State of Hawaii, Department of Transportation, Highways Division

Financial Statements
Fiscal Year Ended June 30, 2008

Submitted by

THE AUDITOR
STATE OF HAWAII

KMHLLP

A Hawaii Limited Liability Partnership

March 23, 2009

Office of the Auditor
State of Hawaii

Dear Ms. Higa:

This is our report on the financial audit of the Highways Division of the Department of Transportation of the State of Hawaii (the Division) as of and for the fiscal year ended June 30, 2008. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, Government Auditing Standards, *Audits of States, Local Governments, and Non-Profit Organizations.*

OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the Division's basic financial statements as of and for the fiscal year ended June 30, 2008, and to comply with the requirements of OMB Circular A-133. The objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the Division's basic financial statements.

2. To determine whether expenditures and other disbursements have been made and revenues and other receipts to which the Division is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government.

3. To determine whether the Division has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.

4. To determine whether the Division has complied with the laws and regulations that may have a material effect on the basic financial statements and on its major federal financial assistance programs.

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards,* issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the Division for the fiscal year ended June 30, 2008.

ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I – The basic financial statements and related notes of the Division as of and for the fiscal year ended June 30, 2008, and our opinion on the basic financial statements.
- Part II – Our report on internal control over financial reporting and compliance.
- Part III – Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV – The schedule of findings and questioned costs.
- Part V – The summary schedule of prior audit findings.

We wish to express our sincere appreciation for the cooperation and assistance extended by the officers and staff of the Division.

Sincerely,

Wilcox Choy

Wilcox Choy
Partner

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

PART I

FINANCIAL SECTION

A Hawaii Limited Liability Partnership

Independent Auditor's Report

Office of the Auditor
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Highways Division of the Department of Transportation of the State of Hawaii (Division), as of and for the year ended June 30, 2008, which collectively comprise the Division's basic financial statements as listed in the preceding table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 of America. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of the Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and each major fund of the State of Hawaii that is attributable to the transactions of the Division. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008, and the changes in its financial position for the fiscal year 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 and each major fund of the Division, as of June 30, 2008, and the respective changes in financial position and the respective budgetary comparison of the State Highway Fund thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

1003 Bishop Street ■ Suite 2400 ■ Honolulu, HI 96813 ■ Telephone: 808-526-2255 ■ Fax: 808-536-5817 ■ www.kmhllp.com

In accordance with *Government Auditing Standards*, we have also issued our report dated March 23, 2009, on our consideration of the Division's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that 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 considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 8 through 19 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Division's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KMH LLP

KMH LLP

Honolulu, Hawaii
March 23, 2009

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION – HIGHWAYS DIVISION

MANAGEMENT'S DISCUSSION AND ANALYSIS – UNAUDITED
AS OF AND FOR THE YEAR ENDED JUNE 30, 2008

The following Management's Discussion and Analysis ("MD&A") of the Highways Division, Department of Transportation, State of Hawaii ("Division") activities and financial performance provides the reader with an introduction and overview to the financial statements of the Division for the year ended June 30, 2008. 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 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 Division are to plan, design, construct, and maintain highway facilities. In addition, the 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 Division is managed by the 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 Division. Other major functional operations within the Division include Engineering Services Office, Landscape Services Office, Motor Vehicle Safety Office, Planning Branch, Design Branch, Rights-of-Way Branch, Materials Testing and Research Branch, Construction and Maintenance Branch, and Traffic Branch.

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

The assets of the Division exceeded its liabilities at June 30, 2008 by $5.3 billion. Of this amount, $249 million is considered unrestricted and may be used to meet the Division's ongoing obligations.

The current year change in net assets was a decrease of $60 million. This resulted from an excess of expenses over revenues of $43 million and a transfer of $17 million to other State departments for debt service payments on general obligation bonds. The excess of expenses over revenues was significantly impacted by depreciation expense of $228 million.

Fund Financial Statements

At June 30, 2008, the Division's Governmental Funds reported a combined ending fund balance of $273 million. The combined fund balance decreased by $41 million from the prior year's ending fund balance.

The Division's State Highway Fund (SHF), the major operating fund, reported an ending fund balance of $223 million, of which $83 million is considered unreserved. There was a $13 million decrease in fund balance for the year ended June 30, 2008.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

The government-wide statements report information about the Division as a whole in a manner similar to a private-sector business. The statements provide both long-term and short-term information about the 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:

The Statement of Net Assets presents all of the Division's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Division's net assets are an indicator of whether its financial health is improving or deteriorating.

The Statement of Activities presents information showing how the 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 Division's activities are considered governmental activities, and are primarily funded by taxes, charges for services, and intergovernmental revenues.

The government-wide financial statements can be found on pages 20 to 22 of this report.

Fund 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 Division, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the Division are considered governmental funds.

The fund 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. Fund financial statements are prepared using the current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Division's finances that assist in determining whether there will be adequate financial resources available to meet the current needs of the 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 Division's near-term financing decisions. A reconciliation to facilitate this comparison between governmental fund financial statements and government-wide financial statements is included on pages 25 and 28 of this report.

The 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 Division's three governmental funds are the SHF (a Special Revenue Fund), the Debt Service Fund, and the Capital Projects Fund.

The basic governmental funds financial statements can be found on pages 23 through 28 of this report.

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

The governmental funds financial statements are followed by a budgetary comparison statement, which compares the SHF's original budget, final budget, and actual amounts prepared on a budgetary basis. A reconciliation between the actual SHF revenues and expenditures compared to the SHF 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 page 29 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 31 through 56 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 Division's financial position. The Division's assets exceeded liabilities by $5.3 billion and $5.4 billion at June 30, 2008 and 2007, respectively.

	2008	2007
Assets		
Current and other assets	$ 352,158,459	$ 390,955,786
Capital assets – net of accumulated depreciation	5,306,914,550	5,342,690,979
Total assets	$ 5,659,073,009	$ 5,733,646,765
Liabilities		
Current liabilities	$ 76,173,525	$ 74,361,452
Long-term liabilities	277,697,971	293,697,860
Total liabilities	353,871,496	368,059,312
Net Assets		
Invested in capital assets—net of related debt	5,029,113,828	5,065,373,798
Restricted	27,256,519	14,885,000
Unrestricted	248,831,166	285,328,655
Total net assets	5,305,201,513	5,365,587,453
Total liabilities and net assets	$ 5,659,073,009	$ 5,733,646,765

The largest portion of the Division's net assets (94 percent at June 30, 2008 and 2007) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the 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 Division's net assets (0.5 percent and 0.2 percent at June 30, 2008 and 2007, respectively) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for payment of the Division's revenue bond debt service. The remaining balance of unrestricted net assets may be used to meet the Division's on-going obligations to citizens and creditors.

Capital assets – net decreased by $36 million from June 30, 2007 to June 30, 2008 and by $92 million from June 30, 2006 to June 30, 2007 primarily because depreciation expense more than offset additions to construction in progress.

Long-term liabilities decreased by $16 million from June 30, 2007 to June 30, 2008 and $16 million from June 30, 2006 to June 30, 2007 primarily due to principal payments on revenue bonds.

Statement of Activities

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

	2008	2007
EXPENSES:		
Program expenses:		
Operations and maintenance	$ 158,679,947	$ 158,744,838
Administration of Highways Division	30,099,922	34,142,406
Surcharge on gross receipts	8,629,725	8,091,700
Motor Vehicle Safety Office	8,888,617	8,710,955
Capital projects	7,227,619	6,949,735
Depreciation expense	227,537,321	231,003,194
Debt service/interest expense	12,146,769	12,061,575
Total expenses	453,209,920	459,704,403
REVENUES:		
Program revenues:		
Charges for services	25,599,665	25,400,271
Operating grants and contributions	70,079,462	46,974,987
Capital grants and contributions	137,320,675	86,338,003
Total program revenues	232,999,802	158,713,261
General revenues:		
Taxes	170,630,178	165,384,250
Interest income	4,782,301	18,238,962
Other	1,308,822	1,487,783
Total general revenues	176,721,301	185,110,995
Total revenues	409,721,103	343,824,256
Decrease in net assets before transfers (Carried forward)	$ (43,488,817)	$ (115,880,147)

	2008	2007
Decrease in net assets before transfers (Brought forward)	$ (43,488,817)	$ (115,880,147)
Transfers	(16,897,123)	(17,370,368)
Decrease in net assets	(60,385,940)	(133,250,515)
Net Assets, beginning of year	5,365,587,453	5,498,837,968
Net Assets, end of year	$ 5,305,201,513	$ 5,365,587,453

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 57 percent and 46 percent of total revenues in fiscal years 2008 and 2007, respectively. The largest components of program revenues (89 percent and 84 percent for fiscal years 2008 and 2007, 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 primarily consist of taxes which represented 97 percent and 89 percent of general revenues for fiscal years 2008 and 2007, respectively.

The fiscal year 2008 decrease in net assets of $60 million resulted from the excess of expenses over revenues of $43 million due primarily to depreciation expense of $227 million and a transfer out of $17 million to other State departments for the payment of debt service on general obligation bonds.

The fiscal year 2007 decrease in net assets of $133 million resulted from the excess of expenses over revenues of $116 million due primarily to depreciation expense of $231 million and a transfer out of $17 million to other State departments for the payment of debt service on general obligation bonds.

FINANCIAL ANALYSIS OF THE DIVISION'S GOVERNMENTAL FUNDS

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

The focus of the 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 Division's financing requirements.

At June 30, 2008, the Division's Governmental Funds reported combined ending fund balances of $273 million, representing a decrease of $41 million from the prior year. Substantially all of the fund balance is reserved to indicate that it is not available for new spending primarily because it has already been committed to liquidate contracts and purchase orders of the prior period.

At June 30, 2007, the Division's Governmental Funds reported combined ending fund balances of $314 million, representing a decrease of $57 million from the prior year. Approximately $173 million of this amount constitutes unreserved fund balance.

The SHF is the major operating fund of the 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 SHF established under Section 248-8, Hawaii Revised Statutes ("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 SHF. 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, 2008, the total fund balance of the SHF was $223 million, of which $83 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 29 percent of total fund expenditures (including transfers out), while total fund balance represents 78 percent of the same amount.

The SHF's fund balance decreased by $13 million in the current year compared to a $21 million decrease in the prior year. During the current year, the Division collected more revenues but also expended more for operations and maintenance.

At June 30, 2007, the total fund balance of the SHF was $236 million, of which $97 million was unreserved. Unreserved fund balance represented 35 percent of total fund expenditures (including transfers out), while total fund balance represented 85 percent of the same amount.

The SHF's fund balance decreased by $21 million in fiscal year 2007. During that fiscal year, the Division also collected more revenues but also expended more on operations and maintenance.

The Debt Service Fund ("DSF") is used to track the revenue bond debt service for the Division. Debt service requirements are transferred from the SHF. The decrease in debt service expense on the government-wide financial statements from $12 million in fiscal year 2007 to $13 million in fiscal year 2008 is attributable to decreased interest expense.

The Capital Projects Fund ("CPF") accounts for the Division's capital improvements program. At June 30, 2008, the CPF had a total fund balance of $51 million, including an unreserved fund deficit of $304 million. The CPF fund balance decreased by $28 million in fiscal year 2008 compared to a $36 million decrease in the prior year. The change from the prior year was due primarily to an increase in contract encumbrances in the current year.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of $203 million which is equal to the original budget. The actual revenues on a budgetary basis were $9.9 million higher than the final budget, primarily due to an increase in interest income.

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

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The Division's investment in capital assets as of June 30, 2008 amounted to $5.3 billion, net of accumulated depreciation of $3.9 billion. This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During fiscal year 2008, the Division put out 39 projects to bid with a contract amount of approximately $89 million. There were 15 projects on Oahu, 6 projects on Hawaii, 10 projects on Maui, (includes Molokai and Lanai), and 8 projects on Kauai.

During fiscal year 2007, the Division put out 43 projects to bid with a contract amount of approximately $251 million. There were 13 projects on Oahu, 10 projects on Hawaii, 9 projects on Maui, (includes Molokai and Lanai), and 11 projects on Kauai.

At June 30, 2008, the Division had $355 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2008, with construction expected to start in fiscal year 2009.

At June 30, 2007, the Division had $348 million in contracts encumbered in the Capital Projects Fund. This amount represents projects in the in-house planning stage and contracts awarded in fiscal year 2007, with construction that started in fiscal year 2008.

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

Long-Term Debt

As of June 30, 2008, $262 million in Highway Revenue Bonds were outstanding, compared to $279 million as of June 30, 2007.

See Note 10 for additional information on Highway Revenue Bonds.

As of June 30, 2008, $53 million in State of Hawaii General Obligation Bonds were outstanding, compared to $67 million as of June 30, 2007. These bonds are considered general obligations of the State, and not the Division. Accordingly, no amounts are recorded by the Division for these liabilities. The Division makes debt service payments to repay principal and interest on these amounts. The payments for the fiscal year ended June 30, 2008 amounted to $17 million, and the amount was recorded as an other financing use and transfer out in the financial statements.

See Note 11 for further information on general obligation bonds.

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

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

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

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the 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

Statement of Net Assets
June 30, 2008

Assets

	Governmental Activities
Cash	$ 282,850,938
Receivables, net of allowance for doubtful accounts:	
Due from U.S. Government	31,512,089
Due from City and Counties	4,510,474
Due from State of Hawaii	907,614
Other receivables	481,597
Prepaid Expenses	2,023,754
Restricted Cash:	
Revenue bond debt service	20,778,557
Security deposits	6,477,962
Bond Issuance Costs, net of accumulated amortization of $1,555,183	1,266,388
Other Assets	1,349,086
Capital Assets, net of accumulated depreciation	5,306,914,550
Total assets	$ 5,659,073,009

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Net Assets
June 30, 2008

Liabilities and Net Assets

	Governmental Activities
Accounts Payable	$ 9,237,602
Accrued Payroll	3,850,153
Contracts Payable:	
Current portion	27,850,168
Retained percentage	7,948,857
Payable from Restricted Assets:	
Revenue bonds payable - due within one year	15,495,000
Interest payable	5,283,557
Security deposits	6,477,962
Other Liabilities	30,226
Long Term Liabilities:	
Due within one year:	
Workers' compensation payable	616,678
Accrued vacation payable	2,910,534
Due after one year:	
Workers' compensation payable	4,174,987
Accrued vacation payable	7,690,050
Revenue bonds payable	262,305,722
Total liabilities	353,871,496
Net Assets:	
Invested in capital assets, net of related debt	5,029,113,828
Restricted for current portion of revenue bonds	27,256,519
Unrestricted	248,831,166
Total net assets	5,305,201,513
Total liabilities and net assets	$ 5,659,073,009

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Activities
For the Fiscal Year Ended June 30, 2008

	Governmental Activities
Operations and Maintenance:	
Oahu highways and services	$ 90,843,163
Hawaii highways and services	13,234,137
Maui highways and services	15,762,214
Kauai highways and services	10,942,335
Molokai highways and services	956,699
Lanai highways and services	2,033,951
Pass through for County highways and services	24,907,448
Administration of Highways Division	30,099,922
Surcharge on Gross Receipts	8,629,725
Motor Vehicle Safety Office	8,888,617
Capital Projects	7,227,619
Depreciation Expense	227,537,321
Interest Expense	12,146,769
Total expenses	453,209,920
Program Revenues:	
Charges for services:	
Vehicle registration fees	21,033,096
Other fees and permits	1,770,142
Penalties and fines	1,421,160
Rentals	1,375,267
Operating grants and contributions	70,079,462
Capital grants and contributions	137,320,675
Total program revenues	232,999,802
General Revenues:	
Taxes:	
State fuel taxes	87,885,082
Rental motor and tour vehicle surcharge taxes	49,195,958
Vehicle weight taxes and penalties	33,549,138
Interest income	4,782,301
Non-imposed fringe benefits	1,308,822
Total general revenues	176,721,301
Deficiency of revenues under expenditures	(43,488,817)
Transfers	(16,897,123)
Change in net assets	(60,385,940)
Net Assets:	
Beginning of year	5,365,587,453
End of year	$ 5,305,201,513

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds
June 30, 2008

Assets	**State Highway Fund**	**Debt Service Fund**	**Capital Projects Fund**	**Total**
Cash	$ 147,251,823	$ -	$ 135,599,115	$ 282,850,938
Receivables, net of allowance for doubtful accounts:				
Due from Capital Projects Fund	82,107,007	-	-	82,107,007
Due from U.S. Government	8,276,334	-	23,235,755	31,512,089
Due from City and Counties	4,510,474	-	-	4,510,474
Due from State of Hawaii	907,614	-	-	907,614
Other receivables	481,597	-	-	481,597
Prepaid Expenses	1,991,649	-	32,105	2,023,754
Restricted Cash:				
Revenue bond debt service	-	20,778,557	-	20,778,557
Security deposits	6,477,962	-	-	6,477,962
Total assets	$ 252,004,460	$ 20,778,557	$ 158,866,975	$ 431,649,992

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds
June 30, 2008

Liabilities and Fund Balances	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Accounts Payable	$ 7,415,252	$ -	$ 1,822,350	$ 9,237,602
Accrued Payroll	3,850,153	-	-	3,850,153
Contracts Payable:				
Current portion	7,962,341	-	19,887,827	27,850,168
Retainage payable	3,425,715	-	4,523,142	7,948,857
Payable from Restricted Assets:				
Matured bonds and interest payable	-	20,778,557	-	20,778,557
Security deposits	6,477,962	-	-	6,477,962
Due to State Highway Fund	-	-	82,107,007	82,107,007
Other Liabilities	30,226	-	-	30,226
Total liabilities	29,161,649	20,778,557	108,340,326	158,280,532
Fund Balances:				
Reserved for:				
Encumbrances	138,349,333	-	354,628,620	492,977,953
Prepaid expenses	1,991,649	-	32,105	2,023,754
Unreserved	82,501,829	-	(304,134,076)	(221,632,247)
Total fund balances	222,842,811	-	50,526,649	273,369,460
Total liabilities and fund balances	$ 252,004,460	$ 20,778,557	$ 158,866,975	$ 431,649,992

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets
June 30, 2008

Total Fund Balances - Governmental Funds		$ 273,369,460
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the Governmental Funds financial statements. These assets consist of:		
Governmental capital assets	9,234,837,786	
Less accumulated depreciation	(3,927,923,236)	
		5,306,914,550
Bonds issuance costs are recorded as expenditures in Governmental Funds financial statements when incurred. However, in Government Wide financial statements, such amounts are recorded as a deferred charge and amortized over the life of the related bonds		1,266,388
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 payable	(10,600,584)	
Accrued workers' compensation payable	(4,791,665)	
Revenue bonds payable	(262,305,722)	
		(277,697,971)
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 Governmental Fund financial statements		1,349,086
Net Assets of Governmental Activities		$ 5,305,201,513

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Fiscal Year Ended June 30, 2008

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Expenditures:				
Operations and maintenance:				
Oahu highways and services	$ 92,048,980	$ -	$ -	$ 92,048,980
Hawaii highways and services	23,831,613	-	-	23,831,613
Maui highways and services	15,850,377	-	-	15,850,377
Kauai highways and services	11,368,731	-	-	11,368,731
Molokai highways and services	956,699	-	-	956,699
Lanai highways and services	2,033,951	-	-	2,033,951
Pass through for County highways and services	24,907,448	-	-	24,907,448
Administration of Highways Division	30,087,843	-	-	30,087,843
Surcharge on gross receipts	8,629,725	-	-	8,629,725
Motor Vehicle Safety Office	8,888,617	-	-	8,888,617
Capital projects	-	-	186,924,899	186,924,899
Debt service:				
Principal payment	-	15,495,000	-	15,495,000
Interest expense	-	12,929,616	-	12,929,616
Total expenditures	218,603,984	28,424,616	186,924,899	433,953,499
Program Revenues:				
Charges for services:				
Vehicle registration fees	21,033,096	-	-	21,033,096
Other fees and permits	1,770,142	-	-	1,770,142
Penalties and fines	1,421,160	-	-	1,421,160
Rentals	1,375,267	-	-	1,375,267
Operating grants and contributions	70,079,462	-	-	70,079,462
Capital grants and contributions	-	-	137,320,675	137,320,675
Total program revenues	95,679,127	-	137,320,675	232,999,802

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds
For the Fiscal Year Ended June 30, 2008

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
General Revenues:				
Taxes:				
Fuel Taxes	87,885,082	-	-	87,885,082
Rental motor and tour vehicle surcharge taxes	49,195,958	-	-	49,195,958
Vehicle weights taxes	33,549,138		-	33,549,138
Interest income	4,782,301	-	-	4,782,301
Non-imposed fringe benefits	1,308,822	-	-	1,308,822
Total general revenues	176,721,301	-	-	176,721,301
Excess (deficiency) of revenues over expenditures	53,796,444	(28,424,616)	(49,604,224)	(24,232,396)
Other Financing Sources (Uses):				
Transfers in	-	28,424,616	21,673,899	50,098,515
Transfers out	(66,995,638)	-	-	(66,995,638)
Total other financing sources (uses)	(66,995,638)	28,424,616	21,673,899	(16,897,123)
Deficiency of revenues and other financing sources over expenditures and other financing uses	(13,199,194)	-	(27,930,325)	(41,129,519)
Fund Balances:				
Beginning of year	236,042,005	-	78,456,974	314,498,979
End of year	$ 222,842,811	$ -	$ 50,526,649	$ 273,369,460

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balances to the Statement of Activities
For the Fiscal Year Ended June 30, 2008

Net Change in Fund Balances - Total Governmental Funds		$ (41,129,519)
Amounts reported for governmental activities in the statement of activities 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:		
Expenditures for capital assets	191,760,892	
Less current fiscal year depreciation and loss on disposal	(227,537,321)	
		(35,776,429)
Repayment of bond principal is reported as expenditures in the Governmental Funds financial statements, but the repayment reduces long-term liabilities in the Government-Wide financial statements		15,495,000
Bond issue costs, original issue premium, and deferred amount on refunding are reported as incurred in Governmental Funds as they require the use of current financial resources. However, in the Government-Wide financial statements, these expenses are deferred and amortized to expense over the remaining life of the related bond:		
Amortization of bond premiums	1,768,436	
Amortization of deferred amount on refunding	(795,908)	
Amortization of deferred bond issuance costs	(189,681)	
		782,847
Other revenues and expenditures in the Government-Wide financial statements do not provide or use current financial resources and therefore are not reported as revenues and expenditures in Governmental Funds financial statements		242,161
Change in Net Assets - Governmental Activities		$ (60,385,940)

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

State Highway Fund
Statement of Revenues and Expenditures - Budget and Actual (Non-GAAP Budgetary Basis)
For the Fiscal Year Ended June 30, 2008

	Original	Final	Actual on Budgetary Basis	Variance Over (Under)
Revenues:				
Fuel taxes	$ 86,688,000	$ 86,688,000	$ 87,885,082	$ 1,197,082
Vehicle weight taxes	33,725,000	33,725,000	34,009,878	284,878
Rental motor and tour vehicle surcharge tax	47,929,000	47,929,000	49,195,958	1,266,958
Vehicle registration fees	21,025,000	21,025,000	21,155,501	130,501
Interest income	10,000,000	10,000,000	15,493,566	5,493,566
Other fees and penalties	4,071,000	4,071,000	5,637,909	1,566,909
	203,438,000	203,438,000	213,377,894	9,939,894
Expenditures:				
Operations and maintenance:				
Oahu highways and services	61,945,421	78,299,513	77,753,304	(546,209)
Hawaii highways and services	24,490,830	25,005,486	23,329,503	(1,675,983)
Maui highways and services	18,396,271	18,920,691	18,717,002	(203,689)
Kauai highways and services	13,135,766	13,699,662	13,538,102	(161,560)
Molokai highways and services	3,523,206	4,112,305	3,955,225	(157,080)
Lanai highways and services	842,565	368,087	203,048	(165,039)
Administration of Highways Division including debt service	68,543,450	71,724,797	60,563,080	(11,161,717)
State of Hawaii surcharge on gross receipts	7,571,691	7,571,691	8,629,725	1,058,034
Motor Vehicle Safety Office	5,978,053	5,978,053	5,832,992	(145,061)
	204,427,253	225,680,285	212,521,981	(13,158,304)
Excess (deficiency) of revenues over expenditures and other uses	$ (989,253)	$ (22,242,285)	$ 855,913	$ 23,098,198

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Agency Fund
Statement of Asset and Liabilities
June 30, 2008

	Agency Fund
Asset	
Cash	$ 9,178,391
Total asset	$ 9,178,391
Liabilities	
Due to Others	$ 9,178,391
Total liabilities	$ 9,178,391

See accompanying notes to the basic financial statements.

1. Financial 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 (Division). Through the 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 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). The 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 Division.

2. Significant Accounting Policies

a. Basis of Presentation

The Division's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America.

b. Governmental Funds Financial Statements

The accounts of the 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. Government 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

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

activities are controlled. For financial reporting purposes, the Division includes all funds that are controlled by or dependent on the Division's administrative head. Control by or dependence on the Division was determined on the basis of statutory authority and monies flowing through the 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 Division considers all revenues reported in the Governmental Funds to be available if the revenues are collected within 90 days after year-end. Revenues susceptible to accrual include federal grants and tax and fee revenues. 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, 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 Highway Fund established under Section 264-41, HRS.

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

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

Capital Projects Fund – The Capital Projects Fund accounts for the Division's construction projects and the related sources of financing.

The accompanying financial statements include highway projects authorized by legislative acts through June 30, 2008.

c. Government-Wide Financial Statements

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

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

Statement of Activities – The statement of activities reports expenses and revenues in a format that focuses on the cost of the Division's programs. 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.

d. Fiduciary Fund Financial Statements

The agency fund is used to account for assets held by the Division on behalf of other departments of the State. Cash reported in the agency fund statement of assets and liabilities includes cash in the State Treasury, including deposits received and held for others in the amount of $9,178,391 at June 30, 2008.

2. Significant Accounting Policies (continued)

e. Cash and Restricted Cash

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

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

At June 30, 2008, a portion of the State Treasury Investment Pool was invested in auction rate securities. Due to ongoing issues in the credit market of the United States, particularly related to auction rate securities, the State Treasury Investment Pool recorded a decrease in fair value related to its investments in auction rate securities. The change in fair value amounts to approximately $9.5 million, which is recorded against interest income in the accompanying financial statements.

Restricted cash consists of monies and other resources, the use of which is legally restricted. Restricted cash accounts for the principal and interest amounts accumulated to make debt service payments on the Division's revenue bonds and also include security deposits collected from third parties.

2. Significant Accounting Policies (continued)

f. 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 Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected. At June 30, 2008, the allowance for uncollectible receivables was approximately $227,000.

g. Capital Assets

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

Class of Assets	Estimated Useful Life	Capitalization Threshold
Land improvements	15 years	$ 100,000
Buildings	30 years	$ 100,000
Building improvements	30 years	$ 100,000
Vehicles and equipment	5 to 7 years	$ 5,000
Infrastructure	13 to 75 years	$ 100,000

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

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

2. Significant Accounting Policies (continued)

h. Accrued Vacation and Compensatory Pay

The 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 employee's 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.

i. Long-Term Obligations

In the Government-Wide Financial Statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums, issuance costs, and deferred amounts 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 deferred amounts 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 as paid. 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.

j. Encumbrances

The 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 expenditures are reported in the period in which the liability is incurred. Encumbrances are not recognized in the Government-Wide statement of net assets.

k. Employees' Retirement System

The Division's contributions to the Employee's 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 Division's policy is to fund its required contribution each pay period.

2. Significant Accounting Policies (continued)

l. Risk Management

The 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 State 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.

m. Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

n. 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.

o. New Accounting Pronouncements

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups.

This Statement is effective for financial statement periods beginning after December 15, 2007. The Division has not yet analyzed the potential effect on the financial statements, if any, of adopting Statement No. 49.

3. Budgets and Budgetary Accounting

a. State Highway Fund

In the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis), amounts reflected as original and amended budgeted revenues are the official estimates as compiled by the Division's management and the State Department of Budget and Finance at the time of budget consideration and adoption by the State Legislature. Revenue received from federal grants-in-aid is not included in the State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (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 Fund State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 2006 (Act 160, SLH 2006) authorizations for expenditures for operating purposes for the Division of $198,449,200 and the MVSO $5,978,053.

Allotments are made and expenditures are controlled at the program level reflected in the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis). State Highway Fund allotments lapse at year-end.

3. Budgets and Budgetary Accounting (continued)

a. State Highway Fund (continued)

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

Excess of revenues over expenditures, non-GAAP budgetary basis	$ 855,913
Federal grants-in-aid	70,079,462
Operating transfers out of State of Hawaii for debt service	16,897,123
Pass through expenditures for county projects	(24,907,448)
Net decrease in the fair value of State Treasury Investment Pool	(9,534,356)
Other adjustments to modified accrual basis of accounting	405,750
Excess of revenues over expenditures, GAAP basis	$ 53,796,444

b. Capital Projects Fund

Excess Capital Projects Fund allotments lapse after completion of the project, which is generally two or three years subsequent to allotment. Funds allotted as part of a qualified federal award program do not lapse.

4. Tax and Fee Revenues

a. State Fuel Tax

The primary source of revenue for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For fiscal year 2008, the tax imposed on each gallon of fuel was as follows:

Gasoline	17 cents
Diesel Fuel:	
Non-highway use	2 cents
Highway use	17 cents
Liquefied Petroleum Gas	5.2 cents

b. Vehicle Weight Tax and Penalties

The vehicle weight tax was 0.75 to 1.25 cents per pound of net vehicle weight, to a maximum of $150 per vehicle.

c. Rental Motor and Tour Vehicle Surcharge Tax

The rental motor vehicle surcharge tax was $2 to $3 a day or any portion of a day that a rental motor vehicle is rented or leased. The tour vehicle surcharge tax was $65 a month for tour vehicles categorized by the Public Utilities Commission as an over 25-passenger carrier vehicle and $15 a month for tour vehicles categorized as an 8 to 25 passenger carrier vehicle.

d. Vehicle Registration and Motor Carrier Safety Inspection Fee

The vehicle registration fee was $25 per vehicle, of which $5 is earmarked for deposit into the Emergency Medical Services (EMS) special fund. During the year ended June 30, 2008 the Division collected approximately $5,290,000 on behalf of the EMS special fund. All amounts were disbursed to the EMS special fund. Accordingly, no amounts are reported in the financial statements at June 30, 2008. The motor carrier safety inspection fee was $1.50 per vehicle every six months.

5. Federal Grants-In-Aid

The 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, 2008, receivables totaling $31,512,089 from the U.S. Government are comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement.

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. Cost 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 Division for economy, efficiency, and program results. The Division's management believes that any federal aid received as of June 30, 2008 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 Division at June 30, 2008, 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 Division are assumed by the State and are not charged to the Division's operating funds. These costs totaling $1,308,822 for fiscal year 2008 have been reported as revenues and expenditures in the State Highway Fund.

7. Capital Assets

Changes in capital assets during the year ended June 30, 2008 was as follows:

	Balance July 1, 2007	Additions	Deductions	Transfers	Balance June 30, 2008
Nondepreciable assets:					
Land	$ 430,734,972	$ 1,034,632	$ (27,396)	$ -	$ 431,742,208
Construction in progress	216,320,667	186,317,895	-	(108,357,572)	294,280,990
Infrastructure	730,402,881	-	-	14,892,344	745,295,225
Total	1,377,458,520	187,352,527	(27,396)	(93,465,228)	1,471,318,423
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Buildings and improvements	27,847,147	-	-	416,695	28,263,842
Vehicles and equipment	53,869,038	4,408,365	(1,406,031)	-	56,871,372
Infrastructure	7,587,513,160	-	(4,393,017)	93,048,533	7,676,168,676
Total	7,671,444,818	4,408,365	(5,799,048)	93,465,228	7,763,519,363
Less accumulated depreciation	(3,706,212,359)	(226,881,373)	5,170,496	-	(3,927,923,236)
Depreciable assets, net	3,965,232,459	(222,473,008)	(628,552)	93,465,228	3,835,596,127
Capital assets, net	$ 5,342,690,979	$ (35,120,481)	$ (655,948)	$ -	$ 5,306,914,550

8. Net Assets

At June 30, 2008 net assets consisted of the following:

Invested in Capital Assets, Net of Related Debt:	
Net property, plant and equipment	$ 5,306,914,550
Less: Long term debt	(277,800,722)
	5,029,113,828
Restricted for Debt Service and Capital Activity:	
Restricted for debt service	20,778,557
Restricted for capital activity	6,477,962
	27,256,519
Unrestricted	258,365,522
Total net assets	$ 5,314,735,869

9. General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2008 were as follows:

	Balance July 1, 2007	Additions	Reductions	Balance June 30, 2008	Amount Due Within One Year
Accrued vacation payable	$ 10,293,563	$ 4,111,447	$ (3,804,426)	$ 10,600,584	$ 2,910,534
Workers' compensation payable	4,631,047	777,296	(616,678)	4,791,665	616,678
Revenue bonds payable	293,658,250	-	(15,857,528)	277,800,722	15,495,000
Total governmental activities long-term liabilities	$ 308,582,860	$ 4,888,743	$(20,278,632)	$293,192,971	$19,022,212

10. Revenue Bonds

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

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

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

On July 1, 1998, the Division issued $94,920,000 in State of Hawaii Highway Revenue Bond, Series 1998 (1998 Bonds). The 1998 Bonds bear interest at rates ranging from 4.5% to 5.5% and mature in increasing annual installments through 2018. The 1998 Bonds maturing on and after July 1, 2009 through July 1, 2016 are subject to redemption at the option of the State on or after July 1, 2008 at prices ranging from 101% to 100% plus accrued interest.

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

10. Revenue Bonds (continued)

On October 3, 2001, the Division issued $70,000,000 in State of Hawaii Highway Revenue Bond, Series 2001 (2001 Bonds). The 2001 Bonds bear interest at rates ranging from 3.8% to 5.4% and mature in increasing annual installments through 2022. The 2001 Bonds maturing on and after July 1, 2011 are subject to redemption at the option of the State at a redemption of 100% plus accrued interest. These bonds were issued at a premium of $2,787,593, which will be amortized over the life of the bonds using the effective interest method.

On April 15, 2003, the 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 State Highways 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 interest expense over the next 21 years. The 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 payment) of approximately $3,687,000.

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

10. Revenue Bonds (continued)

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

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

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

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

10. Revenue Bonds (continued)

The following is a summary of revenue bonds issued and outstanding at June 30, 2008:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1996	3.8% - 6.0%	2016	$ 55,000,000	$ 5,830,000
1998	4.5% - 5.5%	2018	94,920,000	30,290,000
2000	4.4% - 5.5%	2020	50,000,000	6,690,000
2001	3.8% - 5.4%	2022	70,000,000	16,975,000
2003	2.0% - 5.25%	2013	44,940,000	28,905,000
2005	3.0% - 5.25%	2025	183,915,000	179,735,000
			$ 498,775,000	268,425,000
		Add: unamortized premium		14,447,107
		Less: deferred amount on refunding		(5,071,385)
		Less: current portion		(15,495,000)
		Noncurrent portion		$ 262,305,722

During 2008, $28,424,616 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of $15,495,000 due in July 2008 and interest of $12,929,616.

10. Revenue Bonds (continued)

The approximate maturities in each of the next five years and thereafter are as follows:

Years Ending June 30	Principal	Interest	Total
2009	$ 15,495,000	$ 12,597,053	$ 28,092,053
2010	16,150,000	11,880,394	28,030,394
2011	16,935,000	11,156,285	28,091,285
2012	17,570,000	10,444,598	28,014,598
2013	18,305,000	9,645,673	27,950,673
2014-2018	106,495,000	33,769,826	140,264,826
2019-2023	64,685,000	9,645,725	74,330,725
2024-2026	12,790,000	924,125	13,714,125
Total	$ 268,425,000	$ 100,063,679	$ 368,488,679

11. 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 activities as transfers, are summarized as follows:

Description	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total	Statement of Activities
Funding of highway capital projects	$(21,673,899)	$ -	$21,673,899	$ -	$ -
Reimbursement to State for debt service on general obligation bonds	(16,897,123)	-	-	(16,897,123)	(16,897,123)
Funding of revenue bond debt service	(28,424,616)	28,424,616	-	-	-
	$(66,995,638)	$ 28,424,616	$21,673,901	$(16,897,123)	$ (16,897,123)

11. Other Financing Sources and Uses/Transfers (continued)

a. Funding of Highway Capital Projects

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

b. 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. These bonds are the obligations of the State and are not included in these financial statements. The amount of the 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, 2008 are as follows:

Years Ending June 30,	Principal	Interest	Total
2009	$ 11,294,925	$ 1,786,968	$ 13,081,893
2010	6,720,599	1,325,388	8,045,987
2011	10,091,760	1,060,325	11,152,085
2012	7,517,802	648,874	8,166,676
2013	4,495,130	325,076	4,820,206
2014-2018	12,503,224	531,593	13,034,817
2019-2021	7,639	777	8,416
Total	$ 52,631,079	$ 5,679,001	$ 58,310,080

Debt service reimbursements are accounted for as expenditures of the Administration of Highway Division program on the Governmental Funds State Highway Fund Statement of Revenues and Expenditures - Budget and Actual (non-GAAP budgetary basis) and are accounted for as other financing transfers out of the State Highway Fund on the Governmental Funds statement of revenues, expenditures, and changes in fund balances. Reimbursement payments of $16,897,123 consisted of $14,413,816 for principal and $2,483,307 for interest for the year ended June 30, 2008.

12. Retirement Benefits

a. Employees' Retirement System (ERS)

All eligible employees of the State and counties are required by Chapter 88, HRS, to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues a comprehensive annual financial report that is available to the public. That report may be obtained by writing to the ERS at 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan was a contributory plan only. In 1984, legislation was enacted to add a new non-contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the non-contributory plan. The non-contributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new non-contributory plan and receive a refund of employee contributions. All benefits vest after five and ten year credited service under the contributory and non-contributory plans, respectively.

Both plan options provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited services or age 55 and 30 years of credit service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 are required to join the new hybrid plan.

12. Retirement Benefits (continued)

a. Employees' Retirement System (ERS) (continued)

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

The Division's contribution to the ERS for fiscal years 2008, 2007, and 2006 was approximately $6,301,000, $5,939,000, and $5,753,000, respectively, and represented the required contributions for each year.

b. Post-Retirement Health Care and Life Insurance Benefits

Plan Description
The Division contributes to the Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer defined benefit plan that replaced the Hawaii Public Employees Health Fund effective July 1, 2003, pursuant to Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county workers, retirees, and their dependents. The eligibility requirements for retiree health benefits are as follows:

For employees hired before July 1, 1996, the Division pays the entire base monthly contribution for employees retiring with 10 years of more of credited service, and 50% of the base monthly contribution for employees retiring with fewer than ten years of credited service. A retiree can elect a family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with at less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

12. Retirement Benefits (continued)

b. Post-Retirement Health Care and Life Insurance Benefits (continued)

For employees hired on or after July 1, 2001, and who retire with less than 10 years of service, the Division makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the Division pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the Division pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the Division pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

State Policy

The actuarial valuation of the EUTF does not provide other postemployment benefits (OPEB) information by department or agency. Accordingly, the State's policy on the accounting and reporting for OPEB is to allocate a portion of the State's Annual Required Contribution (ARC), interest, and any adjustment to the ARC, to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR) or in stand alone departmental financial statements. The basis for the allocation is the proportionate share of contributions made by each component unit and proprietary fund for retiree health benefits.

Amount of Contributions Made

Contributions are financed on a pay-as-you-go basis and the Division's contributions for the years June 30, 2008, 2007, and 2006 were approximately $3,937,000, $3,054,000 and $2,807,000, respectively.

The State's Comprehensive Annual Financial Report includes the required footnote disclosures and required supplementary information on the State's OPEB plans. The State's CAFR can be found at the Department of Accounting and General Services' website: http://hawaii.gov/dags/rpts

12. Retirement Benefits (continued)

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

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 assessment amounted to approximately $8,630,000 in fiscal year 2008.

The Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2008, assessments net of amounts refunded amounted to approximately $5,658,000 which is included in administration expense in the accompanying financial statements.

14. Operating Leases

a. Rental Expenditures

The Division leases office and baseyard space under various long-term operating lease agreements expiring at various dates through fiscal year 2019. Rental expenditures are recorded based on the terms of the lease agreements. Scheduled minimum rental payments for succeeding fiscal years ending June 30 are as follows:

Years Ending June 30,	
2009	$ 957,000
2010	957,000
2011	957,000
2012	957,000
2013	957,000
2014-2018	4,783,000
2019	239,000
Total	$ 9,807,000

The total rental expenditures during fiscal year 2008 for operating leases were approximately $1,285,000.

b. Rental Revenue

The Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled minimum revenues for succeeding fiscal years are as follows:

Years Ending June 30,	
2009	$ 307,000
2010	307,000
2011	307,000
2012	307,000
2013	307,000
2014-2018	1,535,000
2019-2023	1,366,000
2024-2028	1,326,000
2029-2033	408,000
2034-2038	382,000
Thereafter	380,000
Total	$ 6,932,000

15. Commitments

a. Condemnation Proceedings

The Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Division to compensate existing property owners for the fair market value of their real property. Prior to the determination of the fair market value, the Division is required to deposit funds in State courts for these proceedings. The amount of funds deposited in the State courts was approximately $1,349,000 at June 30, 2008. 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 Division.

b. Accumulated Sick Leave

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 in the Division's financial statements. However, a public 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, 2008 aggregated approximately $22,363,000.

16. Risk Management

a. Property and Liability Insurance

The Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and workers' compensation. The State generally retains the first $1 million per occurrence of property losses and the first $4 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is $175 million for windstorm, boiler and machinery and $50 million for terrorism. The annual aggregate limit for property loss is $175 million for flood and earthquake. The limit per occurrence of general liability losses is $10 million. For certain general liability claims, the annual aggregate limit is $10 million. The State also has an insurance policy to cover crime risk with a deductible of $500,000 per occurrence and a $10 million annual aggregate limit.

16. Risk Management (continued)

b. Workers' Compensation

The State is self-insured for workers' compensation. Accordingly, the 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 $4,791,665 at June 30, 2008.

17. Contingent Liabilities and Other

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 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 provision for any liabilities that might result from the lawsuits have been made in the accompanying financial statements.

18. Deficit Balance

At June 30, 2008, the Capital Projects Fund had an unreserved fund balance deficit of approximately $304 million. The deficit balance resulted primarily from the excess funds reserved for all committed capital contracts at year end.

SUPPLEMENTARY INFORMATION

State of Hawaii, Department of Transportation, Highways Division

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2008

Federal Grantor's Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures[1,2]
U.S. Department of Transportation			
Highway Planning and Construction	20.205		$ 192,339,528
State and Community Highway Safety Program:			
NHTSA Grant	20.600		2,109,963
Fatal accident reporting system grant	20.600		65,438
National Motor Carrier Safety Program -			
Assistance program grant	20.218		634,759
Total Federal Expenditures			$ 195,149,688

1 The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.

2 Of the federal expenditures presented in the schedule, the Division provided federal awards to subrecipients totaling $21,046,871.

PART II

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Independent Auditor’s Report on Internal Control Over Financial Reporting and On Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Office of the Auditor
State of Hawaii

We have audited the financial statements of the Highways Division of the Department of Transportation of the State of Hawaii (Division), as of and for the year ended June 30, 2008, and have issued our report thereon dated March 23, 2009. We conducted our audit 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 of America.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Division's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential, will not be prevented or detected by the entity's internal control. We consider the deficiencies described in item 08-01 to 08-06 in the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

1003 Bishop Street ■ Suite 2400 ■ Honolulu, HI 96813 ■ Telephone: 808-526-2255 ■ Fax: 808-536-5817 ■ www.kmhllp.com

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KMH LLP

KMH LLP
March 23, 2009

PART III

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

Office of the Auditor
State of Hawaii:

Compliance

We have audited the compliance of the Highways Division of the Department of Transportation of the State of Hawaii (Division) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Division's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Division's management. Our responsibility is to express an opinion on the Division's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Division's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Division's compliance with those requirements.

As described in items 08-07 to 08-09 in the accompanying Schedule of Findings and Questioned Costs, the Division did not comply with requirements regarding equipment and real property management, reporting, special tests and provisions and subrecipient monitoring that are applicable to its Highway Planning and Construction Program. Compliance with such requirements is necessary, in our opinion, for the Division to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Division complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

1003 Bishop Street ■ Suite 2400 ■ Honolulu, HI 96813 ■ Telephone: 808-526-2255 ■ Fax: 808-536-5817 ■ www.kmhllp.com

Internal Control over Compliance

The management of the Division is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Division's internal control over compliance with the requirements that could have a direct and material effect on its major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 08-07 to 08-11 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, we consider items 08-07, 08-08 and 08-09 to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

KMH LLP

KMH LLP
March 23, 2009

PART IV

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

State of Hawaii
Department of Transportation-Highways Division

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2008

Section I – Summary of Auditors' Results

Financial Statements
Type of auditors' report issued: Unqualified

Internal control over financial reporting:

- Material weakness (es) identified? √ yes ___ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? √ yes ___ no
- Noncompliance material to financial statements noted? ___ yes √ no

Federal Awards
Internal control over major programs:

- Material weakness(es) identified? √ yes ___ no
- Significant deficiency(ies) identified that are not considered to be material weaknesses? √ yes ___ no

Type of auditor's report issued on compliance for major programs: Qualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? √ yes ___ no

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
20.205	Highway Planning and Construction

Dollar threshold used to distinguish between type A and type B programs? $3,000,000

Auditee qualified as low-risk auditee? ___ yes √ no

Section II – Financial Statement Findings

Finding No.: 08-01 Capital Assets – Significant Deficiency

Criteria: The Division does not internally communicate the status of capital assets in a timely manner. Additionally, the Division does not reconcile its capital asset balances in an accurate or timely manner.

Condition, cause, and context: During our audit, we noted following items related to the Division's capital assets:

- 14 instances where replacements of existing infrastructure assets were reported without a corresponding disposal of the infrastructure assets being replaced.

- The Division only reconciles its capital assets once a year and as such, was not able to provide us with completed reconciliation and the related government-wide journal entries until November 2008.

- The Division's fiscal office uses form 17-A to communicate changes in capital asset activity to the Department of Accounting and General Services (DAGS). DAGS is the State's official recordkeeper of capital asset balances. We noted 566 instances where form 17-A was not submitted to DAGS in a timely manner. We also noted that the Division's fiscal office does not reconcile its capital asset balances with DAGS to ensure that its listing is complete and accurate.

- We noted that there is no formal documentation of policies/procedures to ensure that the knowledge necessary to properly record and/or reconcile capital assets will survive any turnover of key employees.

Effect: Due to the conditions above, we noted the following items:

- Recording infrastructure replacements without identifying and removing the related disposals resulted in an overstatement of the Division's capital asset balances of approximately $629,000.

- Inability to reconcile its capital asset balances in timely manner may inhibit the Divisions ability to identify and correct errors.

- The Division's fiscal office does not receive information from its district offices in a timely manner and as a result, there is a difference in capital asset balances reported between the Division and DAGS. Furthermore, without an accurate and timely reconciliation, the Division may not become aware of capital assets that are improperly included or excluded from its capital asset listings.

Section II – Financial Statement Findings

- A lack of written policies and procedures makes the transfer of knowledge difficult and inefficient. During the transition period, new personnel may not be able to efficiently and effectively perform the tasks required to reconcile the Division's capital asset balances.

Recommendation: We recommend the Division establish formalized processes and procedures to ensure that capital assets are accurately and timely reconciled, both internally and with DAGS. This process could include implementing a standardized policy to facilitate communication between the project engineers at the Division's district offices and the fiscal office to identify when infrastructure items are being disposed of or replaced to ensure proper addition or removal to/from the capital asset listing. The policy should also include detailed instructions documenting how to accumulate the necessary information to accurately prepare the required reconciliations as well as providing a timeframe in which the reconciliations should be performed.

Section II – Financial Statement Findings

Finding No.: 08-02 Restricted Cash – Significant Deficiency

Criteria: The Division's should reconcile its detail sub-ledger that supports its restricted cash balances on an individual project basis.

Condition, cause, and context: The Division's financial statements reflect approximately $6.5 million of restricted cash at June 30, 2008. This balance represents cash received from various entities to be used in support of specific projects by the Division at a future date. The Division maintains a detail sub-ledger to support the restricted cash balance. During our testing, we noted that the restricted cash recorded at June 30, 2008 includes approximately $2 million of unapplied credit balances. The division is unable to determine which projects to apply the credit balances to. In addition, we noted entries made by the previous Chief Accountant to "plug" unreconciled differences of approximately $900,000. Accordingly, the Division is unable to determine the remaining restricted cash balances on an individual project basis.

Effect: Due to the Division's failure to properly apply cash receipts against individual project expenditures, the Divisions restricted cash detail sub-ledger is inaccurate and does not serve as an effective management control to monitor restricted cash balances. This limits the Division's ability to determine whether a project received the appropriate external support and whether or not there are funds that should no longer be considered restricted.

Recommendation: We recommend the Division reconcile its restricted cash balances on an individual project basis. We further recommend the Division implement processes and procedures to ensure that restricted cash receipts and expenditures are properly recorded and applied. We also recommend the Division establish a formal policy to standardize all restricted cash transaction entries to the Division's accounting system. This will help reduce the risk of cash receipts and disbursements being applied to incorrect sub-ledger account.

Section II – Financial Statement Findings

Finding No.: 08-03 Accounts Receivable – Significant Deficiency

Criteria: The Division's accounts receivable and allowance balances should be maintained accurately by individual customer.

Condition, cause, and context: The Division maintains an accounts receivable sub-ledger and aging detail to support the approximately $707,000 included as accounts receivable in the financial statements at June 30, 2008. The receivable balance represents amounts due from lessees and tenants for lease rent and revocable permit charges. During our audit, we noted following items related to the sub-ledger detail and aging report:

- The receivables balance includes approximately 400 unapplied cash receipt transactions totaling approximately $434,000.

- At June 30, 2008, the accounts receivable sub-ledger lists balances of approximately $902,000 that are greater than 90 days past due, which is greater than the account balance and is deemed uncollectible. The Division believes that a majority of the unapplied cash receipts, approximately $434,000, relate to the outstanding balances that are greater than 90 days past due, but is unable to properly apply the cash receipts to the appropriate receivable balance.

Effect: The Division lacks controls to ensure that cash receipts are applied to the proper aging balances in a timely manner. As a result of the above condition, the Division's aging report is inaccurate and does not serve as an effective management control to monitor the collection of receivables.

Recommendation: We recommend the Division reconcile its accounts receivable sub-ledger on an individual customer basis. We further recommend the Division implement processes and procedures to ensure that cash receipts are properly/timely allocated and applied. This could include establishing a formal policy to standardize all cash receipt entries to the Division's accounting system. Establishing a formal policy may also help to reduce the risk of cash receipts being applied to incorrect sub-ledger accounts and will also assist the Division with managing the collection of its receivable balances.

Section II – Financial Statement Findings

Finding No.: 08-04 Accrual of Federal Reimbursement to Pass-through Entity – Significant Deficiency

Criteria: In accordance with Government Accounting Standard Board (GASB) Statement No. 33, cash pass-through grants should be recognized as revenue/expenditures in a governmental fund and should be accrued in a manner consistent under the modified accrual basis presentation.

Condition, cause, and context: The Division records revenue and expenditures on the pass-through grants received during the year through its State Highway and Capital Projects Fund. Both of these funds are considered governmental funds. During our audit, we noted that the Division does not accrue for expenditures and the related revenue of pass-through entity transactions that occurred during the fiscal year and whose reimbursement request was received subsequent to year-end.

Effect: The expenditures and related revenues for grants to pass-through entities should be recorded accurately to ensure the Division's financial statements are not misstated.

***Recommendation*:** We recommend the Division account for cash pass-through grants in accordance with GASB Statement No. 33.

Finding No.: 08-05 Retention Payable – Significant Deficiency

Criteria: In accordance with the Divisions' Retention Provision Policy, retention payables should be recognized on all applicable contracts, including selected open-ended Operations & Maintenance (O&M) contracts.

Condition, cause, and context: During our audit, we noted that retention payable balances related to open-ended O&M contracts are not recorded. Management indicated that the provision to require retention on open-ended O&M contracts had been implemented within the past three years and that retention provisions are not applicable to all O&M contracts. As a result, retention balances related to O&M contracts were overlooked and were not recorded on the Division's financial statements.

Effect: Failure to record retention payable related to the Division's open-ended O&M contracts resulted in a misstatement of approximately $179,000.

Recommendation: We recommend the Division comply with its Retention Provision Policy to ensure that retention liabilities for all contracts, including open-ended O&M contracts, are properly recorded.

Section II – Financial Statement Findings

Finding No.: 08-06 Accrued Vacation – Significant Deficiency

Criteria: Accrued vacation balances should be recorded accurately and vacation requests should be approved in timely manner. Employee vacation balances are maintained manually by each district's timekeeper using Form 7, a spreadsheet based schedule which captures vacation activity for a calendar year, including ending balances. All vacation days taken by an employee are supported by form G-1, a vacation request form, that an employee must have approved by a supervisor prior to the requested vacation date.

Condition, cause, and context: During our audit, we noted the following items related to the Division's accrued vacation:

- In one instance, a portion of an employee's sick day was improperly recorded against vacation.
- In 14 instances, the employee's accumulated vacation hours from the liability detail did not agree to the employee's Form 7.
- In one instance, an employee's accrued vacation hours were entered incorrectly, resulting in overstatement of approximately 7,000 vacation hours.
- For employees under the District of Hawaii and Kauai, the accrued vacation liability was determined using the employees' pay rates at July 1, 2008, instead of current pay rate at Jun 30, 2008. By utilizing July 1, 2008, the accrued vacation balance was overstated due to pay raises that were not in effect as of June 30, 2008.

Effect: Failure to properly prepare and reconcile the Division's accrued vacation schedules could result in a misstatement of the Division's financial statements. Consequently, the misstatement may not allow management to properly budget for staffing levels to meet reporting and operational deadlines, efficiently service the public and manage employee morale and well-being.

Recommendation: We recommend the Division adopt a formal vacation policy. The policy should include steps to ensure that the accrued vacation balance is properly and consistently calculated throughout the Division, the appropriate approvals are received within an established timeframe and that appropriate reviews are performed to demonstrate compliance.

Section III – Federal Award Findings and Questioned Costs

Department of Transportation – Highway Planning and Construction CFDA No. 20.205

Finding No.: 08-07 Equipment and Real Property Management – Material Weakness

Criteria: The Division is required by 23 USC §156 to charge a minimum of fair market value for the rent, lease, or use of real property acquired with federal assistance.

Condition, cause, and context: In order to comply with the fair value requirement, it is the Division's policy to obtain an appraisal for each rental property. During our audit, we noted the following:

- 18 of 38 selected rental properties did not have an appraisal report.
- 3 instances where we could not determine whether an appraisal or a lease agreement existed due to a lack of documentation.
- 2 instances where rental properties did not have lease agreements that agree to the appraisal reports.
- 1 instance where an outdated appraisal (2003) was utilized.

Effect: Failure to obtain appraisals within the required timeframe resulted in non-compliance with program requirements. Additionally, failure to obtain appraisals may result in the Division obtaining/receiving less than the highest possible return.

Questioned costs: None

Recommendation: We recommend that the Division obtain appraisals on a periodic basis for all of its rental properties in a manner which ensures that rental charges reflect the fair market value. The Division should review its rent rolls against its appraisal files to ensure that rent charges are based on recent appraisals and appraisals are obtained in a timely manner.

Section III – Federal Award Findings and Questioned Costs

Department of Transportation – Highway Planning and Construction CFDA No. 20.205

Finding No.: 08-08 Reporting - Material Weakness

Criteria: The Division is required by 23 USC §121 to file a PR-20 report for every completed project that uses federal funds.

Condition, cause, and context: To assist in the compliance with the reporting requirement, the Division utilizes an "ADV Checklist" (Checklist) which tracks the status of all projects that utilize federal funds. The Checklist notes the date of final payment and that final disposition was received by Division management from the respective project manager. When a date of final payment and affirmative completion (final disposition) are provided for, a PR-20 report will be generated. During our audit, we noted the following:

- 2 projects which listed final payment dates prior to FYE 2006 on the Checklist and for which there was no current year activity, did not have a completed final disposition log. Accordingly, there was no PR-20 report completed. Management was unsure as to what was preventing the completion of the final disposition log so that a PR-20 could be issued.

- 2 projects which listed a final payment date and completed a final disposition did not have a PR-20 report. Management indicated that the projects, although marked as completed on the Checklist were still pending certain items.

Effect: Failure to properly utilize the Checklist, including proper review, resulted in non-compliance with program requirements. Untimely preparation of the report may also impact the awarding agency's ability to monitor completeness and accuracy in recording of federal awards received by the Division.

Questioned costs: None

Recommendation: We recommend that the Division re-evaluate the procedures/tools used to ensure compliance with the program requirements. The checklist should be reviewed on a regular basis to ensure timely closing and proper classification of the projects. The Division's procedures should also be updated to include assignment of personnel accountable for each step of the project closing process along with completion deadlines to ensure timely closing of all projects. The Checklist should also provide a section for information on all projects for which the final payments were made for which no final disposition log has been received.

Section III – Federal Award Findings and Questioned Costs

Department of Transportation – Highway Planning and Construction CFDA No. 20.205

Finding No.: 08-09 Special Tests and Provisions - Material Weakness

Criteria: The Division is required by CFR §637.205 to have a sampling program in place to ensure the quality of materials and workmanship.

Condition, cause, and context: In order to comply with the sampling program requirement, the Division has established a materials testing program guide that establishes requirements over the frequency and number of testing selections based on the materials used during construction. During our audit, we noted the following:

- There is currently no monitoring control in place to ensure that a sufficient amount of selections is made in accordance with program requirements during the construction phase of a project.
- Of the 38 projects examined, documentation for 22 projects was not available to corroborate that the amount of samples submitted are in compliance with the guidelines.
- Six selections examined lacked documentation evidencing that testing was performed.
- Four selections examined lacked documentation to determine the sufficiency of the sample size.
- One selection examined lacked documentation to determine the sufficiency of the sample size but was accepted by the Engineer.

Effect: Failure to properly implement monitoring controls and apply the sampling plan as required, results in non-compliance with program requirements. As a result, the Division may be unable to provide reasonable assurance that materials and workmanship generally conform to approved plans and specifications of projects.

Questioned costs: None

Recommendation: We recommend the Division implement controls to ensure that compliance is maintained with the Division's materials testing program requirements. This could include:

- Modification of the sampling card documentation to include additional information that would determine if the appropriate number of samples has been submitted for testing,
- A summary schedule of sample materials for each project that details testing performed and results to date. This schedule should be periodically reviewed by management throughout the construction phase.

Section III – Federal Award Findings and Questioned Costs

Department of Transportation – Highway Planning and Construction CFDA No. 20.205

Finding No.: 08-10 Corrective Action Plan/Summary Schedule of Prior Audit Findings – Significant Deficiency

Criteria: In accordance with Circular OMB A-133, the auditee is required to prepare a Summary Schedule of Prior Audit Findings (Summary Schedule). A requirement of the Summary Schedule is to present the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards.

Condition, cause, and context: During our review of the Division's 2008 Summary Schedule, management indicated that prior year findings 07-05 Subrecipient Monitoring and 07-06 Reporting were resolved. However, during our current year testing, we noted that these finding were not resolved and the items were reported as current year findings (08-11 and 08-08).

Effect*:* Failure to properly prepare a Summary Schedule is a direct violation of Circular OMB A-133 and could lead to action from the federal government up to and including a reduction in funding. As a result, the Division may be unable to provide reasonable assurance that the Division administers Federal awards in compliance with law, regulations, and the provisions of grant agreements.

Questioned costs*:* None

Recommendation: We recommend that management review the process used to compile/prepare the Summary Schedule to ensure that it is accurately prepared in accordance with the requirements set forth by Circular OMB A-133.

Section III – Federal Award Findings and Questioned Costs

Department of Transportation – Highway Planning and Construction CFDA No. 20.205

Finding No.: 08-11 Subrecipient Monitoring – Significant Deficiency

Criteria: 31 USC 7502(f)(2)(B), requires the pass-through entity to monitor the subrecipient's use of Federal awards. Sub-recipient monitoring includes identification of the award information, during-the-award monitoring and sub-recipient audits.

Condition, cause, and context: During-the-award monitoring is performed through site visits, limited scope audits, or other means. During a site visit conducted by Division personnel, certain monitoring procedures were performed. The results of those procedures identified non-compliance with specific sampling program provisions. Although management indicated that the findings and recommendations were communicated to the sub-recipients, there was no documentation of such communications. Consequently, we could not corroborate management's assertion.

Effect*:* Failure to properly apply the during-the-award procedures could result in non-compliance with program requirements. As a result, the Division may be unable to provide reasonable assurance that the subreceipient administers Federal awards in compliance with law, regulations, and the provisions of grant agreements and that performance goals are achieved.

Questioned costs*:* None

Recommendation: We recommend that the Division ensure that its sub-recipient monitoring program include provisions for formally documenting its communications with sub-recipients regarding the conduct and results of its during-the-award monitoring procedures.

PART V

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

STATUS REPORT

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2007, dated March 31, 2008.

Recommendations	Status

Part II – Financial Statement Findings Section

07-01 Financial Statement Reporting

The Division's financial statement preparation and review process needs improvement. The following conditions were noted during our audit of the Division's financial statements for the year ended June 30, 2007:

- The Division is required by Governmental Accounting Standards Board (GASB) Statement No. 34 and State of Hawaii Comptroller's Memorandum 2005-19 to prepare both governmental fund financial statements and government-wide financial statements. However, the Division does not have the ability to prepare or record the entries required to prepare government-wide financial statements. As a result, the required journal entries are not recorded by the Division.

- The Division was unable to produce a trial balance for the governmental funds financial statements in a timely manner. Although we noted a substantial improvement in the preparation of the journal entries and trial balances by the Division from the previous audit, the Division was unable to deliver preliminary trial balances and journal entries until November 2007, and the final trial balances until December 2007.

- The Division failed to accrue a receivable for interest income due for its share of the State's investment pool earnings. This condition resulted in an audit adjustment to accrue a receivable of approximately $2 million at June 30, 2007.

Status: The Division provided a governmental fund trial balance in a timely manner. Additionally, the Division also prepared both governmental fund financial statements and government-wide financial statements. The Division also accrued its share of investment income from the State's investment pool.

Recommendations	Status

Part II – Financial Statement Findings Section (continued)

07-02 Workers Compensation Reserve Liability

At June 30, 2007, the Division had recorded a liability of approximately $4.6 million for unpaid claims costs associated with the Division's workers' compensation benefits obligation. The liability balance has not changed in over three years, while the total annual claims payments made during those years have varied from approximately $581,000 to $1.1 million. Although the Department of Human Resources Development (DHRD) manages the workers' compensation benefits program for all state departments, the Division is responsible for determining its share of unpaid claims costs and estimates of incurred but not reported claims to record in the financial statements.

The Division determined its share of unpaid claim costs, however, this amount did not include an estimate of incurred but not reported claims.

07-03 Accounts Receivable

The Division maintains an accounts receivable subledger and aging detail to support the amount included in the financial statements of approximately $773,000 at June 30, 2007. These receivables represent amounts due from lessees and tenants for lease rent and revocable permit charges. The following conditions were noted during our examination of the subledger detail and aging report at June 30, 2007:

- The Division lacks controls to ensure that cash receipts are applied to the proper aging balances in a timely manner. The receivables recorded at June 30, 2007 include 559 unapplied cash receipts totaling approximately $668,000.
- As a result of the above condition, the Division's aging report is inaccurate and does not serve as an effective management control to monitor the collection of receivables. At June 30, 2007, the aging report indicates $1.2 million of accounts receivable balances that are greater than 90 days past due.

The Division has made minimal progress on this finding. See current year finding 08-03.

Recommendations	Status

Part III – Federal Award Findings and Questioned Costs Section

07-04 Equipment and Real Property Management

The Division is required by 23 USC §156 to charge a minimum of fair market value for the rent, lease, or use of real property acquired with federal assistance. The Division's controls and compliance with respect to this program requirement need improvement. During our audit, we noted the following:

- The Division does not have controls in place to ensure appraisals are performed periodically on rental properties. We noted 11 of 16 selected rental amounts have not been updated since the inception of the rental or lease in prior years dating back to 1990.
- The Division's controls over the appraisal review process need improvement. We noted two instances where the signature of the reviewing appraiser on the appraisal report was not obtained.
- The Division's controls over the review of rental amounts need improvement. We noted one instance where the rent charged did not agree to the appraisal report.

These control deficiencies and noncompliance with the program requirement could jeopardize future program funding.

The Division does not believe that formal appraisal reviews are required. The Division acknowledges that it is required to charge fair market value for rentals. However, the Division does not believe that the determination of fair market value requires an appraisal. The Division further asserts that the USC & CFR sections that pertain to property management do not prescribe fair market value and that it is up to the State to determine fair market value.

We agree that the USC & CFR do not specifically prescribe how to determine fair market value. However, we believe that an appraisal is the most effective method for determining the fair market value of real property. Accordingly, we consider this finding unresolved. See current year finding 08-07.

Recommendations	Status

Part III – Federal Award Findings and Questioned Costs Section (continued)

07-05 Subrecipient Monitoring

We noted the Division's controls and compliance with program requirements for subrecipient monitoring need improvement. The Division is required by 31 USC §7502 to perform subrecipient monitoring consisting of:

- Identifying to the subrecipient the federal award information and applicable compliance requirements

- During the award monitoring through reporting, site visits, regular contact, or other means to provide reasonable assurance of the subrecipient's compliance with program requirements

- Issuing management decisions on subrecipient single audit findings and ensuring the subrecipient takes timely and appropriate corrective action on all audit findings.

The Division reported approximately $16 million in pass through awards to subrecipients for fiscal year 2007. However the Division did not perform any "during the award" monitoring activities during the fiscal year. The Division's subrecipient monitoring activities primarily occur at a high level through the review of single audit reports received by the Division's fiscal officer. Failure to adequately monitor subrecipients could result in noncompliance with program requirements not being identified in a timely manner, thereby jeopardizing future program funding.

Status: The Division performed its subrecipient monitoring activities; however, the Division did not communicate its findings to the sub-recipients. Accordingly, we consider this finding unresolved. See current year finding 08-11.

Recommendations	Status

Part III – Federal Award Findings and Questioned Costs Section (continued)

07-06 Reporting

The Division's controls over the monitoring of projects in the final stage of completion to ensure timely submission of Form PR-20 to the Federal Highway Administration (FHWA) could be improved. Form PR-20 is used to report the final balances and indicate the completed status of projects receiving federal assistance. The Division does not have a process in place to ensure periodic follow up is performed on outstanding projects near completion as the Division relies on individual project managers to prepare and submit project disposition forms. The FHWA provides a monthly report of inactive projects, but this report is only reviewed by management when the FHWA makes specific inquiries regarding a project's status. This condition negatively impacts the funding available for projects, as the remaining obligated federal amount may be in excess of the remaining costs to complete.	Finding not resolved. See current year finding 08-08.

07-07 Procurement

The Division's controls over program requirements for procurement need improvement. Effective November 26, 2003, the Division must verify that the awardee of professional service contracts is not suspended or otherwise debarred from federal procurement by checking the federal Excluded Parties List System (EPLS) or by collecting a certification from the provider in accordance with OMB Circular A-110 requirements. During our audit, we noted that the Division does not review the EPLS prior to awarding a contract. In addition, the Division's professional service contracts do not include a clause or condition from the vendor certifying that they are not suspended or debarred from federal procurement. Although we noted no professional service contracts were awarded during fiscal year 2007 to providers included on the EPLS, this condition increases the risk that future procurement awards could be granted to parties included on the EPLS and jeopardize future program funding.	Finding resolved.

Recommendations	Status

Part III – Federal Award Findings and Questioned Costs Section (continued)

07-08 Special Tests and Provisions

The Division's controls and compliance with program requirements over the existence of a materials sampling program could be improved. The Division is required by 23 CFR §637.205 to have a sampling program in place to ensure the quality of materials and workmanship. In addition, the Division has established a materials testing program guide that establishes requirements over the frequency and number of testing selections based on the materials used during construction. During our audit, we noted the following:

- There is currently no monitoring control in place to ensure that a sufficient amount of selections is made in accordance with program requirements during the construction phase of a project.

- Three selections examined lacked documentation to determine the sufficiency of the sample size.

- Three selections examined lacked documentation to determine the sufficiency of the sample size.

- One selection examined lacked documentation evidencing that testing was performed.

Status: Finding not resolved. See current year finding 08-09.