State of Hawaii, Department of Transportation, Highways Division

Financial Statements
Fiscal Year Ended June 30, 2009

Submitted by

THE AUDITOR
STATE OF HAWAII

KMHLLP

A Hawaii Limited Liability Partnership

March 24, 2010

Office of the Auditor
State of Hawaii

Mr. Brennon Morioka
Director - Department of Transportation, Highways Division
869 Punchbowl Street
Honolulu, HI 96813

Dear Mr. Morioka:

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, 2009. 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, 2009, 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, 2009.

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, 2009, 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

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PART I

FINANCIAL SECTION

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, 2009, 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, 2009, 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, 2009, 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 24, 2010, 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 24, 2010

State of Hawaii, Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2009

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, 2009. 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 Project Coordination and Technical Services Office, 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, 2009 by $5.2 billion. Of this amount, $276 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 $93 million. This resulted from a deficiency of revenues under expenditures of $80 million and a transfer of $13 million to other State departments for debt service payments on general obligation bonds. The deficiency of revenues under expenditures was significantly impacted by depreciation expense of $222 million.

Fund Financial Statements

At June 30, 2009, the Division's Governmental Funds reported a combined ending fund balance of $306 million. The combined fund balance increased by $33 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 $167 million, of which $30 million is considered unreserved. There was a $56 million decrease in fund balance for the year ended June 30, 2009.

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 57 of this report.

State of Hawaii,
Department of Transportation – Highways Division

Management's Discussion and Analysis – Unaudited
As of and for the Year Ended June 30, 2009

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 $5.2 billion and $5.3 billion at June 30, 2009 and 2008, respectively.

	2009	2008
Assets		
Current and other assets	$ 403,527,585	$ 352,158,459
Capital assets – net of accumulated depreciation	5,287,349,669	5,306,914,550
Total assets	$ 5,690,877,524	$ 5,659,073,009
Liabilities		
Current liabilities	$ 92,445,019	$ 76,173,525
Long-term liabilities	386,705,203	277,697,971
Total liabilities	479,150,222	353,871,496
Net Assets		
Invested in capital assets—net of related debt	4,946,587,525	5,029,113,828
Restricted	36,024,437	27,256,519
Unrestricted	229,115,340	248,831,166
Total net assets	5,211,727,302	5,305,201,513
Total liabilities and net assets	$ 5,690,877,524	$ 5,659,073,009

The largest portion of the Division's net assets (94 and 95 percent at June 30, 2009 and 2008, respectively) reflects its investment in capital assets (e.g., land and land improvements, buildings and improvements, vehicles and equipment, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The 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 (0.7 percent and 0.5 percent at June 30, 2009 and 2008, 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 $20 million from June 30, 2008 to June 30, 2009 and by $36 million from June 30, 2007 to June 30, 2008 primarily because depreciation expense more than offset additions to construction in progress.

Long-term liabilities increased by $109 million from June 30, 2008 to June 30, 2009 and decreased $16 million from June 30, 2007 to June 30, 2008, primarily due to issuance of Hawaii Revenue Bonds, Series 2008.

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.

	2009	2008
EXPENSES:		
Program expenses:		
Operations and maintenance	$ 211,309,768	$ 158,679,947
Administration of Highways Division	7,789,571	30,099,922
Surcharge on gross receipts	7,343,493	8,629,725
Motor Vehicle Safety Office	10,047,170	8,888,617
Capital projects	15,923,884	7,227,619
Depreciation expense	221,934,320	227,537,321
Debt service/interest expense	15,066,810	12,146,769
Total expenses	489,415,016	453,209,920
REVENUES:		
Program revenues:		
Charges for services	28,159,153	25,599,665
Operating grants and contributions	72,915,021	70,079,462
Capital grants and contributions	151,639,687	137,320,675
Total program revenues	252,713,861	232,999,802
General revenues:		
Taxes	159,300,992	170,630,178
Investment (loss) income	(4,075,865)	4,782,301
Other	1,083,710	1,308,822
Total general revenues	156,308,837	176,721,301
Total revenues	409,022,698	409,721,103
Decrease in net assets before transfers (Carried forward)	$ (80,392,318)	$ (43,488,817)

	2009	2008
Decrease in net assets before transfers (Brought forward)	$ (80,392,318)	$ (43,488,817)
Transfers	(13,081,893)	(16,897,123)
Decrease in net assets	(93,474,211)	(60,385,940)
Net Assets, beginning of year	5,305,201,513	5,365,587,453
Net Assets, end of year	$ 5,211,727,302	$ 5,305,201,513

Program revenues, which comprise charges for services as well as operating and capital grants, accounted for 62 percent and 57 percent of total revenues in fiscal years 2009 and 2008, respectively. The largest components of program revenues (89 percent for fiscal years 2009 and 2008, 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.

The fiscal year 2009 decrease in net assets of $93 million resulted from the excess of expenses over revenues of $80 million due primarily to depreciation expense of $222 million and a transfer out of $13 million to other State departments for the payment of debt service on general obligation bonds.

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.

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, 2009, the Division's Governmental Funds reported combined ending fund balances of $306 million, representing an increase of $33 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, 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.

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, 2009, the total fund balance of the SHF was $166 million, of which $30 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 10 percent of total fund expenditures (including transfers out), while total fund balance represents 53 percent of the same amount.

The SHF's fund balance decreased by $56 million in the current year compared to a $13 million decrease in the prior year. During the current year, the Division collected fewer revenues and also expended more for operations and maintenance.

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 fiscal year 2008. During that fiscal year, the Division collected more revenues but also expended more for operations and maintenance.

The Debt Service Fund ("DSF") is used to track the revenue bond debt service for the Division. Debt service requirements are transferred from the SHF. The increase in debt service expense on the government-wide financial statements from $28 million in fiscal year 2008 to $32 million in fiscal year 2009 is attributable to increased interest expense.

The Capital Projects Fund ("CPF") accounts for the Division's capital improvements program. At June 30, 2009, the CPF had a total fund balance of $140 million, including an unreserved fund deficit of $155 million. The CPF fund balance increased by $89 million in fiscal year 2009 compared to a $28 million decrease in the prior year. The change from the prior year was due primarily to issuance of Hawaii Revenue Bonds, Series 2008.

STATE HIGHWAY FUND BUDGETARY HIGHLIGHTS

The final SHF budget had total revenues of $213 million which is equal to the original budget. The actual revenues on a budgetary basis were $23 million less than the final budget, primarily due to a decrease in rental motor and tour vehicle surcharge tax and interest income.

Expenditures on the budgetary actual basis were $23 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, 2009 amounted to $5.3 billion, net of accumulated depreciation of $4.1 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 2009, the Division put out 40 projects to bid with a contract amount of approximately $153 million. There were 14 projects on Oahu, 5 projects on Hawaii, 9 projects on Maui, (includes Molokai and Lanai), and 12 projects on Kauai.

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.

At June 30, 2009, the Division had $294 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 2009, with construction expected to start in fiscal year 2009.

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 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, 2009, $387 million in Highway Revenue Bonds were outstanding, compared to $278 million as of June 30, 2008.

See Note 10 for additional information on Highway Revenue Bonds.

As of June 30, 2009, $41 million in State of Hawaii General Obligation Bonds were outstanding, compared to $53 million as of June 30, 2008. 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, 2009 amounted to $13 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, 2009

Assets

	Governmental Activities
Cash	$ 317,990,795
Receivables, net of allowance for doubtful accounts:	
Due from U.S. Government	28,009,121
Due from City and Counties	5,576,758
Due from State of Hawaii	8,472,553
Other receivables	2,836,587
Prepaid Expenses	1,541,238
Restricted Cash:	
Revenue bond debt service	25,840,643
Security deposits	10,183,794
Bond Issuance Costs, net of accumulated amortization of $1,555,183	1,727,280
Other Assets	1,349,086
Capital Assets, net of accumulated depreciation	5,287,349,669
Total assets	$ 5,690,877,524

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Statement of Net Assets
June 30, 2009

Liabilities and Net Assets

	Governmental Activities
Accounts Payable	$ 10,262,056
Accrued Payroll	4,111,258
Contracts Payable:	
Current portion	32,722,516
Retained percentage	9,309,452
Payable from Restricted Assets:	
Revenue bonds payable - due within one year	16,150,000
Interest payable	9,690,643
Security deposits	10,183,794
Other Liabilities	15,300
Long Term Liabilities:	
Due within one year:	
Workers' compensation payable	613,447
Accrued vacation payable	2,897,493
Due after one year:	
Workers' compensation payable	3,819,637
Accrued vacation payable	8,197,475
Revenue bonds payable	371,177,151
Total liabilities	479,150,222
Net Assets:	
Invested in capital assets, net of related debt	4,946,587,525
Restricted for current portion of revenue bonds	36,024,437
Unrestricted	229,115,340
Total net assets	5,211,727,302
Total liabilities and net assets	$ 5,690,877,524

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, 2009

	Governmental Activities
Operations and Maintenance:	
Oahu highways and services	$ 99,199,886
Hawaii highways and services	22,468,256
Maui highways and services	30,066,315
Kauai highways and services	13,329,427
Molokai highways and services	11,673,850
Lanai highways and services	463,326
Pass through for County highways and services	34,108,708
Administration of Highways Division	7,789,571
Surcharge on Gross Receipts	7,343,493
Motor Vehicle Safety Office	10,047,170
Capital Projects	15,923,884
Depreciation Expense	221,934,320
Interest Expense	15,066,810
Total expenses	489,415,016
Program Revenues:	
Charges for services:	
Vehicle registration fees	20,875,490
Other fees and permits	4,540,894
Penalties and fines	1,509,557
Rentals	1,233,212
Operating grants and contributions	72,915,021
Capital grants and contributions	151,639,687
Total program revenues	252,713,861
General Revenues:	
Taxes:	
State fuel taxes	86,151,439
Rental motor and tour vehicle surcharge taxes	39,750,756
Vehicle weight taxes and penalties	33,398,797
Investment loss	(4,075,865)
Non-imposed fringe benefits	1,083,710
Total general revenues	156,308,837
Deficiency of revenues under expenditures	(80,392,318)
Transfers	(13,081,893)
Change in net assets	(93,474,211)
Net Assets:	
Beginning of year	5,305,201,513
End of year	$ 5,211,727,302

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds
June 30, 2009

Assets	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Cash	$ 137,750,098	$ -	$ 180,240,697	$ 317,990,795
Receivables, net of allowance for doubtful accounts:				
Due from Capital Projects Fund	40,228,188	-	-	40,228,188
Due from U.S. Government	4,517,673	-	23,491,448	28,009,121
Due from City and Counties	5,576,758	-	-	5,576,758
Due from State of Hawaii	4,442,619	-	4,029,934	8,472,553
Other receivables	779,972	-	-	779,972
Prepaid Expenses	1,217,125	-	324,113	1,541,238
Restricted Cash:				
Revenue bond debt service	-	25,840,643	-	25,840,643
Security deposits	10,183,794	-	-	10,183,794
Total assets	$ 204,696,227	$ 25,840,643	$ 208,086,192	$ 438,623,062

See accompanying notes to the basic financial statements.

State of Hawaii, Department of Transportation, Highways Division

Balance Sheet – Governmental Funds
June 30, 2009

Liabilities and Fund Balances	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Accounts Payable	$ 9,371,794	$ -	$ 890,262	$ 10,262,056
Accrued Payroll	4,111,258	-	-	4,111,258
Contracts Payable:				
Current portion	10,049,095	-	22,673,421	32,722,516
Retainage payable	4,791,231	-	4,518,221	9,309,452
Payable from Restricted Assets:				
Matured bonds and interest payable	-	25,840,643	-	25,840,643
Security deposits	10,183,794	-	-	10,183,794
Due to Capital Projects Fund	-	-	40,228,188	40,228,188
Other Liabilities	15,300	-	-	15,300
Total liabilities	38,522,472	25,840,643	68,310,092	132,673,207
Fund Balances:				
Reserved for:				
Encumbrances	135,076,146	-	294,055,633	429,131,779
Prepaid expenses	1,217,125	-	324,113	1,541,238
Unreserved	29,880,484	-	(154,603,646)	(124,723,162)
Total fund balances	166,173,755	-	139,776,100	305,949,855
Total liabilities and fund balances	$ 204,696,227	$ 25,840,643	$ 208,086,192	$ 438,623,062

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, 2009

Total Fund Balances - Governmental Funds		$ 305,949,855
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	9,435,164,744	
Less accumulated depreciation	(4,147,815,075)	
		5,287,349,669
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		1,727,280
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	(11,094,968)	
Accrued workers' compensation payable	(4,433,084)	
Revenue bonds payable	(371,177,151)	
		(386,705,203)
Long term receivables are not due and receivable in the current period and therefore are not reported in the Governmental Funds financial statements		2,056,615
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		$5,211,727,302

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, 2009

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
Expenditures:				
Operations and maintenance:				
Oahu highways and services	$ 100,437,724	$ -	$ -	$ 100,437,724
Hawaii highways and services	23,882,633	-	-	23,882,633
Maui highways and services	30,580,596	-	-	30,580,596
Kauai highways and services	13,854,783	-	-	13,854,783
Molokai highways and services	11,673,850	-	-	11,673,850
Lanai highways and services	463,326	-	-	463,326
Pass through for County highways and services	34,108,708	-	-	34,108,708
Administration of Highways Division	10,881,080	-	-	10,881,080
Surcharge on gross receipts	7,343,493	-	-	7,343,493
Motor Vehicle Safety Office	10,047,170	-	-	10,047,170
Capital projects	-	-	211,374,159	211,374,159
Debt service:				
Principal payment	-	16,150,000	-	16,150,000
Interest expense	-	15,822,888	-	15,822,888
Total expenditures	243,273,363	31,972,888	211,374,159	486,620,410
Program Revenues:				
Charges for services:				
Vehicle registration fees	20,875,490	-	-	20,875,490
Other fees and permits	4,540,894	-	-	4,540,894
Penalties and fines	1,509,557	-	-	1,509,557
Rentals	1,233,212	-	-	1,233,212
Operating grants and contributions	70,858,406	-	-	70,858,406
Capital grants and contributions	-	-	151,639,687	151,639,687
Total program revenues	99,017,559	-	151,639,687	250,657,246

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, 2009

	State Highway Fund	Debt Service Fund	Capital Projects Fund	Total
General Revenues:				
Taxes:				
Fuel Taxes	$ 86,151,439	$ -	$ -	$ 86,151,439
Rental motor and tour vehicle surcharge taxes	39,750,756	-	-	39,750,756
Vehicle weights taxes	33,398,797	-	-	33,398,797
Investment loss	(4,075,865)	-	-	(4,075,865)
Non-imposed fringe benefits	1,083,710	-	-	1,083,710
Total general revenues	156,308,837	-	-	156,308,837
Excess (deficiency) of revenues over (under) expenditures	12,053,033	(31,972,888)	(59,734,472)	(79,654,327)
Other Financing Sources (Uses):				
Proceeds from the issuance of revenue bonds	-	-	125,175,000	125,175,000
Premium on issuance of revenue bonds	-	-	857,616	857,616
Transfers in	-	31,972,888	23,667,310	55,640,198
Costs related to the issuance of revenue bonds	-	-	(716,001)	(716,001)
Transfers out	(68,722,091)	-	-	(68,722,091)
Total other financing sources (uses)	(68,722,091)	31,972,888	148,983,925	112,234,722
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(56,669,058)	-	89,249,453	32,580,395
Fund Balances:				
Beginning of year	222,842,813	-	50,526,647	273,369,460
End of year	$ 166,173,755	$ -	$ 139,776,100	$ 305,949,855

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, 2009

Net Change in Fund Balances - Total Governmental Funds		$ 32,580,395
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	202,369,439	
Less current fiscal year depreciation and loss on disposal	(221,934,320)	
		(19,564,881)
Borrowings provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets. In the current period, proceeds were received from:		
Revenue bonds issued	(125,175,000)	
Premium on bond issuance	(857,616)	
		(126,032,616)
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:		
Bond principal repayment	16,150,000	
Bond issuance costs	716,001	
		16,866,001
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	1,782,678	
Amortization of deferred amount on refunding	(771,491)	
Amortization of deferred bond issuance costs	(255,109)	
		756,078
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		1,920,812
Change in Net Assets - Governmental Activities		$ (93,474,211)

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, 2009

	Original	Final	Actual on Budgetary Basis	Variance Over (Under)
Revenues:				
Fuel taxes	$ 88,544,220	$ 88,544,220	$ 86,151,439	$ (2,392,781)
Vehicle weight taxes	34,435,001	34,435,001	33,407,241	(1,027,760)
Rental motor and tour vehicle surcharge tax	49,687,918	49,687,918	39,750,756	(9,937,162)
Vehicle registration fees	21,419,944	21,419,944	20,787,810	(632,134)
Interest income	14,000,000	14,000,000	6,167,782	(7,832,218)
Other fees and penalties	4,781,013	4,781,013	3,232,638	(1,548,375)
	212,868,096	212,868,096	189,497,668	(23,370,428)
Expenditures:				
Operations and maintenance:				
Oahu highways and services	80,844,748	84,309,094	85,746,267	1,437,173
Hawaii highways and services	22,960,942	21,574,475	21,026,738	(547,737)
Maui highways and services	19,251,543	22,291,543	21,994,631	(296,912)
Kauai highways and services	14,214,142	13,680,150	13,425,889	(254,261)
Molokai highways and services	4,137,940	1,562,940	1,189,897	(373,043)
Lanai highways and services	868,087	403,087	240,477	(162,610)
Administration of Highways Division including debt service	80,759,587	87,018,700	66,080,419	(20,938,281)
State of Hawaii surcharge on gross receipts	7,803,000	7,803,000	6,568,969	(1,234,031)
Motor Vehicle Safety Office	5,978,053	5,978,053	5,686,667	(291,386)
	236,818,042	244,621,042	221,959,955	(22,661,087)
Deficiency of revenues under expenditures and other uses	$ (23,949,946)	$ (31,752,946)	$ (32,462,287)	$ (709,341)

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, 2009

	Agency Fund
Asset	
Cash	$ 9,092,776
Total asset	$ 9,092,776
Liabilities	
Due to Others	$ 9,092,776
Total liabilities	$ 9,092,776

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.

2. Significant Accounting Policies (continued)

b. Governmental Funds Financial Statements (continued)

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.

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, 2009.

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.

2. Significant Accounting Policies (continued)

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 $9,092,776 at June 30, 2009.

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, 2009, 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 allocated to the Division amounted to approximately $13.9 million, which is recorded against interest income in the accompanying financial statements.

2. Significant Accounting Policies (continued)

e. Cash and Restricted Cash (continued)

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.

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, 2009, the allowance for uncollectible receivables was approximately $627,000.

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

2. Significant Accounting Policies (continued)

g. Capital Assets (continued)

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.

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.

2. Significant Accounting Policies (continued)

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.

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.

2. Significant Accounting Policies (continued)

o. New Accounting Pronouncements

The Division adopted GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement establishes standards for accounting and financial reporting for pollution (including contamination) remediation obligations.

The Division is subject to laws and regulations relating to the protection of the environment. The Division has been identified by the State Department of Health (DOH) as a potentially responsible party for petroleum contamination in the Honolulu Harbor/Iwilei area. Pursuant thereto, the Division entered into a voluntary agreement with the DOH and other third parties to share in the responsibility for the investigation and potential remediation of petroleum contamination in the Iwilei District.

This group of potentially responsible parties known as the Iwilei District Participating Parties (IDPP) has conducted various investigations to determine potential contamination in the Iwilei area from 1997 to present, which investigations have determined the existence of petroleum contamination at various locations. Potential remedial alternatives are still being studied. At this stage, the project has not yet advanced to the stage where total costs to the IDPP can reasonably be estimated, due to : (1) the extent of environmental impact, (2) the undetermined allocation among the potentially responsible parties, (3) the ongoing review of reasonable remediation alternatives, and (4) continued discussion with the regulatory authorities. As a result, it is not possible to reasonably estimate the amount of the potential cost to the IDPP and allocable share of the Division, and if there would be a material impact to the Division's financial statements. Accordingly, no estimate of loss has been recorded in the accompanying financial statement.

The Division adopted GASB Statement No. 51, *Accounting and Reporting for Intangible Assets*. This Statement establishes standards of accounting and financial reporting standards for intangible assets. This Statement is effective for financial statement periods beginning after June 15, 2009.

2. Significant Accounting Policies (continued)

o. New Accounting Pronouncements (continued)

In 2009, the Division entered into a contract with a third party to manage the purchasing, designing, and implementation phases of a new accounting system. A commercial accounting system was purchased and another third party was contracted to customize the system capability and functionality to meet the requirements set forth by the Division. The Division expects the new accounting system to be fully implemented effective July 1, 2010. As of June 30, 2009, the Division incurred costs of $3,003,812 related to the acquisition and customization of the new accounting system.

In 2009, the Division adopted GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates into GASB the following three accounting and reporting guidelines currently existing in the American Institute of Certified Public Accounts' Statement on Auditing Standards – related party transactions, going concern considerations and subsequent events. The adoption of GASB Statement No. 56 did not have an impact on the Division's financial position or results of operations.

In 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement establishes standards of accounting and financial reporting standards for all governments that report governmental funds. It establishes criteria for classifying fund balances into specially defined classifications and clarifies definitions for governmental fund types. This Statement is effective for financial statement periods beginning after June 15, 2010.

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.

3. Budgets and Budgetary Accounting (continued)

a. State Highway Fund (continued)

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 $230,839,989 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.

The reconciliation of the budgetary actual deficiency 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:

Deficiency of revenue over expenditures, non-GAAP budgetary basis	$ (32,462,287)
Federal grants-in-aid	69,814,279
Operating transfers out of State of Hawaii for debt service	13,081,893
Pass through expenditures for county projects	(34,108,708)
Net decrease in the fair value of State Treasury Investment Pool	(13,870,435)
Other adjustments to modified accrual basis of accounting	9,598,291
Excess of revenues over expenditures, GAAP basis	$ 12,053,033

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 2009, 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 $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, 2009 the Division collected approximately $5,197,000 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, 2009. 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, 2009, receivables totaling $28,078,447 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, 2009 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, 2009, 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 $1,083,710 for fiscal year 2009 have been reported as revenues and expenditures in the State Highway Fund.

State of Hawaii,
Department of Transportation - Highways Division

Notes to the Basic Financial Statements
June 30, 2009

7. Capital Assets

Changes in capital assets during the year ended June 30, 2009 was as follows:

	Balance July 1, 2008	Additions	Deductions	Transfers	Balance June 30, 2009
Nondepreciable assets:					
Land	$ 431,742,208	$ 9,900	$ (9,402)	$ -	$ 431,742,706
Construction in progress	294,280,990	195,526,077	-	(132,475,915)	357,331,152
Software under development	-	3,003,812	-	-	3,003,812
Infrastructure	745,295,225	-	-	18,424,251	763,719,476
Total	1,471,318,423	198,539,789	(9,402)	(114,051,664)	1,555,797,146
Depreciable assets:					
Land improvements	2,215,473	-	-	-	2,215,473
Buildings and improvements	28,263,842	-	-	6,513	28,270,355
Vehicles and equipment	56,871,372	3,562,204	(1,802,262)	-	58,631,314
Infrastructure	7,676,168,676	267,446	(230,817)	114,045,151	7,790,250,456
Total	7,763,519,363	3,829,650	(2,033,079)	114,051,664	7,879,367,598
Less accumulated depreciation	(3,927,923,236)	(221,917,223)	2,025,384	-	(4,147,815,075)
Depreciable assets, net	3,835,596,127	(218,087,573)	(7,695)	114,051,664	3,731,552,523
Capital assets, net	$ 5,306,914,550	$ (19,547,784)	$ (17,097)	$ -	$ 5,287,349,669

8. Net Assets

At June 30, 2009 net assets consisted of the following:

Invested in Capital Assets, Net of Related Debt:	
Net property, plant and equipment	$ 5,287,349,669
Less: Revenue bonds payable	(387,327,151)
Add: Unspent debt proceeds	46,565,007
	4,946,587,525
Restricted for Debt Service and Capital Activity:	
Restricted for capital projects	46,565,007
Restricted for debt service	25,840,643
Restricted for security deposits	10,183,794
Less: Unspent debt proceeds	(46,565,007)
	36,024,437
Unrestricted	229,115,340
Total net assets	$ 5,211,727,302

9. General Long-Term Liabilities

Changes in general long-term liabilities during the year ended June 30, 2009 were as follows:

	Balance July 1, 2008	Additions	Reductions	Balance June 30, 2009	Amount Due Within One Year
Accrued vacation payable	$ 10,600,584	$ 4,339,505	$ (3,845,121)	$ 11,094,968	$ 2,897,493
Workers' compensation payable	4,791,665	254,866	(613,447)	4,433,084	613,447
Revenue bonds payable	277,800,722	126,032,616	(16,506,187)	387,327,151	19,750,000
Total governmental activities long-term liabilities	$ 293,192,971	$130,626,987	$ (20,964,755)	$402,855,203	$ 23,260,940

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.

At June 30, 2009, approximately $72,295,000 of revenue bonds outstanding are considered defeased.

10. Revenue Bonds (continued)

On December 17, 2008, the Division issued $125,175,000 in State of Hawaii Revenue Bonds, Series 2008 (2008 Bonds). The 2008 Bonds bear interest at rates ranging from 4.0% to 6.00% and mature in annual installments through 2029. The 2008 Bonds maturing on and after January 1, 2020 are subject to redemption at the option of the State at 100% plus accrued interest. These bonds were issued at a premium of $857,616, which will be amortized over the life of the bonds using the effective interest method.

The following is a summary of revenue bonds issued and outstanding at June 30, 2009:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount
1996	3.8% - 6.0%	2016	$ 55,000,000	$ 3,000,000
1998	4.5% - 5.5%	2018	94,920,000	28,955,000
2000	4.4% - 5.5%	2020	50,000,000	4,565,000
2001	3.8% - 5.4%	2022	70,000,000	14,265,000
2003	2.0% - 5.25%	2013	44,940,000	24,595,000
2005	3.0% - 5.25%	2025	183,915,000	177,550,000
2008	3.0% - 5.25%	2029	125,175,000	125,175,000
			$ 623,950,000	378,105,000
		Add: unamortized premium		13,522,045
		Less: deferred amount on refunding		(4,299,894)
		Less: current portion		(16,150,000)
		Noncurrent portion		$ 371,177,151

During 2009, $31,972,888 was transferred from the State Highway Fund to the Debt Service Fund for repayment of Revenue Bonds principal of $16,150,000 due in July 2009 and interest of $15,822,888.

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
2010	$ 19,750,000	$ 18,740,389	$ 38,490,389
2011	20,935,000	17,615,498	38,550,498
2012	21,730,000	16,743,810	38,473,810
2013	22,630,000	15,778,485	38,408,485
2014	23,700,000	14,686,373	38,386,373
2015-2019	138,405,000	54,228,260	192,633,260
2020-2024	77,945,000	25,251,206	103,196,206
2025-2029	53,010,000	8,430,788	61,440,788
Total	$ 378,105,000	$ 171,474,809	$ 549,579,809

11. Operating 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	$(23,667,310)	$ -	$23,667,310	$ -	$ -
Reimbursement to State for debt service on general obligation bonds	(13,081,893)	-	-	(13,081,893)	(13,081,893)
Funding of revenue bond debt service	(31,972,888)	31,972,888	-	-	-
	$(68,722,091)	$ 31,972,888	$23,667,310	$ (13,081,893)	$ (13,081,893)

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.

11. Operating Transfers (continued)

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, 2009 are as follows:

Years Ending June 30,	Principal	Interest	Total
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	3,785,344	223,132	4,008,476
2015-2019	8,720,301	308,842	9,029,143
2020-2021	5,219	395	5,614
Total	$ 41,336,155	$ 3,892,032	$ 45,228,187

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 $13,081,893 consisted of $11,294,925 for principal and $1,786,968 for interest for the year ended June 30, 2009.

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 2009, 2008, and 2007 was approximately $7,257,000, $6,301,000, and $5,939,000, 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, 2009, 2008, and 2007 were approximately $4,286,000, $3,937,000 and $3,054,000, 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 $7,343,000 in fiscal year 2009.

The Division is also assessed a percentage of the cost of the general administration expenses of the Department. During fiscal year 2009, assessments net of amounts refunded amounted to approximately $4,544,000 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 annual minimum rental payments through 2014 and in five-year increments thereafter are as follows:

Years Ending June 30,		
2010	$	957,000
2011		957,000
2012		957,000
2013		957,000
2014		957,000
2015-2019		4,783,000
Total	$	9,568,000

The total rental expenditures during fiscal year 2009 for operating leases were approximately $1,225,000.

b. Rental Revenue

The Division is a lessor of various properties under non-cancelable lease agreements that expire through fiscal year 2044. Scheduled annual minimum revenues through 2014 and in five-year increments thereafter are as follows:

Years Ending June 30,		
2010	$	307,000
2011		307,000
2012		307,000
2013		307,000
2014		307,000
2015-2019		1,519,000
2020-2024		1,376,000
2025-2029		1,133,000
2030-2034		407,000
2035-2039		377,000
2040-2044		304,000
Total	$	6,651,000

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 $2,541,000 at June 30, 2009. 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, 2009 aggregated approximately $23,774,000.

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 $4,433,084 at June 30, 2009.

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, 2009, the Capital Projects Fund had an unreserved fund balance deficit of approximately $155 million. The deficit balance resulted primarily from the excess funds reserved for all committed capital contracts at year end.

State of Hawaii, Department of Transportation, Highways Division

Schedule of Expenditures of Federal Awards
For the Fiscal Year Ended June 30, 2009

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		$ 217,003,437
State and Community Highway Safety Program:			
NHTSA Grant	20.600		2,861,912
Fatal accident reporting system grant	20.600		56,201
National Motor Carrier Safety Program - Assistance program grant	20.218		752,085
Total Federal Expenditures			$ 220,673,635

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 $35,565,394.

SUPPLEMENTARY INFORMATION

PART II

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

KMHLLP

A Hawaii Limited Liability Partnership

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, 2009, and have issued our report thereon dated March 24, 2010. 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 09-01 through 09-03 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.

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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, of the significant deficiencies described above, we consider items 09-01 through 09-03 to be material weaknesses.

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*.

We noted certain matters that we reported to management of the Division in a separate letter dated March 24, 2010.

The Division's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Division's response and, accordingly, we express no opinion on it.

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

Honolulu, Hawaii
March 24, 2010

PART III

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

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, 2009. 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 item 09-04 in the accompanying Schedule of Findings and Questioned Costs, the Division did not comply with requirements regarding special tests and provisions 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, 2009.

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

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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 09-04 through 09-05 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 item 09-04 to be a material weakness.

The Division's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Division's response and, accordingly, we express no opinion on it.

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

Honolulu, Hawaii
March 24, 2010

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, 2009

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's 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.: 09-01 Accrual of Federal Reimbursement to Pass-through Entity – Material Weakness

Criteria: In accordance with Government Accounting Standard Board (GASB) Statement No. 33, cash pass-through grants should be recognized as revenue 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 due to a lack of monitoring, the Division did not accrue for revenue and the related receivable of pass-through entity transactions that occurred during the fiscal year and whose reimbursement request was received subsequent to year-end.

Effect: As a result of the above, grant revenues and the related receivables were understated. Accordingly we proposed and management accepted an adjustment to increase grant revenues and the related receivables by approximately $2.2 million.

Recommendation: We recommend the Division improve its monitoring to ensure that pass-through entity transactions are accounted for in accordance with GASB Statement No. 33.

Management Response: We concur with the finding. Appropriate monitoring procedures will be taken by our accountant to ensure that pass-through entity transactions are accounted for. We accept the adjustment prepared by the auditor. Our accountant will prepare the related entries in the future.

Expected Completion Date: June 2010

Responsible Party: Jerry Sikorski

Contact Number: (808) 587-2256

Section II – Financial Statement Findings

Finding No.: 09-02 Accounts Receivable Reserve – Material Weakness

Criteria: The purpose of a reserve is to provide an allowance for receivables that may not be realizable. The Division has adopted a policy which requires the establishment of a reserve for any receivable that is aged over 90 days and whose balance is likely uncollectible.

Condition, cause, and context: During our audit, we noted that the Division did not properly monitor its accounts receivable balance which resulted in the Division not complying with its policy to determine its accounts receivable reserve. The Division's reserves were recorded at the same time the Division recorded its receivable transactions by debiting a receivable and crediting the receivable reserve account.

Effect: As result of the above, we noted the following:

- The Division's reserves are not properly determined and/or stated and are therefore not in compliance with the conceptual purpose of what a reserve is as well as the Division's policy.

- Inadequate reserve determinations/computations can lead to incorrect financial reporting. As a result of the Division's processes we proposed and management accepted adjustments to decrease the accounts receivable reserve and increase revenues by approximately $9,900,000.

Recommendation: We recommend the Division follow its policy to record reserves and to monitor its receivable balance to ensure proper recording.

Management Response: We concur with the finding. Accounts receivable reserve accounts will be closely monitored by our Chief Accountant to ensure that the Division's policies are followed.

Expected Completion Date: June 2010

Responsible Party: Jerry Sikorski

Contact Number: (808) 587-2256

State of Hawaii,
Department of Transportation - Highways Division

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2009

Section II – Financial Statement Findings

Finding No.: 09-03 Communication of Third-Party Agreements – Material Weakness

Criteria: On December 12, 1996, the Division and Castle and Cooke (C&C) entered in to the Transportation and Development Agreement (Agreement). The Agreement required the Division to pay for the "Highway Work", as defined, with federal funds and also required C&C to pay the Division's matching share for the federal funds, administrative labor charge and all other construction costs not eligible for federal participation via reimbursement to the State Highway Fund. In 2003 the Division and C&C began the process to enter in to the Second Amendment to the Agreement to finalize the repayment schedule based on Final Cost, as defined; however, the Second Amendment was never completed.

Condition, cause, and context: On January 16, 2009, the Division received a cash receipt of approximately $530,000. This receipt is the first payment of six installments scheduled to be received annually over the next five years in accordance with the Second Amendment to the Agreement. Upon inquiry with management it was determined that the original Agreement and subsequent amendments were either forgotten about or were not properly communicated for follow up action.

Effect: As a result of the above, accounts receivable and contribution revenue were understated. Accordingly we proposed and management accepted an adjustment to record a receivable and the related contribution revenue in the government-wide financial statements of approximately $2.6 million.

Recommendation: We recommend the Division examine its process for communicating third party reimbursement or cost-sharing agreements to the appropriate accounting personnel to ensure that any financial reporting impact is given proper consideration.

Management Response: We concur with the finding. We have assigned our Chief Accountant to coordinate and monitor the payment process. Communication line between Fiscal staff and other offices will be reopened to ensure that third-party agreements and payments are properly monitored. We accept the adjustment prepared by the auditors.

Expected Completion Date: June 2010

Responsible Party: Jerry Sikorski

Contact Number: (808) 587-2256

Section III – Federal Award Findings

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

Finding No.: 09-04 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 selected 38 items and noted the following:

- For 28 items, there is currently no monitoring control in place to ensure that a sufficient sample is made in accordance with program requirements during the construction phase of a project.
- For 6 items, the project file was not available to corroborate that the samples submitted were in compliance with the guidelines.
- For 3 items, one of two project binders was not available to corroborate that the samples submitted were in compliance with the guidelines.
- For 7 items, the selections examined lacked documentation evidencing that the testing was performed.
- For 1 item, the selection examined lacked documentation to determine if a sample was done for a pay item.

Effect: Failure to properly implement monitoring controls and apply the sampling plan as required, resulted 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. Additionally, non-compliance could jeopardize the Divisions' federal funding.

Questioned costs: None

Recommendations:

- 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.

Section III – Federal Award Findings

- 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.
- Establishing responsibilities/requirements between HWY-L and the respective project managers for tracking the tested sample materials for a project to ensure that a sufficient number of samples are being submitted, received, and approved for testing.

Management Response: We concur with the finding. The following actions have been implemented:

1. HWY-L has issued a memo requesting districts to complete a checklist before requesting HWY-L issue a Letter of Material Certification.

2. HWY-L has issued a memo requesting districts to provide additional information on the existing sample cards they submit to HWY-L.

The information will be used to categorize all sample cards in the new DOTCMS computerized database. The new database will assist the districts and HWY-L in ensuring that all materials used in the project were tested and/or certified and reduce the chance of sample cards being misplaced.

HWY-L is also working on the following additional actions:

1. Preparing a memo to the districts that will be based on the recommendations from a recent FHWA audit. The specific recommendation relates to expanding Oahu district's computerized "construction management system" that helps track all payment items for all projects. The computerized system will assist with generating a summary schedule of sample materials for each project that detail testing performed and results to date.

2. Initiate a branch reorganization to establish a "Materials Certification" unit that will oversee the materials certification program. The unit will conduct periodic audits/reviews of construction offices and their individual summary schedule of sample materials for each project throughout the construction phase. In the interim, HWY-L will temporarily assign personnel from various sections to conduct the audits/reviews which will start before the end of calendar year 2010.

Expected Completion Date: June 2011

Responsible Party: Casey Abe

Contact Number: (808) 483-2515

Section III – Federal Award Findings

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

Finding No.: 09-05 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 2009 Summary Schedule, management indicated that prior year finding 08-09 Sampling was resolved. However, during our current year testing, we noted that this finding was not resolved and the item was reported as a current year finding (09-04).

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 which could jeopardize the Division's funding.

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.

Management Response: We concur with the finding. We will continue our effort to improve the controls and apply the sampling plan in accordance with program requirements. We have implemented a Sampling, Testing and Inspection Schedule at the project construction management level and will maintain a material tracking and monitoring system.

Expected Completion Date: June 2010

Responsible Party: Wai Lee

Contact Number: (808) 587-2251

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, 2008, dated March 23, 2009.

Recommendations	Status

Part II – Financial Statement Findings Section

08-01 Financial Statement Reporting

Recommendations	Status
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.	Finding resolved.

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.

Recommendations | Status

Part II – Financial Statement Findings Section (continued)

08-01 Financial Statement Reporting (continued)

- 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.
- 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.

08-02 Restricted Cash

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

Status: Finding resolved.

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.

Recommendations	Status
Part II – Financial Statement Findings Section (continued)	
08-03 Accounts Receivable	
Criteria: The Division's accounts receivable and allowance balances should be maintained accurately by individual customer.	Finding still applicable. See current year finding 09-02.
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.	

Recommendations	Status
Part II – Financial Statement Findings Section (continued)	
08-04 Accrual of Federal Reimbursement to Pass-through Entity	
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.	Finding still applicable. See current year finding 09-01.
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.	
08-05 Retention Payable	
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.	Finding resolved.
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.	

Recommendations	Status

Part II – Financial Statement Findings Section (continued)

08-06 Accrued Vacation

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.	Finding resolved.

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.

Recommendations	Status
Part III – Federal Award Finding and Questioned Costs Section	
08-07 Equipment and Real Property Management	
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.	Finding resolved.
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	

Recommendations	Status

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

08-08 Reporting

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

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

Recommendations	Status

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

08-09 Special Tests and Provisions

Criteria: The Division is required by CFR §637.205 to have a sampling program in place to ensure the quality of materials and workmanship.	Finding not resolved. See current year finding 09-04.

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

Recommendations	Status

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

08-10 Corrective Action Plan/Summary Schedule of Prior Audit Findings

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	Finding not resolved. See current year finding 09-05.

Recommendations	Status
Part III – Federal Award Findings and Questioned Costs Section (continued)	
08-11 Subrecipient Monitoring	
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.	Finding resolved.
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	