%).

The pledge to pay the reimbursable general obligation bonds is subordinate to payment of highway revenue bonds and the operations and maintenance expenses of the Highway Division. For all outstanding debt supported by highway revenues (including reimbursable general obligation bonds), pledged revenues in fiscal 2004 provide 4 times coverage of maximum annual debt service. Excluding the general obligation bonds, coverage of peak debt service on Hawaii's highway revenue bonds alone is 6.3 times. As the Highways Division has continued debt issuance for highway purposes over the last ten years, debt service coverage on its highway revenue bonds has declined steadily from 24 times in fiscal 1995 to a still strong 9.6 times in fiscal 2004.

In the last ten years Hawaii's combined primary highway revenues (before interest and miscellaneous revenues) declined only twice, in fiscal years 1999 and 2001, and in both cases the drop was minimal at -0.4% and -0.5% respectively. Interest revenues fluctuate somewhat due to rate changes and one-time events such as a \$22 million gasoline litigation settlement in fiscal year 2002 and \$2.5 million property sale in fiscal year 2004 occasionally boost miscellaneous revenues. These may cause slightly greater swings in total pledged revenues although debt service coverage averaged 9.3 times in the period from fiscal year 2000 to fiscal year 2004.

The final amended State Highway Fund budget had total appropriations of approximately \$680 thousand more than the original budget. The total original appropriations were \$176.3 million, while the final appropriations were \$177 million. The increase in budgeted revenues was the result of higher than expected tax collections.

Expenditures on the budgetary actual basis were \$13 million lower than the final budgeted amounts. The difference was due primarily to significant repairs and maintenance work which was budgeted for being deferred into future periods.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Highways Division's investment in capital assets as of June 30, 2004 amounts to \$5.620 billion, net of accumulated depreciation. 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 2004, the Highways Division put out 95 projects to bid with a contract amount of approximately \$22 million. There were 48 projects on Oahu, 7 projects on Hawaii, 12 projects on Maui, (includes Molokai and Lanai), and 13 projects on Kauai.

At June 30, 2004, the Highways Division had \$222 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 2004, with construction expected to start in fiscal year 2005.

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

Long-Term Debt

At June 30, 2004 and 2003, respectively, the Highways Division had \$268.7 and \$279.7 million in outstanding long-term debt. At June 30, 2004, the amount consisted of revenue bonds payable in the amount of \$265.5 million, unamortized revenue bond premiums of \$4.08 million, and a deferred loss of \$0.953 million. The bond issuance premiums and deferred loss is amortized over the life of the related bonds and recorded as interest expense.

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 either of 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 capital assets can be found in Notes 8 and 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, 2004**

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

(Continued)

STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

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

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

See notes to financial statements.

(Concluded)

STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

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

JUNE 30, 2003 (Restated)

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	\$ 213,293,635	\$ -	\$ 146,107,617	\$ 359,401,252	\$ -	\$ 359,401,252
Receivables, net of allowance for doubtful accounts:						
Due from U.S. Government (Note 5)	5,429,021		7,408,322	12,837,343		12,837,343
Due from Capital Projects Fund	10,995,289			10,995,289	(10,995,289)	-
Due from City and Counties	4,042,254			4,042,254		4,042,254
Land parcels held for sale	681,300			681,300		681,300
Prepaid expenses	2,726,166		392,481	3,118,647		3,118,647
Restricted cash:						
Revenue bond debt service (Note 9)		17,185,496		17,185,496		17,185,496
Security deposits	4,966,147			4,966,147		4,966,147
Bond issue costs, net of accumulated amortization (Note 9)					1,186,268	1,186,268
Other assets					1,603,579	1,603,579
Capital assets, net of accumulated depreciation (Note 7)					5,758,762,513	5,758,762,513
TOTAL	<u>\$ 242,133,812</u>	<u>\$ 17,185,496</u>	<u>\$ 153,908,420</u>	<u>\$ 413,227,728</u>	<u>\$ 5,750,557,071</u>	<u>\$ 6,163,784,799</u>

(Continued)

STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION

**GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS
JUNE 30, 2003 (Restated)**

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	\$ 1,865,847	\$ -	\$ 738,197	\$ 2,604,044	\$ -	\$ 2,604,044
Accrued payroll	2,359,742			2,359,742		2,359,742
Contracts payable:						
Current portion	3,603,156		8,410,550	12,013,706		12,013,706
Retained percentage	3,183,616		7,729,518	10,913,134		10,913,134
Payable from restricted assets:						
Matured bonds and interest payable (Notes 8 and 9)		17,185,496		17,185,496		17,185,496
Security deposits	4,966,147			4,966,147		4,966,147
Due to State Highway Fund			10,995,289	10,995,289	(10,995,289)	-
Other liabilities	1,058,652			1,058,652		1,058,652
Long-term liabilities (Note 8):						
Due within one year:						
Workers' compensation payable (Note 16)					1,036,959	1,036,959
Accrued vacation payable					3,394,446	3,394,446
Due after one year:						
Workers' compensation payable (Note 16)					3,594,088	3,594,088
Accrued vacation payable					5,981,712	5,981,712
Revenue bonds payable (Notes 8 and 9)					269,114,144	269,114,144
Total liabilities	<u>17,037,160</u>	<u>17,185,496</u>	<u>27,873,554</u>	<u>62,096,210</u>	<u>272,126,060</u>	<u>334,222,270</u>
FUND BALANCES / NET ASSETS (Note 11):						
Fund Balances:						
Reserved for encumbrances	87,057,035		135,387,578	222,444,613	(222,444,613)	
Reserved for prepaid expenses	2,726,166		392,481	3,118,647	(3,118,647)	
Reserved for land parcels held for sale	681,300			681,300	(681,300)	
Unreserved, reported in State Highway Fund	134,632,151			134,632,151	(134,632,151)	
Unreserved, reported in Capital Projects Fund (Note 18)			(9,745,193)	(9,745,193)	9,745,193	
Total fund balances	<u>225,096,652</u>		<u>126,034,866</u>	<u>351,131,518</u>	<u>(351,131,518)</u>	
Net Assets:						
Invested in capital assets, net of related debt					5,459,907,797	5,459,907,797
Restricted for revenue bonds					8,000,000	8,000,000
Restricted contributions					187,895	187,895
Unrestricted					361,466,837	361,466,837
Total net assets					<u>5,829,562,529</u>	<u>5,829,562,529</u>
Total liabilities and fund balance / net assets	<u>\$ 242,133,812</u>	<u>\$ 17,185,496</u>	<u>\$ 153,908,420</u>	<u>\$ 413,227,728</u>	<u>\$ 5,750,557,071</u>	<u>\$ 6,163,784,799</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, 2004**

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

(Continued)

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

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

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

(Continued)

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

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

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

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2003 (Restated)**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
EXPENDITURES / EXPENSES:						
Operations and maintenance:						
Oahu highways and services	\$ 44,752,770	\$ -	\$ -	\$ 44,752,770	\$ (12,695,386)	\$ 32,057,384
Hawaii highways and services	23,121,203			23,121,203	(1,867,398)	21,253,805
Maui highways and services	11,880,525			11,880,525	(295,854)	11,584,671
Kauai highways and services	12,046,653			12,046,653	(1,725,292)	10,321,361
Molokai highways and services	2,790,263			2,790,263		2,790,263
Lanai highways and services	184,866			184,866		184,866
Pass through for County highways and services	37,820,436			37,820,436		37,820,436
Administration of Highways Division	29,047,804			29,047,804	(6,927,474)	22,120,330
Surcharge on gross receipts (Note 13)	5,569,742			5,569,742		5,569,742
Motor Vehicle Safety Office	6,546,238			6,546,238		6,546,238
Capital projects			108,630,780	108,630,780	(102,118,480)	6,512,300
Depreciation expense				-	248,555,598	248,555,598
Debt service:						
Principal payment (Note 9)		10,635,000		10,635,000	(10,635,000)	-
Interest expense (Note 9)		14,139,998		14,139,998	(96,406)	14,043,592
Loss on disposal of capital assets					107,144	107,144
Total expenditures / expenses	<u>173,760,500</u>	<u>24,774,998</u>	<u>108,630,780</u>	<u>307,166,278</u>	<u>112,301,452</u>	<u>419,467,730</u>
PROGRAM REVENUES:						
Charges for services:						
Vehicle registration fees (Note 4)	19,283,281			19,283,281		19,283,281
Other fees and permits (Note 4)	2,517,651			2,517,651		2,517,651
Penalties and fines (Note 4)	1,009,301			1,009,301		1,009,301
Rentals	875,634			875,634		875,634
Operating grants and contributions (Note 5)	67,755,567			67,755,567	(6,573,641)	61,181,926
Capital grants and contributions (Note 5)			68,544,961	68,544,961		68,544,961
Total program revenues	<u>91,441,434</u>		<u>68,544,961</u>	<u>159,986,395</u>	<u>(6,573,641)</u>	<u>153,412,754</u>
NET PROGRAM EXPENSE (Forward)	<u>(82,319,066)</u>	<u>(24,774,998)</u>	<u>(40,085,819)</u>	<u>(147,179,883)</u>	<u>(118,875,093)</u>	<u>(266,054,976)</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, 2003 (Restated)**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
NET PROGRAM EXPENSE (Forwarded)	\$ (82,319,066)	\$ (24,774,998)	\$ (40,085,819)	\$ (147,179,883)	\$ (118,875,093)	\$ (266,054,976)
GENERAL REVENUES:						
Taxes (Note 4):						
Fuel taxes	75,506,033			75,506,033		75,506,033
Rental motor and tour vehicle surcharge taxes	39,472,268			39,472,268		39,472,268
Vehicle weight taxes	25,908,862			25,908,862		25,908,862
Interest income	11,954,041			11,954,041		11,954,041
Non-imposed fringe benefits (Note 6)	83,620			83,620		83,620
Other	402,345			402,345		402,345
Total general revenues	<u>153,327,169</u>			<u>153,327,169</u>		<u>153,327,169</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>71,008,103</u>	<u>(24,774,998)</u>	<u>(40,085,819)</u>	<u>6,147,286</u>	<u>(118,875,093)</u>	<u>(112,727,807)</u>
OTHER FINANCING SOURCES (USES) (Note 10):						
Transfers in	2,331,608	24,774,998	47,957,345	75,063,951	(75,063,951)	-
Transfers out	<u>(45,650,539)</u>		<u>(46,749,377)</u>	<u>(92,399,916)</u>	<u>92,399,916</u>	<u>-</u>
Total other financing sources (uses)	<u>(43,318,931)</u>	<u>24,774,998</u>	<u>1,207,968</u>	<u>(17,335,965)</u>	<u>17,335,965</u>	<u>-</u>
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES (Note 11)	27,689,172	-	(38,877,851)	(11,188,679)	(101,539,128)	(112,727,807)
TRANSFERS OUT (Note 10)					<u>(17,858,196)</u>	<u>(17,858,196)</u>
CHANGE IN NET ASSETS (Note 11) (Forward)					(119,397,324)	(130,586,003)

(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, 2003 (Restated)**

	Governmental Funds			Total	Adjustments (Note 11)	Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
CHANGE IN NET ASSETS (Forwarded)					\$ (119,397,324)	\$ (130,586,003)
FUND BALANCE / NET ASSETS:						
Beginning of year	<u>197,407,480</u>	<u> </u>	<u>164,912,717</u>	<u>362,320,197</u>	<u>5,597,828,335</u>	<u>5,960,148,532</u>
End of year	<u>\$ 225,096,652</u>	<u>\$ -</u>	<u>\$ 126,034,866</u>	<u>\$ 351,131,518</u>	<u>\$ 5,478,431,011</u>	<u>\$ 5,829,562,529</u>

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, 2004**

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

See notes to financial statements.

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES AND EXPENDITURES—
BUDGET AND ACTUAL—STATE HIGHWAY FUND (NON-GAAP BUDGETARY BASIS)
YEAR ENDED JUNE 30, 2003**

	Original Budget	Final Budget	Budgetary Actual	Variance
REVENUES:				
Fuel taxes	\$ 70,706,000	\$ 73,722,360	\$ 75,506,032	\$ 1,783,672
Vehicle weight taxes	22,475,838	25,082,842	27,222,003	2,139,161
Rental motor and tour vehicle surcharge tax	36,319,000	36,515,124	39,472,268	2,957,144
Vehicle registration fees	16,228,574	17,692,540	19,036,913	1,344,373
Interest income	13,900,000	13,900,000	11,952,468	(1,947,532)
Enforcement fee	1,202,687	1,350,000	1,452,828	102,828
Vehicle registration penalties	874,789	993,620	961,802	(31,818)
Commercial drivers license fee	318,036	318,036	264,698	(53,338)
Rentals	850,000	850,000	875,634	25,634
Other	250,784	2,676,000	8,227,166	5,551,166
	<u>163,125,708</u>	<u>173,100,522</u>	<u>184,971,812</u>	<u>11,871,290</u>
EXPENDITURES:				
Operations and maintenance:				
Oahu highways and services	43,300,947	44,089,582	40,760,112	3,329,470
Hawaii highways and services	18,449,055	18,830,459	16,265,244	2,565,215
Maui highways and services	14,584,858	14,814,461	8,844,509	5,969,952
Kauai highways and services	9,773,222	9,930,794	9,621,173	309,621
Molokai highways and services	3,240,376	3,307,304	2,124,578	1,182,726
Lanai highways and services	766,500	796,744	743,591	53,153
Administration of Highways Division including debt service (Note 10)	65,884,818	59,094,135	59,438,281	(344,146)
State of Hawaii surcharge on gross receipts	5,699,695	5,699,695	5,416,463	283,232
Motor Vehicle Safety Office	6,511,868	6,702,549	5,581,696	1,120,853
	<u>168,211,339</u>	<u>163,265,723</u>	<u>148,795,647</u>	<u>14,470,076</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>\$ (5,085,631)</u>	<u>\$ 9,834,799</u>	<u>\$ 36,176,165</u>	<u>\$ 26,341,366</u>

See notes to financial statements.

STATE OF HAWAII

DEPARTMENT OF TRANSPORTATION—HIGHWAYS DIVISION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2004 AND 2003 (Restated)

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. 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 and Basis of Accounting—In June 1999, the Governmental Accounting Standards Board ("GASB") issued Statement No. 34, *Basic Financial Statements -- and Management's Discussion and Analysis -- for State and Local Governments*. Statement No. 34, as amended, establishes financial reporting standards for state and local governments. Among its requirements, Statement No. 34 requires governmental entities to report certain supplementary information, including management's discussion and analysis of the entity's financial performance. Statement No. 34 also requires that governments should report all capital assets, including infrastructure assets, in a government-wide statement of net assets, and should report depreciation expense in the statement of activities. The Highways Division adopted the provisions of Statement No. 34 effective July 1, 2001.

In conjunction with the implementation of GASB Statement No. 34, the Highways Division has also implemented the following GASB Statements in fiscal year 2002: Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures*. Statement No. 37 clarifies requirements set forth in Statement No. 34 related to the management's discussion and analysis, the modified approach, program revenue classifications, and major fund criteria. Statement No. 38 establishes and modifies disclosure requirements related to the summary of significant accounting policies, actions taken to address violations of significant finance-related legal and contractual

provisions, debt and lease obligations, short-term debt, disaggregation of receivable and payable balances, and interfund balances and transfers.

Implementation of these GASB statements resulted in a change in the July 1, 2001 fund balance as reported in the governmental fund financial statements on the modified accrual basis of accounting of \$13,421,091 and \$(12,739,791) in the State Highway Fund and Capital Projects Fund, respectively. Implementation of these GASB statements also resulted in a \$5,776,196,123 increase in net assets as of July 1, 2001 for the government-wide financial statements.

The Highways Division's financial statements are prepared in conformity with generally accepted accounting principles as prescribed by GASB.

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, 2004.

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.

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

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

Cash—Cash reported in the balance sheet/statement of net assets includes cash in the State Treasury, including deposits received and held for others in the amount of \$5,349,027 and \$4,966,147 at June 30, 2004 and 2003, respectively. The deposits were received on the Highways Division's contracts with third parties. The Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury (cash pool).

At June 30, 2004 and 2003, information relating to the 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. Cash deposits of the State are covered by federal deposit insurance or by collateral held either by the State Treasury or by the State's fiscal agent in the State's name.

Effective fiscal 2000, the Highways Division participates in the State Treasury Investment Pool System, pursuant to Act 199, Session Laws of Hawaii 1998. The investment pool system centralizes all phases of the investment process under the direction of the Director of Finance, thereby pooling the State's cash resources to maximize investment returns. State departments and agencies are eligible to invest all funds of qualifying appropriation accounts, eliminating their responsibility for the investment of appropriated funds. The State Treasury allocates investment earnings (interest) monthly, based on the average weighted cash balance of each account. At June 30, 2004 and 2003, all of the Highways Division's restricted and unrestricted cash were deposited in the State Treasury Investment Pool System.

The HRS authorize the Director of Finance to invest in obligations of or guaranteed by the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with State statutes.

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 government-wide and Governmental Funds financial statements.

Restricted Assets—Restricted assets consist of monies and other resources, the use of which is legally restricted. Certain resources set aside for the repayment of highways system revenue bonds are classified as restricted assets on the government-wide statement of net assets as they are maintained separately. Restricted assets account for the principal and interest amounts accumulated to make debt service payments and also include security deposits from third parties.

Capital Assets—Capital assets, which include land and improvements, buildings and improvements, vehicles and equipment, and infrastructure (i.e., roads, bridges, tunnels) 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 May 2002, the GASB issued Statement No. 39, *The Financial Reporting Entity*. Statement No. 39 provides guidance to determine whether certain organizations should be reported as component units of the primary organization. The Highways Division adopted this Statement effective July 1, 2004. Management believes that the adoption of this Statement did not have a significant impact on the financial statements.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures*. Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The Highways Division will adopt this Statement effective July 1, 2005. Management believes that the adoption of this Statement will not have a significant impact on the financial statements.

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

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 2003 (Act 200, SLH 2003)—authorizations for expenditures for operating purposes for the Highways Division (\$163,699,000) and the MVSO (\$6,933,976).

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:

	2004	2003
Excess of revenues over expenditures, non-GAAP budgetary basis	\$ 41,928,936	\$ 36,176,165
Federal grants-in-aid	50,206,022	67,755,567
Operating transfers out to State of Hawaii for debt service	10,987,493	17,858,196
Pass through expenditures for county projects	(20,300,822)	(37,820,436)
Other adjustments to modified accrual basis of accounting	<u>(2,971,243)</u>	<u>(12,961,389)</u>
Excess of revenues over expenditures, GAAP basis	<u>\$ 79,850,386</u>	<u>\$ 71,008,103</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, 2004 and 2003, the tax imposed on each gallon of fuel was as follows:

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

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

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

Vehicle Registration Fee—The vehicle registration fee was \$20 per vehicle.

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

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

5. FEDERAL GRANTS-IN-AID

The Highways Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration ("FHWA") through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2004 and 2003, 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, 2004 and 2003, expenditures of approximately \$4,484,000 and \$3,600,000, 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, 2004 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, 2004, 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 \$79,648 and \$83,620 for fiscal years 2004 and 2003, respectively, have been reported as revenues and expenditures.

7. CAPITAL ASSETS

Changes in capital assets during the years ended June 30, 2004 and 2003 were as follows:

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

	Balance July 1, 2002	(As Restated)			(As Restated) Balance June 30, 2003
		Additions	Deductions	Transfers	
Capital assets not being depreciated:					
Land	\$ 417,382,435	\$ 1,847,212	\$ -	\$ -	\$ 419,229,647
Construction in progress	87,646,758	101,149,921		(22,221,933)	166,574,746
Infrastructure	<u>672,459,071</u>			<u>3,111,071</u>	<u>675,570,142</u>
Total	<u>1,177,488,264</u>	<u>102,997,133</u>		<u>(19,110,862)</u>	<u>1,261,374,535</u>
Capital assets being depreciated:					
Land improvements	235,509	1,826,976			2,062,485
Buildings and improvements	9,059,383	3,294,537			12,353,920
Vehicles and equipment	38,875,642	6,432,727	(2,000,246)		43,308,123
Infrastructure	<u>7,206,656,388</u>		<u>(85,467)</u>	<u>19,110,862</u>	<u>7,225,681,783</u>
Total	7,254,826,922	11,554,240	(2,085,713)	19,110,862	7,283,406,311
Less accumulated depreciation	<u>(2,539,441,304)</u>	<u>(248,555,598)</u>	<u>1,978,569</u>		<u>(2,786,018,333)</u>
Capital assets being depreciated—net	<u>4,715,385,618</u>	<u>(237,001,358)</u>	<u>(107,144)</u>	<u>19,110,862</u>	<u>4,497,387,978</u>
Total capital assets	<u>\$ 5,892,873,882</u>	<u>\$(134,004,225)</u>	<u>\$ (107,144)</u>	<u>\$ -</u>	<u>\$ 5,758,762,513</u>

8. GENERAL LONG-TERM LIABILITIES

Changes in general long-term liabilities during the years ended June 30, 2004 and 2003 were as follows:

	Balance June 30, 2003	Increase	Decrease	Balance June 30, 2004	Due Within One Year	Due After One Year
Accrued workers' compensation	\$ 4,631,047	\$ 1,036,959	\$ (1,036,959)	\$ 4,631,047	\$ 1,330,124	\$ 3,300,923
Accrued vacation	9,376,158	2,824,942	(3,021,222)	9,179,878	2,702,086	6,477,792
Revenue bonds	<u>279,749,144</u>		<u>(11,041,307)</u>	<u>268,707,837</u>	<u>11,385,000</u>	<u>257,322,837</u>
	<u>\$ 293,756,349</u>	<u>\$ 3,861,901</u>	<u>\$ (15,099,488)</u>	<u>\$ 282,518,762</u>	<u>\$ 15,417,210</u>	<u>\$ 267,101,552</u>
	Balance June 30, 2002	Increase	Decrease	Balance June 30, 2003	Due Within One Year	Due After One Year
Accrued workers' compensation	\$ 4,631,047	\$ 1,036,959	\$ (1,036,959)	\$ 4,631,047	\$ 1,036,959	\$ 3,594,088
Accrued vacation	8,944,947	3,511,378	(3,080,167)	9,376,158	3,394,446	5,981,712
Revenue bonds	<u>287,323,319</u>	<u>47,300,095</u>	<u>(54,874,270)</u>	<u>279,749,144</u>	<u>10,635,000</u>	<u>269,114,144</u>
	<u>\$ 300,899,313</u>	<u>\$ 51,848,432</u>	<u>\$ (58,991,396)</u>	<u>\$ 293,756,349</u>	<u>\$ 15,066,405</u>	<u>\$ 278,689,944</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, 1993, the Highways Division issued \$75,000,000 in State of Hawaii Highway Revenue Bonds, Series 1993 ("1993 Bonds"). The 1993 Bonds bear interest at rates ranging from 2.6% to 5.0% and mature in increasing annual installments through 2013. 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 1993 Bonds maturing on and after July 1, 2004 and 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 Bonds bear interest at rates ranging from 4.0% to 5.5% and mature in annual installments through 2018. The 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 Bonds bear interest at rates ranging from 4.4% to 5.5% and mature in annual installments through 2020. The 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 Bonds bear interest at rates ranging from 3.8% to 5.4% and mature in annual installments through 2022. The 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 bond 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.

The following is a summary of highways system revenue bonds issued and outstanding at June 30, 2004

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1996	3.8% - 6.0%	2016	\$ 55,000,000	\$ 34,635,000
1998	4.0% - 5.5%	2018	94,920,000	72,610,000
2000	4.4% - 5.5%	2020	50,000,000	45,630,000
2001	3.8% - 5.4%	2022	70,000,000	67,765,000
2003	2.0% - 5.3%	2013	44,940,000	44,940,000
			<u>\$ 314,860,000</u>	265,580,000
		Add unamortized premium		4,081,221
		Less deferred loss on defeasance		(953,384)
		Less current portion		<u>(11,385,000)</u>
		Noncurrent portion		<u>\$ 257,322,837</u>

The approximate maturities for revenue bonds, including interest of \$127,331,685 (debt service fund of \$6,806,464 and general long-term debt of \$120,525,221) in each of the next five years and thereafter are as follows:

Year Ending June 30	Principal	Interest	Total
2005	\$ 11,385,000	\$ 12,941,358	\$ 24,326,358
2006	11,800,000	12,494,380	24,294,380
2007	12,235,000	12,016,210	24,251,210
2008	12,765,000	11,495,755	24,260,755
2009	13,310,000	10,915,155	24,225,155
2010-2014	76,705,000	43,533,170	120,238,170
2015-2019	99,735,000	21,360,007	121,095,007
2020-2023	<u>27,645,000</u>	<u>2,575,650</u>	<u>30,220,650</u>
Total	<u>\$ 265,580,000</u>	<u>\$ 127,331,685</u>	<u>\$ 392,911,685</u>

In 2004, \$24,534,808 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of \$11,385,000 and interest of \$13,149,808.

10. OTHER FINANCING SOURCES AND USES / TRANSFERS

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

Description	Transfers In (Out)				Adjustments	Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total		
2004						
Funding of highway capital projects	\$ (33,304,958)	\$ -	\$ 33,304,958	\$ -	\$ -	\$ -
Reimbursement to State for debt service on general obligation bonds	(10,987,493)			(10,987,493)		(10,987,493)
Funding of revenue bond debt service	(24,534,808)	24,534,808		-		-
Gain on sale of property	<u>1,978,000</u>			<u>1,978,000</u>	<u>(1,978,000)</u>	<u>-</u>
	<u>\$ (66,849,259)</u>	<u>\$ 24,534,808</u>	<u>\$ 33,304,958</u>	<u>\$ (9,009,493)</u>	<u>\$ (1,978,000)</u>	<u>\$ (10,987,493)</u>
2003						
Funding of highway capital projects	\$ (3,017,345)	\$ -	\$ 3,017,345	\$ -	\$ -	\$ -
Proceeds from issuance of refunding bonds			44,940,000	44,940,000	(44,940,000)	-
Payments to refunded bonds escrow agent			(46,749,377)	(46,749,377)	46,749,377	-
Premiums from issuance of revenue bonds	2,331,608			2,331,608	(2,331,608)	-
Reimbursement to State for debt service on general obligation bonds	(17,858,196)			(17,858,196)		(17,858,196)
Funding of revenue bond debt service	<u>(24,774,998)</u>	<u>24,774,998</u>		<u>-</u>		<u>-</u>
	<u>\$ (43,318,931)</u>	<u>\$ 24,774,998</u>	<u>\$ 1,207,968</u>	<u>\$ (17,335,965)</u>	<u>\$ (522,231)</u>	<u>\$ (17,858,196)</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, 2004 are as follows:

Year Ending June 30	Principal	Interest	Total
2005	\$ 6,166,790	\$ 4,428,482	\$ 10,595,272
2006	16,119,899	4,088,306	20,208,205
2007	14,296,149	3,390,267	17,686,416
2008	14,413,816	2,703,441	17,117,257
2009	14,481,840	2,007,099	16,488,939
2010-2014	32,736,277	3,061,575	35,797,852
2015-2019	5,582,497	112,540	5,695,037
2020-2021	<u>43,742</u>	<u>3,242</u>	<u>46,984</u>
Total	<u>\$ 103,841,010</u>	<u>\$ 19,794,952</u>	<u>\$ 123,635,962</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 \$6,292,045 and \$12,446,521 for principal and \$4,695,448 and \$5,411,675 for interest for the years ended June 30, 2004 and 2003, 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, 2004 and 2003:

	2004	2003
Total Governmental Funds fund balances	\$ 348,382,600	\$ 351,131,518
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.	5,620,354,262	5,758,762,513
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.	1,863,637	2,557,158
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	(9,179,878)	(9,376,158)
Accrued workers' compensation	(4,631,047)	(4,631,047)
Revenue bonds payable	(254,195,000)	(265,580,000)
Premium on revenue bonds	(4,081,221)	(4,905,034)
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.	<u>370,839</u>	<u>1,603,579</u>
Total government-wide net assets	<u>\$5,698,956,864</u>	<u>\$5,829,562,529</u>

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

	2004	2003
Governmental Funds change in fund balances	\$ (2,748,918)	\$ (11,188,679)
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 \$90,194,582 and \$125,569,426 offset by depreciation expense of \$229,478,789 and \$248,555,598 in 2004 and 2003.	(139,284,207)	(122,986,172)
Repayment of bond principal is reported as an expenditure in the Governmental Funds, but the repayment reduces long-term liabilities in the statement of net assets.	11,385,000	10,635,000
Bond proceeds provide current financial resources and are recorded as other financing uses 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 the amortization of revenue bond premium of \$823,813 and \$124,893 in 2004 and 2003.	823,813	(47,146,715)
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 \$1,399,377 in 2003, offset by amortization of \$417,506 and \$281,487 in 2004 and 2003.	(417,506)	46,720,890
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 \$522,231 offset by amortization expense of \$30,562 in 2003, and amortization expense of \$276,015 in 2004.	(276,015)	491,669
Government Funds report the full amount of the proceeds from the sale of capital assets as revenues. However, in the statement of activities, a gain or loss from the disposal of capital assets is reported only to the extent of the difference between the selling price and the carrying value of the asset disposed.	<u>(356,578)</u>	<u>(107,144)</u>
Subtotal (Forwarded)	(130,874,411)	(123,581,151)

(Continued)

	2004	2003
Subtotal (Forwarded)	\$(130,874,411)	\$(123,581,151)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in Governmental Funds.	72,672	(6,573,641)
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>196,074</u>	<u>(431,211)</u>
Government-wide change in net assets	<u>\$(130,605,665)</u>	<u>\$(130,586,003)</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 5 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 2004, 2003, and 2002 was approximately \$3,348,000, \$3,009,000, and \$11,000, 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 for retired employees. Contributions are based upon negotiated collective bargaining agreements and are limited by state statute to the actual cost of benefit coverage. The Highways Division pays for 100% of these benefits for employees who have at least 10 years of service. The Highways Division's share of the cost of these benefits is pro-rated for employees with less than 10 years of service. The Highways Division also reimburses Medicare expenses of retirees and qualified spouses (through the State) who are at least 62 years of age and have at least 10 years of service. Contributions are based upon negotiated collective bargaining agreements and are limited by state statute to the actual cost of benefit coverage. The amounts allocated to the Highways Division for fiscal years 2004 and 2003 aggregated approximately \$2,714,000 and \$2,605,000, 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 \$8,180,000 and \$5,416,000 in fiscal years 2004 and 2003, respectively.

The Highways Division is assessed a percentage of the cost of the general administration expenses of the Department. During fiscal years 2004 and 2003, the assessments amounted to approximately \$4,888,000 and \$5,530,000, respectively. During fiscal years 2004 and 2003, respectively, the Highways Division received assessment refunds from the Department amounting to approximately \$315,000 and \$1,213,000, resulting in a net general administration expense of approximately \$3,706,000 and \$4,317,000.

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. Scheduled minimum rental payments for succeeding fiscal years ending June 30 are as follows:

Year Ending June 30	
2005	\$ 956,632
2006	956,632
2007	956,632
2008	956,632
2009	956,632
2010-2014	4,783,160
2015-2019	<u>4,145,405</u>
Total	<u>\$ 13,711,725</u>

The total rental expenditures during fiscal years 2004 and 2003 for operating leases were approximately \$1,351,000 and \$1,121,000, respectively.

Rental revenues

The Highways Division also leases various Highways owned properties under noncancelable long-term lease agreements that expire through fiscal year 2043 and beyond. Scheduled minimum revenues for succeeding fiscal years ending June 30 are as follows:

Year Ending June 30	
2005	\$ 306,872
2006	306,872
2007	306,872
2008	306,872
2009	306,872
2010-2014	1,534,360
2015-2019	1,518,510
2020-2024	1,375,860
2025-2029	1,127,360
2030-2034	407,298
2035-2039	376,500
2040-2044	<u>210,925</u>
 Total	 <u><u>\$8,085,173</u></u>

15. COMMITMENTS

Condemnation Proceedings

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways Division to compensate the existing property owner for the fair market value of the real property. Prior to the determination of the fair market value, the Highways Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately \$1,071,000 at June 30, 2004. 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 these 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, 2004 aggregated approximately \$20,456,000.

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, 2004.

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, 2004, the Capital Projects Fund had an unreserved deficit balance of \$114,282,375. The Highways Division intends to take corrective action to eliminate this deficit balance.

19. SUBSEQUENT EVENT

On February 20, 2005, the Highways Division issued \$183,915,000 in State of Hawaii Revenue Bonds 2005 Series A and B. The bonds bear interest at rates ranging from 3.00% to 5.25% and mature in annual installments through 2025. A portion of the proceeds of the sale has been deposited in an escrow

account to be used to refund portions of outstanding bonds. The remaining proceeds will be used to finance certain highways capital improvement projects.

20. RESTATEMENT OF 2003 STATEMENT OF NET ASSETS

Subsequent to the issuance of the Highways Division's financial statements for the year ended June 30, 2003, the Highways Division determined that \$16,382,267 of maintenance related projects were inappropriately capitalized as infrastructure. Of this amount, \$9,414,474 was expended prior to fiscal year 2003. Accordingly, Highways Division has reduced the capital asset balance at June 30, 2003 by \$16,382,267, increased operations and maintenance expense for fiscal year 2003 by \$13,074,794, reduced capital project expenditures for fiscal year 2003 by \$6,107,001, and reduced net assets at July 1, 2002 by \$9,414,474.

In addition, the Highways Division determined that it had inadvertently applied the approved indirect cost rate to the wrong base in fiscal year 2003. The indirect cost rate proposal approved by the Federal Highways Administration used direct payroll as the base, but the Highways Division applied the indirect cost rate to direct payroll and fringe benefits. This had the effect of overstating the receivable from the U.S. Government and capital grants and contributions revenue by \$1,333,723 in the fiscal year 2003 financial statements. Accordingly, the fiscal year 2003 financial statements have been restated to reverse these amounts.

The effect of such adjustments on the 2003 government-wide financial statements is as follows:

	As Previously Reported	As Restated
Due from U.S. Government	\$ 14,171,066	\$ 12,837,343
Capital Assets, net of accumulated depreciation	5,775,144,780	5,758,762,513
Capital grants and contribution revenue	69,878,684	68,544,961
Operations and maintenance:		
Oahu highways and services	29,339,312	32,057,384
Hawaii highways and services	12,829,790	21,253,805
Maui highways and services	9,651,964	11,584,671
Capital project expenditures	12,619,301	6,512,300
Net Assets, beginning of year	5,969,563,006	5,960,148,532
Net Assets, end of year:		
Invested in capital assets, net of related debt	5,476,290,064	5,459,907,797
Restricted for revenue bonds	8,000,000	8,000,000
Restricted contributions	187,895	187,895
Unrestricted	362,800,560	361,466,837
Total	5,847,278,519	5,829,562,529

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