

*State of Hawaii  
Department of  
Transportation -  
Highways Division*

*Financial Statements for the Year Ended  
June 30, 2002 and Independent Auditors' Report*

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

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JUNE 30, 2002**

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## INDEPENDENT AUDITORS' REPORT

The Director  
Department of Transportation  
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Highways Division, Department of Transportation, State of Hawaii ("Highways Division"), as of June 30, 2002 and for the year then ended, listed in the foregoing table of contents. These financial statements are the responsibility of the Highways Division's management. Our responsibility is to express opinions on these financial statements based on our 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. 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 2 to the financial statements, the financial statements of the Highways Division are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Highways Division. They do not purport to, and do not, present the financial position of the State of Hawaii as of June 30, 2002, and the changes in financial position for the 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, each major fund, and the aggregate remaining fund information of the Highways Division at June 30, 2002, and the respective changes in financial position and the respective budgetary comparison for the State Highway Fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Highways Division adopted the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis -- for State and Local Governments*, Statement No. 37,

*Basic Financial Statements -- and Management's Discussion and Analysis -- for State and Local Governments: Omnibus, and Statement No. 38, Certain Financial Statement Note Disclosures, as of July 1, 2001.*

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 12, 2003 on our consideration of the Highways Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche LLP*

March 12, 2003

# STATE OF HAWAII

## DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION

### MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2002

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The following Management's Discussion and Analysis (MD&A) of the Highways Division, Department of Transportation, State of Hawaii ("Highways Division") activities and financial performance provides the reader with an introduction and overview to the financial statements of the Highways Division for the year ended June 30, 2002. Because this is the first year in which the Highways Division implemented the provisions of the Governmental Accounting Standards Board ("GASB") Statement No. 34, this discussion and analysis provides only selected comparative information for the year ended June 30, 2001. Future reports are required to include additional comparisons. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

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

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

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

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

## FINANCIAL HIGHLIGHTS

### Government-Wide Financial Statements

- The assets of the Highways Division exceeded its liabilities at June 30, 2002 by \$5.969 billion. Of this amount, \$385.7 million is considered unrestricted and may be used to meet the Highways Division's ongoing obligations.
- The current year change in net assets was a decrease of \$123.5 million. This resulted from an excess of expenses over revenues of \$81.9 million and a transfer of \$41.6 million to other State departments. The excess of expenses over revenues was significantly impacted by depreciation expense of \$230.7 million.

### Governmental Funds Financial Statements

- At June 30, 2002, the Highways Division's Governmental Funds reported a combined ending fund balance of \$362.3 million. The combined fund balance increased by \$44.8 million from the prior year's ending fund balance. Approximately \$86.2 million of the \$362.3 million fund balance is considered unreserved at June 30, 2002.
- The Highways Division's State Highway Fund, the major operating fund, reported an ending fund balance of \$197.4 million, of which \$89.0 million is considered unreserved. There was a \$15.8 million increase in fund balance for the year ended June 30, 2002.

## OVERVIEW OF THE FINANCIAL STATEMENTS

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

### Government-Wide Financial Statements

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

1. The *Statement of Net Assets* presents all of the Highways Division's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the Highways Division's net assets are an indicator of whether its financial health is improving or deteriorating.
2. The *Statement of Activities* presents information showing how the Highways Division's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items

that will not result in cash flows until future fiscal periods (such as certain receivables and earned, but unused compensatory and vacation leave).

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

The government-wide financial statements can be found to the right of the "Adjustments" column, immediately following the Governmental Funds financial statements on pages 12 to 16 of this report.

### **Governmental Funds Financial Statements**

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

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

Because the focus of Governmental Funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for Governmental Funds with similar information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the Highways Division's near-term financing decisions. A reconciliation to facilitate this comparison between Governmental Funds financial statements and government-wide financial statements is included on pages 30 through 31 of this report (see Note 11).

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

The basic Governmental Funds financial statements can be found to the left of the "Adjustments" column, immediately preceding the government-wide financial statements on pages 12 through 16 of this report.

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

The Governmental Funds financial statements are followed by a budgetary comparison schedule, which includes a reconciliation between the actual State Highway Fund revenues and expenditures on the budgetary basis compared to the State Highway Fund revenues and expenditures prepared for budgetary purposes.

The Statement of Revenues and Expenditures – Budget and Actual – State Highway Fund (Non-GAAP Budgetary Basis) can be found on page 17 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 18 through 36 of this report.

### GOVERNMENT-WIDE FINANCIAL ANALYSIS

#### Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Highways Division's financial position. The Highways Division's assets exceeded liabilities by \$5.969 billion at June 30 2002.

ASSETS	
Current and other assets	\$ 449,449,304
Capital assets, net	<u>5,892,873,882</u>
Total assets	<u>\$ 6,342,323,186</u>
LIABILITIES	
Current liabilities	\$ 83,322,486
Long-term liabilities	<u>289,437,694</u>
Total liabilities	372,760,180
NET ASSETS	
Invested in capital assets, net of related debt	5,575,848,999
Restricted	8,000,000
Unrestricted	<u>385,714,007</u>
Total net assets	<u>5,969,563,006</u>
Total liabilities and net assets	<u>\$ 6,342,323,186</u>

The largest portion of the Highways Division's net assets (93.4 percent) reflects its investment in capital assets (e.g., land and land improvements, buildings, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Highways Division uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Highways Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Highways Division's net assets (0.1 percent) represents resources that are subject to restrictions as to how they may be used. This primarily relates to net assets reserved for the payment of the Highways Division's revenue bond debt service. The remaining balance of unrestricted net assets (\$385.7 million) may be used to meet the Highways Division's on-going obligations to citizens and creditors.

## Statement of Activities

The Highways Division's net assets decreased by \$123.5 million. The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the Highways Division's net assets changed during the year.

### EXPENSES

#### Program expenses:

Operations and maintenance	\$ 79,395,012
Administration of Highways Division	15,153,856
Surcharge on gross receipts	7,187,140
Motor Vehicle Safety Office	6,869,550
Capital projects	37,749,712
Depreciation expense	230,705,793
Debt service/interest expense	13,386,681
Loss on disposal	376,162

Total expenses 390,823,906

### REVENUES

#### Program revenues:

Charges for services	23,859,404
Operating grants and contributions	25,820,089
Capital grants and contributions	109,389,357

Total program revenues 159,068,850

#### General revenues:

Taxes	137,720,412
Interest income	11,439,160
Other	688,192

Total general revenues 149,847,764

Total revenues 308,916,614

DECREASE IN NET ASSETS BEFORE TRANSFERS (81,907,292)

TRANSFERS (41,597,149)

DECREASE IN NET ASSETS (123,504,441)

#### BEGINNING NET ASSETS:

As previously reported	316,870,524
Prior period adjustment	5,776,196,923

As restated 6,093,067,447

ENDING NET ASSETS \$ 5,969,563,006

Approximately 51 percent of the total revenues were derived from program revenues, which comprise charges for services as well as operating and capital grants, primarily from the federal government. The largest component of program revenues (69 percent) resulted from capital grants and

contributions from the Federal Highway Administration for the construction of roads and other infrastructure.

The remaining 49 percent of the revenues were considered general revenues and comprise primarily taxes and interest earnings. Of this amount, taxes represented 92 percent of the total.

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

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

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

At June 30, 2002, the Highways Division's Governmental Funds reported combined ending fund balances of \$362.3 million, an increase of \$44.5 million in comparison with the prior year. Approximately \$86.3 million of this amount constitutes *unreserved fund balance*, which is available for spending in the coming year. The remainder of fund balance is *reserved* to indicate that it is not available for new spending because it has already been committed to liquidate contracts and purchase orders of the prior period.

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

The current taxes, fees and charges deposited to the SHF consist of: (1) the highway fuel taxes; (2) vehicle registration fees; (3) the vehicle weight tax; and (4) the rental motor vehicle and tour vehicle surcharge taxes. Together, these taxes, fees and charges accounted for most of the receipts of the State Highway Fund in the year ended June 30, 2002. Other sources of revenues include interest earnings on moneys 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, 2002, the total fund balance of the SHF was \$197.4 million, of which \$89.0 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 47.9 percent of total fund expenditures (including transfers out), while total fund balance represents 106.2 percent of the same amount.

The fund balance of the Highways Division's SHF increased by \$15.8 million in the current year as compared to a \$34.9 million increase in the prior year. During the current year, the Highways Division incurred less expenditures, but also generated less revenues. The excess of revenues over expenditures before transfers remained virtually flat from the prior year at \$84.6 million in the current year as compared to \$84.1 million in the prior year. Transfers out however, increased substantially in the current year, due primarily to the transfer of unspent funds back to the Airports Division.

The *Debt Service Fund* (“DSF”) is used to track the revenue bond debt service for the Highways Division. Debt service requirements are transferred from the State Highway Fund. Increases in debt service expense from \$18 million in fiscal year 2001 to \$21.5 million in fiscal year 2002 are attributable to additional debt service requirements due to the current year issuance of the 2001 Series Revenue Bonds in the amount of \$70 million.

The *Capital Projects Fund* (“CPF”) accounts for the Highways Division’s capital improvements program. At June 30, 2002, the CPF had a total fund balance of \$164.9 million, including an unreserved fund deficit of \$2.7 million. The fund balance of the CPF increased by \$29.0 million in fiscal year 2002 as compared to an increase of \$12.7 million in the prior year. The change from the prior year was due primarily to increased construction in the current year, which was offset by the issuance of revenue bonds in the current year.

### **STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS**

The final amended State Highway Fund budget had total appropriations of approximately \$1.4 million more than the original budget. The total original appropriations, were \$169.2 million, while the final appropriations were \$170.6 million. There were no significant fluctuations between the original and final appropriations.

Revenues on the budgetary actual basis exceeded the final budget by \$26.3 million primarily due to the receipt of approximately \$22.5 million from the settlement of a lawsuit against certain gas and oil companies. Such amounts were not budgeted for. Of this amount, the Highways Division was allowed to retain \$0.5 million and remitted the balance of \$22 million to the State of Hawaii.

Expenditures on the budgetary actual basis were \$22.2 million lower than the final budgeted amounts. The difference was due primarily to significant repairs and maintenance work which was budgeted for being deferred into future periods.

### **CAPITAL ASSET AND DEBT ADMINISTRATION**

#### **Capital Assets**

The Highways Division’s investment in capital assets as of June 30, 2002 amounts to \$5.893 billion (net of accumulated depreciation). This investment in capital assets includes land and land improvements, buildings and building improvements, vehicles and equipment, infrastructure assets and construction in progress. Infrastructure assets consist of land, roadways, tunnels and bridges, and miscellaneous roadway components.

During the fiscal year 2002, the Highways Division’s buildings and improvements increased by \$3.2 million, or 54.0 percent, from the prior year. This was primarily attributable to the completion of the Oahu District warehouse that accounted for \$1.9 million of the increase. The remaining increase was due to various improvements made to the Highways Division’s buildings.

Effective July 1, 2001, the Highways Division implemented GASB Statement No. 34 which required the capitalization of all infrastructure assets at their estimated historical cost less accumulated depreciation. The implementation of GASB 34 resulted in the prior period adjustment of \$6 billion to record the infrastructure assets, net of accumulated depreciation. The balance of such infrastructure assets was \$5.877 billion, net of accumulated depreciation, at June 30, 2002.

At June 30, 2002, the Highways Division had \$167 million in contracts encumbered in the Capital Projects Fund. Such amounts represent the balance of unliquidated contracts for work to be performed in the future.

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

### **Long-Term Debt**

At June 30, 2002, the Highways Division had \$287.3 million in outstanding long-term debt. This consisted of revenue bonds payable in the amount of \$284.6 million and unamortized revenue bond premiums of \$2.7 million.

Total long-term debt outstanding as of June 30, 2002 increased by \$65.6 million, from the prior year. This is primarily attributable to the issuance of the Series 2001 Revenue Bonds in the amount of \$70 million. These bonds were issued at a \$2.7 million premium which was deferred and will be amortized over the life bond using the effective interest rate.

The Highways Division's revenue bond rating by Moody's Investors Service, Inc., Standard & Poor's Corporation, and Fitch IBCA, Inc. are "Aaa", "AAA" and "AAA", respectively. Moody's Investors Service, Standard & Poor's Corporation, and Fitch IBCA, Inc. have also assigned underlying ratings of "Aa3", "AA" and "AA-", respectively, to all of the Highways Division's revenue bonds.

Bonds which are rated "Aaa" by Moody's Investors Service are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

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

### **REQUEST FOR INFORMATION**

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

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

**GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS  
JUNE 30, 2002**

ASSETS	Governmental Funds				Total	Adjustments (Note 11)	Government- wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund				
Cash with Director of Finance, State of Hawaii	\$ 201,163,003		\$ 194,014,897		\$ 395,177,900		\$ 395,177,900
Receivables, net of allowance for doubtful accounts:							
Due from U.S. Government (Note 5)	5,427,997		9,240,050		14,668,047	\$ 6,573,641	21,241,688
Due from Capital Projects Fund	12,059,741				12,059,741	(12,059,741)	
Due from City and Counties	5,137,406				5,137,406		5,137,406
Due from other State Agencies	1,396,942				1,396,942		1,396,942
Land parcels held for sale	681,300				681,300		681,300
Prepaid expenses	1,733,250		200,000		1,933,250		1,933,250
Restricted cash and cash equivalents:							
Revenue bond debt service (Note 9)		\$ 15,269,995			15,269,995		15,269,995
Security deposits	7,916,224				7,916,224		7,916,224
Bond issue costs, net of accumulated amortization (Note 9)						694,599	694,599
Capital assets, net of accumulated depreciation (Note 7)						5,892,873,882	5,892,873,882
<b>TOTAL</b>	<u>\$ 235,515,863</u>	<u>\$ 15,269,995</u>	<u>\$ 203,454,947</u>		<u>\$ 454,240,805</u>	<u>\$ 5,888,082,381</u>	<u>\$ 6,342,323,186</u>

**STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION, HIGHWAYS DIVISION**  
**GOVERNMENTAL FUNDS BALANCE SHEET / GOVERNMENT-WIDE STATEMENT OF NET ASSETS (Continued)**  
**JUNE 30, 2002**

	Governmental Funds			Total	Adjustments (Note 11)	Government- wide Statement of Net Assets
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
<b>LIABILITIES AND FUND BALANCES / NET ASSETS</b>						
LIABILITIES:						
Accounts payable	\$ 1,998,476		\$ 358,814	\$ 2,357,290		\$ 2,357,290
Accrued payroll	1,905,895			1,905,895		1,905,895
Contracts payable:						
Current portion	1,863,197		19,373,616	21,236,813		21,236,813
Retained percentage	2,409,291		6,750,059	9,159,350		9,159,350
Payable from restricted assets:						
Matured bonds and interest payable (Notes 8 and 9)		\$15,269,995		15,269,995		15,269,995
Security deposits	7,916,224			7,916,224		7,916,224
Due to State Highway Fund			12,059,741	12,059,741	\$ (12,059,741)	
Due to State of Hawaii	22,000,000			22,000,000		22,000,000
Other liabilities	15,300			15,300		15,300
Long-term liabilities (Note 8):						
Due within one year:						
Workers' compensation payable					897,303	897,303
Accrued vacation payable					2,564,316	2,564,316
Due after one year:						
Workers' compensation payable					3,733,744	3,733,744
Accrued vacation payable					6,380,631	6,380,631
Revenue bonds payable (Notes 8 and 9)					279,323,319	279,323,319
Total liabilities	38,108,383	15,269,995	38,542,230	91,920,608	280,839,572	372,760,180
FUND BALANCES / NET ASSETS (Note 11):						
Fund Balances:						
Reserved for encumbrances	105,997,108		167,432,723	273,429,831	(273,429,831)	
Reserved for prepaid expenses	1,733,250		200,000	1,933,250	(1,933,250)	
Reserved for land parcels held for sale	681,300			681,300	(681,300)	
Unreserved, reported in State Highway Fund	88,995,822			88,995,822	(88,995,822)	
Unreserved, reported in Capital Projects Fund			(2,720,006)	(2,720,006)	2,720,006	
Total fund balances	197,407,480		164,912,717	362,320,197	(362,320,197)	
Net Assets:						
Invested in capital assets, net of related debt					5,575,848,999	5,575,848,999
Restricted for revenue bonds					8,000,000	8,000,000
Unrestricted					385,714,007	385,714,007
Total net assets					5,969,563,006	5,969,563,006
Total liabilities and fund balance / net assets	\$ 235,515,863	\$ 15,269,995	\$ 203,454,947	\$ 454,240,805	\$ 5,888,082,381	\$ 6,342,323,186

See notes to financial statements.

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES  
YEAR ENDED JUNE 30, 2002**

	Governmental Funds			Total	Adjustments (Note 11)	Government- wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund			
<b>EXPENDITURES / EXPENSES:</b>						
Operations and maintenance:						
Oahu highways and services	\$ 38,974,924			\$ 38,974,924		\$ 38,974,924
Hawaii highways and services	16,470,004			16,470,004		16,470,004
Maui highways and services	13,593,649			13,593,649		13,593,649
Kauai highways and services	7,762,147			7,762,147		7,762,147
Molokai highways and services	2,347,983			2,347,983		2,347,983
Lanai highways and services	246,305			246,305		246,305
Administration of Highways Division	20,791,723			20,791,723	\$ (5,637,867)	15,153,856
Surcharge on gross receipts (Note 14)	7,187,140			7,187,140		7,187,140
Motor Vehicle Safety Office	6,869,550			6,869,550		6,869,550
Capital projects		\$ 153,068,645		153,068,645	(115,318,933)	37,749,712
Depreciation expense					230,705,793	230,705,793
Debt service:						
Principal payment (Note 9)		\$ 8,000,000		8,000,000	(8,000,000)	
Interest expense (Note 9)		13,452,974		13,452,974	(66,293)	13,386,681
Loss on disposal					376,162	376,162
<b>Total expenditures / expenses</b>	<b>114,243,425</b>	<b>21,452,974</b>	<b>153,068,645</b>	<b>288,765,044</b>	<b>102,058,862</b>	<b>390,823,906</b>
<b>PROGRAM REVENUES:</b>						
Charges for services:						
Vehicle registration fees (Note 4)	19,490,560			19,490,560		19,490,560
Other fees and permits (Note 4)	2,718,931		658,096	3,377,027		3,377,027
Rentals	991,817			991,817		991,817
Operating grants and contributions (Note 5)	25,820,089			25,820,089		25,820,089
Capital grants and contributions (Note 5)			102,815,716	102,815,716	6,573,641	109,389,357
<b>Total program revenues</b>	<b>49,021,397</b>		<b>103,473,812</b>	<b>152,495,209</b>	<b>6,573,641</b>	<b>159,068,850</b>
<b>NET PROGRAM EXPENSE (Forward)</b>	<b>(65,222,028)</b>	<b>(21,452,974)</b>	<b>(49,594,833)</b>	<b>(136,269,835)</b>	<b>(95,485,221)</b>	<b>(231,755,056)</b>

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES (Continued)  
YEAR ENDED JUNE 30, 2002**

	Governmental Funds				Government-wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total	
NET PROGRAM EXPENSE (Forwarded)	\$ (65,222,028)	\$ (21,452,974)	\$ (49,594,833)	\$ (136,269,835)	\$ (231,755,056)
GENERAL REVENUES:					
Taxes (Note 4):					
Fuel taxes	73,045,996			73,045,996	73,045,996
Rental motor and four vehicle surcharge taxes	36,054,296			36,054,296	36,054,296
Vehicle weight taxes	28,620,120			28,620,120	28,620,120
Interest income	11,439,160			11,439,160	11,439,160
Non-imposed fringe benefits (Note 6)	181,520			181,520	181,520
Other	506,672			506,672	506,672
Total general revenues	<u>149,847,764</u>			<u>149,847,764</u>	<u>149,847,764</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	84,625,736	(21,452,974)	(49,594,833)	13,577,929	(81,907,292)
OTHER FINANCING SOURCES (USES) (Note 10):					
Transfers in	2,787,593			102,827,208	-
Transfers out	<u>(71,636,764)</u>			<u>(71,636,764)</u>	<u>-</u>
Total other financing sources (uses)	<u>(68,849,171)</u>	<u>21,452,974</u>	<u>78,586,641</u>	<u>31,190,444</u>	<u>-</u>
EXCESS (DEFICIENCY) OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES (Note 11)	15,776,565	-	28,991,808	44,768,373	(81,907,292)
TRANSFERS OUT (Note 10)					<u>(41,597,149)</u>
CHANGE IN NET ASSETS (Note 11) (Forward)					<u>(123,504,441)</u>

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES / GOVERNMENT-WIDE  
STATEMENT OF ACTIVITIES (Continued)  
YEAR ENDED JUNE 30, 2002**

	Governmental Funds			Adjustments (Note 12)	Government- wide Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund		
CHANGE IN NET ASSETS (Forwarded)					\$ (123,504,441)
FUND BALANCE / NET ASSETS (Note 12):					
Beginning of year, as previously reported	168,209,824		148,660,700	316,870,524	316,870,524
Prior year adjustment	13,421,091		(12,739,791)	681,300	5,776,196,923
	<u>181,630,915</u>		<u>135,920,909</u>	<u>317,551,824</u>	<u>6,093,067,447</u>
Beginning of year, restated					
End of year	<u>\$ 197,407,480</u>	<u>\$ -</u>	<u>\$ 164,912,717</u>	<u>\$ 362,320,197</u>	<u>\$ 5,969,563,006</u>

See notes to financial statements.

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

**GOVERNMENTAL FUNDS STATEMENT OF REVENUES AND EXPENDITURES--  
BUDGET AND ACTUAL--STATE HIGHWAY FUND (NON-GAAP BUDGETARY BASIS)  
YEAR ENDED JUNE 30, 2002**

	<b>Original Budget</b>	<b>Final Budget</b>	<b>Budgetary Actual</b>	<b>Variance</b>
<b>REVENUES:</b>				
Fuel taxes	\$ 70,664,861	\$ 70,476,508	\$ 73,045,996	\$ 2,569,488
Vehicle weight taxes	24,585,729	23,412,331	24,507,850	1,095,519
Rental motor and tour vehicle surcharge tax	38,201,044	34,522,051	36,054,296	1,532,245
Vehicle registration fees	17,647,066	16,904,765	17,461,165	556,400
Interest income	9,000,000	13,900,000	11,452,602	(2,447,398)
Enforcement fee	1,322,777	1,252,799	1,329,998	77,199
Vehicle registration penalties	1,203,450	911,239	935,616	24,377
Commercial drivers license fee	366,487	366,487	313,138	(53,349)
Rentals	850,000	850,000	991,817	141,817
Other	271,000	255,619	23,145,401	22,889,782
<b>Total revenues</b>	<b>164,112,414</b>	<b>162,851,799</b>	<b>189,237,879</b>	<b>26,386,080</b>
<b>EXPENDITURES:</b>				
<b>Operations and maintenance:</b>				
Oahu highways and services	43,968,549	44,353,657	35,090,616	9,263,041
Hawaii highways and services	20,024,067	20,200,734	15,193,225	5,007,509
Maui highways and services	13,544,792	13,653,881	12,652,204	1,001,677
Kauai highways and services	9,433,545	9,507,417	8,525,306	982,111
Molokai highways and services	3,328,468	3,292,758	3,108,395	184,363
Lanai highways and services	825,231	881,084	755,410	125,674
<b>Administration of Highways</b>				
Division including debt service (Note 10)	65,694,172	65,940,055	60,069,019	5,871,036
State of Hawaii surcharge on gross receipts	5,869,414	5,869,414	7,187,140	(1,317,726)
Motor Vehicle Safety Office	6,546,383	6,933,976	5,809,569	1,124,407
<b>Total expenditures</b>	<b>169,234,621</b>	<b>170,632,976</b>	<b>148,390,884</b>	<b>22,242,092</b>
<b>EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES</b>	<b>\$ (5,122,207)</b>	<b>\$ (7,781,177)</b>	<b>\$ 40,846,995</b>	<b>\$ 48,628,172</b>

See notes to financial statements.

# STATE OF HAWAII

## DEPARTMENT OF TRANSPORTATION - HIGHWAYS DIVISION

### NOTES TO FINANCIAL STATEMENTS

#### YEAR ENDED JUNE 30, 2002

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#### 1. REPORTING ENTITY

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

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

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

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

In conjunction with the implementation of GASB Statement No. 34, the Highways Division has also implemented the following GASB Statements in the current fiscal year: Statement No. 37, *Basic Financial Statements -- and Management's Discussion and Analysis -- for State and Local Governments: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures*. Statement No. 37 clarifies requirements set forth in Statement No. 34 related to the management's

discussion and analysis, the modified approach, program revenue classifications, and major fund criteria. Statement No. 38 establishes and modifies disclosure requirements related to the summary of significant accounting policies, actions taken to address violations of significant finance-related legal and contractual provisions, debt and lease obligations, short-term debt, disaggregation of receivable and payable balances, and interfund balances and transfers.

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

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

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

Governmental Funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The Highways Division considers all revenues reported in the Governmental Funds to be available if the revenues are collected within 90 days after year-end. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures when payment is due. General capital asset acquisitions are reported as expenditures in Governmental Funds. Proceeds of general long-term debt are reported as other financing sources.

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

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

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

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

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

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

The accompanying financial statements include highway projects authorized by legislative acts (SLH) through June 30, 2002.

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

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

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

**Cash** - Cash reported in the balance sheet/statement of net assets includes cash in the State Treasury, including deposits received and held for others in the amount of \$7,916,224 at June 30, 2002. The deposits were received on the Highways Division's contracts with third parties. The Director of Finance is responsible for the safekeeping of all moneys paid into the State Treasury (cash pool).

At June 30, 2002, information relating to the insurance and collateral of cash deposits was not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are covered by federal deposit insurance or by collateral held either by the State Treasury or by the State's fiscal agent in the State's name.

Effective fiscal 2000, the Highways Division participates in the State Treasury Investment Pool System, pursuant to Act 199, Session Laws of Hawaii 1998. The investment pool system centralizes all phases of the investment process under the direction of the Director of Finance, thereby pooling the State's cash resources to maximize investment returns. State departments and agencies are eligible to invest all funds of qualifying appropriation accounts, eliminating their responsibility for the investment of appropriated funds. The State Treasury allocates investment earnings (interest) monthly, based on the average weighted cash balance of each account. At June 30, 2002, all of the Highways Division's restricted and unrestricted cash were deposited in the State Treasury Investment Pool System.

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

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

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

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

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

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

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

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

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

***Long-Term Obligations*** - In the government-wide statement of net assets, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and issuance costs 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. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

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

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

***Employees' Retirement System*** - The Highways Division's contributions to the Employees' Retirement System of the State of Hawaii (ERS) are based on the current contribution rate determined by the State Department of Budget and Finance. The Highways Division's policy is to fund its required contribution each pay period.

***Risk Management*** - The Highways Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The Highways Division is self-insured for workers' compensation as discussed in Note 17. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

***Use of Estimates*** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

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

In the case of expenditures, the original and amended budgeted amounts reflected on the Governmental Funds statement of revenues and expenditures--budget and actual--State Highway Fund (non-GAAP budgetary basis) are derived from: the Supplemental Appropriations Act of 2000 (Act 281, SLH 2000)

- authorizations for expenditures for operating purposes for the Highways Division (\$163,699,000) and the MVSO (\$6,933,976).

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

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

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

Excess of revenues over expenditures, non-GAAP budgetary basis	\$40,846,995
Federal grants-in-aid	25,820,089
Operating transfers out to State of Hawaii for debt service	24,494,091
Other adjustments to modified accrual basis of accounting	<u>(6,535,439)</u>
Excess of revenues over expenditures, GAAP basis	<u>\$84,625,736</u>

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

#### 4. TAX AND FEE REVENUES

**State Fuel Tax** - The primary source of revenues for the State Highway Fund is the state tax on liquid (motor vehicle) fuel. For the year ended June 30, 2002, the tax imposed on each gallon of fuel was as follows:

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

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

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

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

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

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

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

The Highways Division has projects in progress in which part of the funding is being provided by the Federal Highway Administration ("FHWA") through grants-in-aid. Such projects are generally accounted for in the Capital Projects and State Highway Funds. At June 30, 2002, the receivable from the U.S. Government is comprised of billed costs, pending reimbursement, as well as unbilled costs, which are eligible for reimbursement. At June 30, 2002, expenditures of approximately \$3,400,000 were not recorded as receivables and as federal grants-in-aid revenue, pending qualification for reimbursement by the Highways Division. In addition, the MVSO has projects in progress in which part of the funding is being provided through federal grants-in-aid. The grants contain various compliance requirements, which must be met by the MVSO, including a matching of the grant amounts with state and local highway safety expenditures as defined in a formula. MVSO's matching requirement is met through the expenditures of the Division of Driver Education, The Judiciary, State of Hawaii. Costs reimbursement by the FHWA and National Highway Traffic Safety Administration ("NHTSA") are subject to final audit by federal agencies. In addition, FHWA and NHTSA reserve the right to examine the Highways Division for economy, efficiency, and program results. The Highways Division's management believes that any federal aid received as of June 30, 2002 that might be required to be repaid to the FHWA or NHTSA based on federal audits would not be material to the financial position of the various funds of the Highways Division at June 30, 2002, or the results of operations of such funds for the year then ended.

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

Payroll fringe benefit costs of employees of the Highways Divisions are assumed by the State and are not charged to the Highways Division operating funds. These costs totaling \$181,520 have been reported as revenues and expenditures.

## 7. CAPITAL ASSETS

Changes in capital assets during the year ended June 30, 2002 were as follows:

	Balance July 1, 2001	Additions	Deductions	Transfers	Balance June 30, 2002
Capital assets not being depreciated:					
Land	\$ 417,382,435				\$ 417,382,435
Construction in progress	61,350,283	\$ 34,592,782		\$ (8,296,307)	87,646,758
Infrastructure	<u>661,387,261</u>	<u>10,055,639</u>		<u>1,016,171</u>	<u>672,459,071</u>
Total	1,140,119,979	44,648,421		(7,280,136)	1,177,488,264
Capital assets being depreciated:					
Land improvements	235,509				235,509
Buildings and improvements	5,884,448	3,043,182		131,753	9,059,383
Vehicles and equipment	36,906,326	2,874,139	\$ (1,811,013)	906,190	38,875,642
Infrastructure	<u>7,129,508,369</u>	<u>70,905,826</u>		<u>6,242,193</u>	<u>7,206,656,388</u>
Total	7,172,534,652	76,823,147	(1,811,013)	7,280,136	7,254,826,922
Less accumulated depreciation	<u>(2,310,170,362)</u>	<u>(230,705,793)</u>	<u>1,434,851</u>		<u>(2,539,441,304)</u>
Capital assets being depreciated - net	<u>4,862,364,290</u>	<u>(153,882,646)</u>	<u>(376,162)</u>	7,280,136	<u>4,715,385,618</u>
Total capital assets	<u>\$ 6,002,484,269</u>	<u>\$ (109,234,225)</u>	<u>\$ (376,162)</u>	<u>\$ -</u>	<u>\$ 5,892,873,882</u>

## 8. GENERAL LONG-TERM LIABILITIES

Changes in general long-term liabilities during the year ended June 30, 2002 were as follows:

	Balance June 30, 2001	Increase	Decrease	Balance June 30, 2002	Current	Noncurrent
Accrued workers' compensation	\$ 4,036,000	\$ 1,492,350	\$ (897,303)	\$ 4,631,047	\$ 897,303	\$ 3,733,744
Accrued vacation	8,307,646	3,224,156	(2,586,855)	8,944,947	2,564,316	6,380,631
Revenue bonds	<u>221,765,000</u>	<u>72,787,593</u>	<u>(7,229,274)</u>	<u>287,323,319</u>	<u>8,000,000</u>	<u>279,323,319</u>
	<u>\$ 234,108,646</u>	<u>\$ 77,504,099</u>	<u>\$ (10,713,432)</u>	<u>\$ 300,899,313</u>	<u>\$ 11,461,619</u>	<u>\$ 289,437,694</u>

## 9. REVENUE BONDS

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

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

On September 1, 1993, the Highways Division issued \$75,000,000 in State of Hawaii Highway Revenue Bonds, Series 1993 ("1993 Bonds"). The 1993 Bonds bear interest at rates ranging from 2.6% to 5.0% and mature in increasing annual installments through 2013. On September 1, 1996, the Highways Division issued \$55,000,000 in State of Hawaii Highway Revenue Bonds, Series 1996 ("1996 Bonds"). The 1996 Bonds bear interest at rates ranging from 3.8% to 6.0% and mature in increasing annual installments through 2016. The 1993 Bonds maturing on and after July 1, 2004, and the 1996 Bonds maturing on and after July 1, 2006 are subject to redemption at the option of the State at prices ranging from 102% to 100% plus accrued interest.

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

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

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

The following is a summary of highways system revenue bonds issued and outstanding at June 30, 2002:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1993	2.6% - 5.0%	2013	\$ 75,000,000	\$ 45,350,000
1996	3.8% - 6.0%	2016	55,000,000	34,635,000
1998	4.0% - 5.5%	2018	94,920,000	85,700,000
2000	4.4% - 5.5%	2020	50,000,000	48,940,000
2001	3.8% - 5.4%	2022	<u>70,000,000</u>	<u>70,000,000</u>
			\$ 344,920,000	284,625,000
				2,698,319
				<u>(8,000,000)</u>
				<u>\$ 279,323,319</u>

The approximate maturities for revenue bonds, including interest of \$157,801,000 (debt service fund of \$7,270,000 and general long-term debt of \$150,531,000) in each of the next five years and thereafter are as follows:

	Principal	Interest	Total
Year ending June 30:			
2003	\$ 8,000,000	\$ 14,339,998	\$ 22,339,998
2004	10,635,000	13,891,905	24,526,905
2005	11,135,000	13,388,925	24,523,925
2006	11,640,000	12,862,572	24,502,572
2007	12,190,000	12,304,765	24,494,765
2008-2012	70,370,000	51,705,080	122,075,080
2013-2017	90,015,000	31,405,398	121,420,398
2018-2022	65,240,000	7,767,791	73,007,791
2023	<u>5,400,000</u>	<u>135,000</u>	<u>5,535,000</u>
Total	<u>\$ 284,625,000</u>	<u>\$ 157,801,434</u>	<u>\$ 442,426,434</u>

In 2002, \$21,452,974 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of \$8,000,000 and interest of \$13,452,974.

**10. OTHER FINANCING SOURCES AND USES / TRANSFERS**

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

Description	Transfers In (Out)				Adjustments	Statement of Activities
	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total		
Funding of highway capital projects	\$ (8,586,641)		\$ 8,586,641			
Proceeds from issuance of revenue bonds			70,000,000	\$ 70,000,000	\$ (70,000,000)	
Premiums from issuance of revenue bonds	2,787,593			2,787,593	(2,787,593)	
Reimbursement to State for debt service on general obligation bonds	(24,494,091)			(24,494,091)		\$ (24,494,091)
Funding of revenue bond debt service	(21,452,974)	\$ 21,452,974				
Transfers of funds to Airports Division	<u>(17,103,058)</u>			<u>(17,103,058)</u>		<u>(17,103,058)</u>
	<u>\$ (68,849,171)</u>	<u>\$ 21,452,974</u>	<u>\$ 78,586,641</u>	<u>\$ 31,190,444</u>	<u>\$ (72,787,593)</u>	<u>\$ (41,597,149)</u>

**Funding of Highway Capital Projects**

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

**Reimbursement to State for Debt Service**

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



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

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

Total Governmental Funds fund balances	\$ 362,320,197
Amounts reported as net assets for government-wide reporting are different because:	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the Governmental Funds financial statements.	5,892,873,882
Bond issuance costs are recorded as expenditures in Governmental Funds financial statements when the costs are first incurred. However, in the government-wide financial statements, such amounts are recorded as a deferred charge and amortized over the life of the related bonds.	694,599
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	(8,944,947)
Accrued workers' compensation	(4,631,047)
Revenue bonds payable	(276,625,000)
Premium on revenue bonds	(2,698,319)
Revenues and the related receivables from government contracts are recorded on the modified accrual basis for Governmental Funds financial statements and on the accrual basis for government-wide financial statements.	<u>6,573,641</u>
Total government-wide net assets	<u><u>\$ 5,969,563,006</u></u>

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

Governmental Funds change in fund balances	\$ 44,768,373
Amounts reported for governmental activities in the statement of net assets are different because:	
Governmental Funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This amount includes the adjustment for capital outlay of \$121,471,568 offset by depreciation expense of \$230,705,793 in the current period.	(109,234,225)
Repayment of bond principal is reported as an expenditure in the Governmental Funds, but the repayment reduces long-term liabilities in the statement of net assets.	8,000,000
Bond proceeds provide current financial resources to governmental funds, but issuing debt and related original issue premium increases long-term liabilities in the statement of net assets. This amount includes the amortization of revenue bond premium of \$89,274 in the current period.	(72,698,319)
Bond issue costs are reported as expenditures in the governmental funds as they require the use of current financial resources. However, in the statement of activities, these expenses are allocated over the remaining life of the related bond and reported as an offset to interest expense. This amount includes bond issue costs of \$717,580 offset by amortization expense of \$22,981 in the current period.	694,599
Government Funds report the full amount of the proceeds from a capital asset sale. However, in the statement of activities, the sale of capital assets are reported only to the extent of the difference between the selling price and the carrying value of the asset sold. The Highways Division did not receive any cash for disposed assets with carrying value of \$376,162.	(376,162)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in Governmental Funds.	6,573,641
Expenses in the statement of activities that do not use current financial resources are not reported as expenditures in Governmental Funds.	<u>(1,232,348)</u>
Government-wide change in net assets	<u>\$ (123,504,441)</u>

## 12. RESTATEMENTS OF FUND BALANCES / NET ASSETS

The following schedule reconciles the June 30, 2001 fund balances / net assets, as previously reported, to the fund balance / net assets, as restated, to include the adoption of new pronouncements:

	State Highway Fund	Capital Projects Fund	Total
Fund balances as of June 30, 2001	\$ 168,209,824	\$ 148,660,700	\$ 316,870,524
Prior period adjustments, Governmental Funds - changes in accounting principle:			
Interfund cash transfers currently recorded as interfund loans	12,739,791	(12,739,791)	
Expenditures for land parcels held for sale currently recorded as an asset	<u>681,300</u>	<u>                    </u>	<u>681,300</u>
Fund balances, as restated	181,630,915	135,920,909	317,551,824
Prior period adjustments, government-wide financial statements - changes in accounting principle:			
Capitalization of capital assets, net			6,002,484,269
Recording of unmatured revenue bonds payable			(214,625,000)
Liability recognition:			
Accrued vacation			(8,307,646)
Workers' compensation			<u>(4,036,000)</u>
Beginning net assets, as restated			<u>\$ 6,093,067,447</u>

## 13. PENSION INFORMATION

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

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

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute. In the contributory plan, employees may elect normal retirement at age 55 with 5 years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by state statute to contribute 7.8% of their salary to the plan;

the Highways Division is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credited service, or elect early retirement at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching 10 years of service; retirement benefits are actuarially reduced for early retirement. The Highways Division is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

The Highways Division's contribution to the ERS for fiscal years 2002, 2001, and 2000 was approximately \$11,000, \$22,000, and \$2,233,000, respectively, and represented the required contributions for each year. Actual contributions paid by the Highways Division equal contributions required by the ERS.

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

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

In addition to providing pension benefits, the State provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees. Contributions are based upon negotiated collective bargaining agreements and are limited by state statute to the actual cost of benefit coverage. The Highways Division pays for 100% of these benefits for employees who have at least 10 years of service. The Highways Division's share of the cost of these benefits is pro-rated for employees with less than 10 years of service. The Highways Division also reimburses Medicare expenses of retirees and qualified spouses (through the State) who are at least 62 years of age and have at least 10 years of service. Contributions are based upon negotiated collective bargaining agreements and are limited by state statute to the actual cost of benefit coverage. The amounts allocated to the Highways Division for fiscal year 2002 aggregated approximately \$209,000.

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

The State assesses a surcharge of 5% for central service expenses on all receipts of the State Highway Fund, after deducting any amounts pledged, charged or encumbered, for the payment of bonds and interest during the year. The assessments amounted to approximately \$7,187,000 in fiscal year 2002.

The Highways Division is assessed a percentage of the cost of the general administration expenses of the Department. The assessments amounted to approximately \$4,857,000. During fiscal year 2002, the Highways Division received assessment refunds from the Department amounting to approximately \$1,202,000, resulting in a net general administration expense of approximately \$3,655,000.

## 15. OPERATING LEASES

### Rental expenditures

The Highways Division leases office and baseyard space under various long-term operating lease agreements expiring at various dates through fiscal year 2019 and beyond. Scheduled minimum rental payments for succeeding fiscal years ending June 30 are as follows:

Year ending June 30:	
2003	\$ 828,708
2004	828,708
2005	828,708
2006	828,708
2007	828,708
2008-2012	4,143,540
2013-2017	4,143,540
2018-2019	<u>1,104,944</u>
Total	<u>\$ 13,535,564</u>

The total rental expenditures during fiscal year 2002 for operating leases were \$828,708.

### Rental revenues

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

Year ending June 30:	
2003	\$ 317,672
2004	317,672
2005	317,672
2006	317,672
2007	317,672
2008-2012	1,588,360
2013-2017	1,588,360
2018-2022	1,477,410
2023-2027	1,429,860
2028-2032	600,860
2033-2037	442,182
2037-2042	362,100
2043	<u>3,025</u>
Total	<u>\$ 9,080,517</u>

## **16. COMMITMENTS**

### **Condemnation Proceedings**

The Highways Division occasionally finds it necessary to condemn property for construction of highways. These proceedings require the Highways Division to compensate the existing property owner for the fair market value of the real property. Prior to the determination of the fair market value, the Highways Division is required to deposit funds in State courts for these proceedings. Such funds deposited may not be sufficient to cover the full amount required for compensation purposes. Management, however, believes any additional compensation in excess of amounts deposited with State courts will not be material to the financial statements of the Highways Division.

### **Deferred Compensation Plan**

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

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

### **Sick Pay**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, a state employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credits in the ERS. Accumulated sick leave at June 30, 2002 aggregated approximately \$19,719,000.

## **17. RISK MANAGEMENT**

### **Property and Liability Insurance**

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

### **Workers' Compensation**

The State is self-insured for workers' compensation. Accordingly, the Highways Division is liable for workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims include the effects of specific incremental claim adjustment expenses, salvage and subrogation, and

other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. The workers' compensation reserve amounted to \$4,631,000 at June 30, 2002.

**18. CONTINGENT LIABILITIES AND OTHER**

**Litigation**

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

**19. DEFICIT BALANCE**

At June 30, 2002, the Capital Projects Fund had an unreserved deficit balance of \$2,720,006. The Highways Division intends to take corrective action to eliminate this deficit balance.

**20. SUBSEQUENT EVENT**

The Highways Division intends to issue \$45.7 million of revenue bonds, which will be used to refund certain previously issued bonds still outstanding. The issuance is expected to take place in April 2003.

\* \* \* \* \*