



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Basic Financial Statements and Single Audit Reports

Year ended June 30, 2003

(With Independent Auditors' Reports Thereon)

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Basic Financial Statements and Single Audit Reports

Year ended June 30, 2003

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SECTION I – INTRODUCTION



P.O. Box 4150
Honolulu, HI 96812-4150

January 30, 2004

To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii:

We have completed the audit of the basic financial statements of the Department of Business, Economic Development and Tourism, State of Hawaii (the Department), as of and for the year ended June 30, 2003. We have also audited the Department's compliance with requirements applicable to its major federal financial assistance programs. We submit herein our reports on the Department's basic financial statements and federal financial assistance programs.

The audit objectives and scope of the financial audit were as follows:

AUDIT OBJECTIVES

1. To provide a basis for an opinion on the fairness of the Department's basic financial statements.
2. To determine whether the Department complied with those provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes), which could have a direct and material effect on the determination of financial statement amounts.
3. To evaluate the Department's system of internal control over financing reporting.
4. To determine whether the Department has complied with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major federal financial assistance program.
5. To evaluate internal control over compliance with requirements of regulations, contracts, and grants that could have a direct and material effect on each major federal financial assistance program.
6. To determine the current status of the audit recommendations included in the prior year's independent auditors' report on compliance and on internal control over financial reporting.

SCOPE OF AUDIT

1. We performed an audit of the Department's basic financial statements as of and for the year ended June 30, 2003 in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.



To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii
January 30, 2004

2. As part of the audit of the Department's basic financial statements, we performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes) and procurement rules, directives, and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We also evaluated the Department's system of internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements.
3. We performed an audit of the Department's federal financial assistance programs for the year ended June 30, 2003 in accordance with auditing standards generally accepted in the United States of America, as adopted by the American Institute of Certified Public Accountants, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, certain provisions of OMB Circular A-133 and the applicable sections described in the *OMB's Circular A-133 Compliance Supplement*.

ORGANIZATION OF REPORT

Our report is organized into four sections as follows:

1. Section I, entitled "Introduction," describes the objectives and scope of our financial audit and the organization and contents of this report.
2. Section II, entitled "Basic Financial Statements," contains the Department's basic financial statements and footnotes for the year ended June 30, 2003, and our report thereon.
3. Section III, entitled "Compliance and Internal Control over Financial Reporting," contains our report on the Department's compliance and internal control over financial reporting based upon our audit of the Department's basic financial statements.
4. Section IV, entitled "Compliance and Internal Control over Federal Awards," contains our report on the Department's compliance and internal control over federal awards in accordance with OMB Circular A-133, a schedule of expenditures of federal awards, and a schedule of findings and questioned costs.

We would like to take this opportunity to express our appreciation to the personnel of the Department of Business, Economic Development and Tourism for the cooperation and assistance extended to us during our audit. We will be pleased to discuss any questions that you or your associates may have regarding our recommendations.

Very truly yours,

KPMG LLP

SECTION II – BASIC FINANCIAL STATEMENTS



P.O. Box 4150
Honolulu, HI 96812-4150

Independent Auditors' Report

To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Department of Business, Economic Development and Tourism, State of Hawaii (the Department), as of and for the year ended June 30, 2003, which collectively comprise the Department's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in note 1, the financial statements of the Department are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and major fund information of the State that are attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Department as of June 30, 2003, and the respective changes in financial position and the respective budgetary comparison for the General and Economic Development Special Revenue Funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.



The Department has not presented management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 30, 2004 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

January 30, 2004

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Statement of Net Assets

June 30, 2003

Assets

Current assets:		
Cash in state treasury (note 4)	\$	49,448,086
Cash in bank (note 4)		132,045
Petty cash		<u>33,050</u>
Total cash		49,613,181
Receivables:		
Accounts, net (note 5)	\$	251,484
Loans, net (note 5)		3,872,547
Interest		22,645
Due from grantor		1,359,252
Transient accommodations tax		6,958,585
Due from Hawaii Convention Center		<u>2,146,885</u>
Total receivables, net		14,611,398
Investment in venture capital limited partnerships, at cost (note 2)		10,634,811
Capital assets (note 7):		
Land and construction in progress		153,411,713
Other capital assets, net		<u>190,203,490</u>
Capital assets, net		<u>343,615,203</u>
Total assets		<u>418,474,593</u>

Liabilities

Current liabilities:		
Vouchers payable		11,027,312
Accrued payroll		521,825
Due to State Department of Budget and Finance (note 8)		6,601,294
Due to other state agencies (note 6)		3,829,000
Due to State General Fund		33,050
Deferred revenues		629,162
Accrued vacation (note 9):		
Due within one year		597,497
Due in more than one year		<u>1,718,383</u>
Total liabilities		<u>24,957,523</u>

Commitments and contingencies (notes 6, 8, 9, 10, 11, 12, and 13)

Net Assets (Note 6)

Invested in capital assets	343,615,203	
Unrestricted	<u>49,901,867</u>	
Total net assets		\$ <u><u>393,517,070</u></u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Statement of Activities

Year ended June 30, 2003

	Program Expenses (Notes 7, 9, 10, 11, and 13)	Program Revenues		Net Expense and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	
Governmental activities:				
Hawaii Tourism Authority (note 8)	\$ 103,422,527	\$ 7,551,799	\$ —	\$ 95,870,728
Natural Energy Laboratory of Hawaii Authority	10,698,414	1,335,208	7,363,439	1,999,767
General support for economic development	2,932,471	—	—	2,932,471
High Technology and Strategic Development	3,850,627	1,478,506	1,298,160	1,073,961
Energy development and management	3,686,427	73,623	848,097	2,764,707
Economic planning and research for economic development	2,994,483	8	—	2,994,475
Business services and development	2,816,770	97,498	30,001	2,689,271
Office of Planning	4,060,868	5,720	2,076,971	1,978,177
Aloha Tower Development Corporation	1,485,320	1,883	—	1,483,437
Foreign-Trade Zone	1,414,859	1,563,222	—	(148,363)
Land Use Commission	486,376	—	—	486,376
Office of Hawaiian Affairs Public Land Trust	240,890	—	—	240,890
Hawaii Tourism Office	40,750	—	—	40,750
Total governmental activities	<u>\$ 138,130,782</u>	<u>\$ 12,107,467</u>	<u>\$ 11,616,668</u>	<u>114,406,647</u>
General revenues:				
Transient accommodations tax				91,851,591
State allotted appropriations, net of reversions and lapses				15,745,703
Lapsed appropriations related to previous years				(2,357,906)
Interest				1,716,703
Nonimposed employee fringe benefits (note 11)				2,042,994
Other				73,371
Total general revenues				<u>109,072,456</u>
Transfers				<u>(6,208,064)</u>
Change in net assets				<u>(11,542,255)</u>
Net assets at July 1, 2002				<u>405,059,325</u>
Net assets at June 30, 2003				<u>\$ 393,517,070</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Balance Sheet – Governmental Funds

June 30, 2003

Assets	<u>General</u>	<u>Economic Development Special Revenue</u>	<u>Capital Projects</u>	<u>Total Governmental Funds</u>
Cash in state treasury (note 4)	\$ 1,309,353	\$ 40,893,914	\$ 7,244,819	\$ 49,448,086
Cash in bank (note 4)	—	132,045	—	132,045
Petty cash	11,000	22,050	—	33,050
Receivables:				
Accounts, net (note 5)	—	251,484	—	251,484
Loans, net (note 5)	—	3,872,547	—	3,872,547
Interest	—	22,645	—	22,645
Due from grantor	—	1,359,252	—	1,359,252
Transient accommodations tax receivable	—	6,958,585	—	6,958,585
Due from Hawaii Convention Center	—	2,146,885	—	2,146,885
Investment in venture capital limited partnerships, at cost (note 2)	—	10,634,811	—	10,634,811
Total assets	<u>\$ 1,320,353</u>	<u>\$ 66,294,218</u>	<u>\$ 7,244,819</u>	<u>\$ 74,859,390</u>
Liabilities and Fund Balances				
Liabilities:				
Vouchers payable	\$ 120,703	\$ 10,748,811	\$ 157,798	\$ 11,027,312
Accrued payroll	276,536	245,289	—	521,825
Due to State Department of Budget and Finance (note 8)	—	6,601,294	—	6,601,294
Due to other state agencies (note 6)	—	3,829,000	—	3,829,000
Due to State General Fund	11,000	22,050	—	33,050
Deferred revenues	—	629,162	—	629,162
Total liabilities	<u>408,239</u>	<u>22,075,606</u>	<u>157,798</u>	<u>22,641,643</u>
Fund balances (deficit):				
Reserved for encumbrances	1,212,570	12,398,996	1,757,879	15,369,445
Reserved for capital projects	—	—	5,329,142	5,329,142
Reserved for other purposes	—	91,107	—	91,107
Unreserved (note 12)	(300,456)	31,728,509	—	31,428,053
Total fund balances	<u>912,114</u>	<u>44,218,612</u>	<u>7,087,021</u>	<u>52,217,747</u>
Total liabilities and fund balances	<u>\$ 1,320,353</u>	<u>\$ 66,294,218</u>	<u>\$ 7,244,819</u>	

Amounts reported 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

343,615,203

Accrued vacation reported in the statement of net assets do not require the use of current financial resources and, therefore, are not reported as liabilities in the governmental funds

(2,315,880)

Net assets of governmental activities

\$ 393,517,070

See accompanying notes to basic financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Statement of Revenues, Expenditures, and Changes in Fund Balances -- Governmental Funds

Year ended June 30, 2003

	General	Economic Development Special Revenue	Capital Projects	Total Governmental Funds
Revenues:				
Transient accommodations tax	\$ ---	\$ 91,851,591	\$ ---	\$ 91,851,591
State allotted appropriations, net of reversions and lapses	11,181,703	---	4,564,000	15,745,703
Charges for current services	---	12,107,469	---	12,107,469
Intergovernmental	---	11,616,668	---	11,616,668
Nonimposed employee fringe benefits (note 11)	2,042,994	---	---	2,042,994
Interest	---	1,716,703	---	1,716,703
Other	---	73,372	---	73,372
Total revenues	13,224,697	117,365,803	4,564,000	135,154,500
Expenditures (notes 7, 9, 10, 11, and 13):				
Hawaii Tourism Authority	293,424	96,652,883	---	96,946,307
Natural Energy Laboratory of Hawaii Authority	944,319	9,697,320	---	10,641,639
General support for economic development	2,650,646	---	---	2,650,646
High Technology and Strategic Development	1,472,650	1,675,209	---	3,147,859
Energy development and management	1,512,438	2,165,039	---	3,677,477
Economic planning and research for economic development	1,145,810	1,799,471	---	2,945,281
Business services and development	3,402,511	291,345	---	3,693,856
Office of Planning	2,091,078	1,891,318	---	3,982,396
Aloha Tower Development Corporation	---	1,485,449	---	1,485,449
Foreign-Trade Zone	---	1,576,753	---	1,576,753
Land Use Commission	492,719	---	---	492,719
Office of Hawaiian Affairs Public Land Trust	---	240,890	---	240,890
Hawaii Tourism Office	40,750	---	---	40,750
Capital outlays	---	---	1,209,202	1,209,202
Total expenditures	14,046,345	117,475,677	1,209,202	132,731,224
Excess (deficiency) of revenues over expenditures	(821,648)	(109,874)	3,354,798	2,423,276
Other financing sources (uses):				
Transfers in	---	318,000	---	318,000
Transfers out	(318,000)	---	---	(318,000)
Transfer to the State Department of Accounting and General Services	---	(6,208,064)	---	(6,208,064)
Lapsed appropriations related to previous years	(1,546,133)	---	(811,773)	(2,357,906)
Total other financing uses, net	(1,864,133)	(5,890,064)	(811,773)	(8,565,970)
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	(2,685,781)	(5,999,938)	2,543,025	(6,142,694)
Fund balances, July 1, 2002	3,597,895	50,218,550	4,543,996	
Fund balances, June 30, 2003	\$ 912,114	\$ 44,218,612	\$ 7,087,021	
Amounts reported in the statement of net assets are different because:				
Governmental funds report capital outlays as expenditures; however, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period				(5,340,730)
Accrued vacation reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds				(58,831)
Change in net assets				\$ (11,542,255)

See accompanying notes to basic financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Statement of Fiduciary Net Assets

Fiduciary Fund

June 30, 2003

	<u>Agency Funds</u>
Assets:	
Cash in state treasury (note 4)	\$ 185,629
Cash in bank (note 4)	<u>36,552</u>
Total assets	222,181
Liabilities:	
Deposits payable	<u>222,181</u>
Net assets	\$ <u><u>—</u></u>

See accompanying notes to basic financial statements.

DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM

STATE OF HAWAII

Statement of Revenues and Expenditures – Budget and Actual
(Budgetary Basis) – General and Economic Development Special Revenue Funds

Year ended June 30, 2003

	General Fund				Economic Development Special Revenue Fund			
	Original Budget	Final Budget	Actual (Budgetary Basis)	Variance Favorable (Unfavorable)	Original Budget	Final Budget	Actual (Budgetary Basis)	Variance Favorable (Unfavorable)
Revenues:								
State allotted appropriations, net of reversions and lapses	\$ 10,938,849	\$ 11,879,827	\$ 11,181,703	\$ (698,124)	\$ —	\$ —	\$ —	\$ —
Other	—	—	—	—	123,696,571	123,955,168	105,303,907	(18,651,261)
Total revenues	<u>10,938,849</u>	<u>11,879,827</u>	<u>11,181,703</u>	<u>(698,124)</u>	<u>123,696,571</u>	<u>123,955,168</u>	<u>105,303,907</u>	<u>(18,651,261)</u>
Expenditures:								
Hawaii Tourism Authority (note 8)	—	—	—	—	102,084,375	102,084,375	94,380,035	7,704,340
Natural Energy Laboratory of Hawaii Authority	705,036	801,599	749,300	52,299	2,479,065	2,491,820	1,784,001	707,819
General support for economic development	1,831,546	2,025,983	1,957,601	68,382	—	—	—	—
High Technology and Strategic Development	1,276,116	1,323,788	1,246,353	77,435	7,465,338	7,509,083	4,643,140	2,865,943
Energy development and management	1,342,346	1,433,942	1,279,869	154,073	300,000	300,000	—	300,000
Economic planning and research for economic development	819,937	922,243	898,931	23,312	1,292,034	1,305,904	1,262,236	43,668
Business services and development	2,970,924	3,178,470	2,978,563	199,907	6,413,134	6,433,876	485,660	5,948,216
Office of Planning	1,595,247	1,756,516	1,665,512	91,004	60,000	60,000	26,196	33,804
Aloha Tower Development Corporation	—	—	—	—	1,503,552	1,525,689	591,916	933,773
Foreign-Trade Zone	—	—	—	—	1,950,827	2,003,531	1,500,227	503,304
Land Use Commission	397,697	437,286	405,574	31,712	—	—	—	—
Office of Hawaiian Affairs Public Land Trust	—	—	—	—	240,890	240,890	240,890	—
Total expenditures	<u>10,938,849</u>	<u>11,879,827</u>	<u>11,181,703</u>	<u>698,124</u>	<u>123,789,215</u>	<u>123,955,168</u>	<u>104,914,301</u>	<u>19,040,867</u>
Excess (deficiency) of revenues over expenditures	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (92,644)</u>	<u>\$ —</u>	<u>\$ 389,606</u>	<u>\$ 389,606</u>

See accompanying notes to basic financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2003

(1) Financial Statement Presentation

(a) *The Financial Reporting Entity*

The Department of Business, Economic Development and Tourism (the Department) is a department of the State of Hawaii (the State). The Department's basic financial statements present the financial position and changes in financial position of only that portion of the governmental activities and major fund information of the State that are attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes comprehensive financial statements for the State annually, which include the Department's financial activities.

The objective of the Department is to make broad policy determinations with respect to economic development within the State and to stimulate research (through research and demonstration projects) in industrial and economic development that offer the most immediate promise to expand the State's economy. In addition, the Department endeavors to gain an understanding of those functions and activities of other governmental agencies and of private agencies that are related to the field of economic development. The Department also encourages initiative and creative thinking in harmony with the objectives of the Department.

The State has defined its reporting entity in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. This statement establishes standards for defining and reporting on the financial reporting entity. The basic criterion for including a potential component unit within the reporting entity is financial accountability. Other criteria include legal standing and fiscal dependency.

The Department's basic financial statements consist of the financial activities of the Department and certain other agencies of the State, that are administratively attached to the Department. The following agencies are blended component units of the State and are included in the Department's basic financial statements:

Aloha Tower Development Corporation
Hawaii Strategic Development Corporation
Hawaii Tourism Authority
High Technology Development Corporation
Land Use Commission
Natural Energy Laboratory of Hawaii Authority
Office of Planning

The Department's basic financial statements do not include the financial statements of the Hawaii Community Development Authority (HCDA) and the Housing and Community Development Corporation of Hawaii (HCDCH).

Complete financial statements for HCDA and HCDCH may be obtained at the HCDA and HCDCH administrative offices.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2003

The basic financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

(b) *Government-Wide and Fund Financial Statements*

The government-wide financial statements, which are the statement of net assets and the statement of activities, report information of all of the nonfiduciary activities of the Department. For the most part, the effect of interfund activity has been removed from these government-wide financial statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, it is generally the Department's policy to use restricted resources first, then unrestricted resources as they are needed.

The financial activities of the Department are recorded in individual funds, each of which is deemed to be a separate accounting entity. The Department uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2003

The financial activities of the Department that are reported in the accompanying fund financial statements have been classified into the following major governmental funds. In addition, a description of the Department's fiduciary fund is as follows:

Governmental Fund Types

The Department reports the following major governmental funds:

General Fund

This fund is the Department's primary operating fund. It accounts for all financial activities of the Department, except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

Economic Development Special Revenue Fund

This fund accounts for all programs related to the development and promotion of industry and international commerce, energy development and management, economic research and analysis, and the utilization of resources.

Capital Projects Fund

This fund accounts for financial resources to be used for the acquisition or construction of major capital facilities.

Fiduciary Fund Type

Agency Fund

This fund accounts for assets held by the Department in an agency capacity.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting and Measurement Focus

The accounting policies of the Department conform to GAAP applicable to state and local governments as prescribed by GASB through its statements and interpretations. The government-wide statement of net assets and statement of activities are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these activities are included on the statement of net assets.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Notes to Basic Financial Statements

June 30, 2003

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

The modified accrual basis of accounting is used by all governmental fund types and trust funds. Under the modified accrual basis of accounting, revenues such as interest are recognized when susceptible to accrual (i.e., when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year-end).

Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after year-end to liquidate liabilities existing at the end of the fiscal year. The Department considers receivables collected within 60 days after year-end to be available and recognizes them as revenues of the current year. Expenditures are recorded when the related fund liability is incurred.

The Department reports deferred revenues on its statement of net assets and balance sheet. Deferred revenues arise when both the "measurable" and "available" criteria for recognition are not met in the current period. Deferred revenues also arise when the Department receives resources before it has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the Department has a legal claim to the resources, the liability for the deferred revenue is removed from the statement of net assets and balance sheet and revenue is recognized.

Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts, and other commitments for the expenditure of resources are recorded to reserve that portion of the applicable appropriation, is utilized in the governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will generally be honored during the subsequent fiscal year.

(b) Investments

Investments in venture capital limited partnerships are carried at cost, which amounted to \$10,634,811 at June 30, 2003. The fair value of these investments approximated \$6,002,200 at June 30, 2003. Fair value of the Department's limited partnership interests is based on the fair value of the underlying securities owned by the limited partnerships obtained from international and national security exchanges or are based on estimated values. The Department has outstanding commitments to fund these venture capital funds of \$1,090,000 at June 30, 2003.

**DEPARTMENT OF BUSINESS,
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Notes to Basic Financial Statements

June 30, 2003

(c) Capital Assets

Capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition and construction are reflected as expenditures in governmental funds, and the related assets are reported in the statement of net assets. Capital assets acquired by purchase are recorded at cost. Donated fixed assets are valued at the estimated fair market value on the date received. Maintenance, repairs, minor replacements, renewals, and betterments are charged to operations as incurred. Major replacements, renewals, and betterments are capitalized. Capital assets are defined as assets with an initial individual cost of \$5,000 or more and are depreciated on the straight-line method over the estimated useful lives of the respective assets (land improvements – 15 years, buildings and improvements – 30 years, and furniture, fixtures, and equipment – 5 to 7 years). Depreciation is recorded on capital assets on the government-wide statement of activities.

(d) Accrued Vacation Payable and Sick Leave

Employees hired on or before July 1, 2001 earn vacation at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001, earn vacation at rates ranging between 1 and 2 working days for each month of service, depending upon the employees' years of service and job classifications. Each employee is allowed to accumulate a maximum of 90 days of vacation as of the end of the calendar year. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in the governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Sick leave is not convertible to pay upon termination of employment and is recorded as an expenditures when taken.

(e) Program Revenues

The Department charges various program fees that include office space and facility rental fees, ground rent fees, storage service fees, maintenance fees, and facility management fees.

Federal grant and assistance awards made on the basis of entitlement periods are recorded as revenue when available and entitlement occurs. All other federal reimbursement-type grants are recorded as receivables and revenues when the related expenditures are incurred.

(f) Transient Accommodations Tax

In accordance with Sections 237D-2 and 237D-6.5, Hawaii Revised Statutes (HRS), a portion of the funding for the Department's economic development special revenue fund operations is derived from 49.9% of the transient accommodations tax collected. The transient accommodations tax is assessed at a rate of 7.25% on the gross rental or gross rental proceeds derived from providing transient accommodations.

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(g) *Nonexchange Transactions*

Effective July 1, 2000, the Department adopted GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, which requires the Department to record grant revenue only when all eligibility requirements have been met and amounts are available.

(h) *Intrafund and Interfund Transactions*

Transfers of financial resources within the same fund are eliminated. Transfers from funds receiving revenues to funds through which the resources are to be expended are recorded as transfers.

(i) *Use of Estimates*

The preparation of basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the date of the basic financial statements, and the reported amounts of revenues, expenditures, and other financing sources and uses during the reporting period. Actual results could differ from those estimates.

(3) *Budgeting and Budgetary Control*

The budget of the Department is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services, and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan, and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented, and controlled.

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues in the statement of revenues and expenditures – budget and actual (budgetary basis) – general and special revenue funds are those estimates as compiled and reviewed by the Department. Budgeted expenditures are derived primarily from the General Appropriations Act of 2001 (Act 259, Session Laws of Hawaii of 2001), as amended by the Supplemental Appropriations Act of 2002 (Act 177, Session Laws of Hawaii of 2002), and from other authorizations contained in the State Constitution, HRS, and other specific appropriations acts in various Session Laws of Hawaii. Federal financial assistance program revenues are not included in the statement of revenues and expenditures – budget and actual (budgetary basis) – general and economic development special revenue funds.

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All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2001 – 2003 biennial budget, as amended by subsequent supplemental appropriations.

The general and economic development special revenue funds have legally appropriated annual budgets. Capital projects fund appropriated budgets are for projects that may extend over several fiscal years.

The final legally adopted budget in the accompanying statement of revenues and expenditures – budget and actual (budgetary basis) – general and economic development special revenue funds represents the original appropriations, transfers, and other legally authorized legislative and executive changes.

The legal level of budgetary control is maintained at the appropriation line item level by department, program, and source of funds as established in the appropriations act. The Governor is authorized to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the Department. During the fiscal year ended June 30, 2003, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, general and economic development special revenue funds appropriations generally lapse at the end of the fiscal year for which the appropriations are made. The State Legislature specifies the lapse dates and any other contingencies which may terminate the authorizations for other appropriations.

Budgets adopted by the State Legislature for the general and economic development special revenue funds are presented in the accompanying statement of revenues and expenditures – budget and actual (budgetary basis) – general and economic development special revenue funds. The Department's annual budget is prepared on the modified accrual basis of accounting with several differences from the preparation of the statement of revenues, expenditures, and changes in fund balances, principally related to (1) encumbrance of purchase orders and contract obligations, (2) accrued revenues and expenditures, and (3) unbudgeted programs (federal award programs). The first two differences represent departures from GAAP.

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A reconciliation of the budgetary to GAAP basis operating results for the fiscal year ended June 30, 2003 follows:

	General	Economic Development Special Revenue	
Excess of revenues over expenditures – actual (budgetary basis)	\$ —	\$ 389,606	
Reserved for encumbrances at year-end	1,212,570	6,655,394	*
Expenditures for liquidation of prior year encumbrances	(3,667,196)	(13,380,812)	*
Net accrued revenues and expenditures	(231,155)	1,089,347	*
Unbudgeted revenues and other financing sources net of expenditures and other financing uses	—	(753,473)	
Deficiency of revenues and other financing sources over expenditures and other financing uses – GAAP basis	\$ (2,685,781)	\$ (5,999,938)	

* Amount reflects the balances related to budgeted programs only.

(4) Cash in State Treasury

The State Director of Finance is responsible for the safekeeping of all monies paid into the state treasury. The State Director of Finance pools and invests any monies of the State, which in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit and repurchase agreements with federally-insured financial institutions.

The State established a policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Cash accounts that participate in the investment pool accrue interest based on the average weighted cash balances of each account. The Department records the pooled assets as cash in state treasury.

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June 30, 2003

For demand or checking accounts and time certificates of deposit, the State requires that the depository banks pledge collateral based on daily available bank balances. 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.

Information regarding the carrying amount and corresponding bank balances of the cash (which includes the Department's cash in state treasury) and collateralization of the cash balances is included in the comprehensive annual financial report of the State.

The carrying value of the Department's cash in bank balance of \$132,045 equals the bank balance and was uncollateralized at June 30, 2003. Such balance primarily represents the Department's bank accounts maintained for out-of-state operations and security deposits held for the Foreign-Trade Zone Division and the High Technology Development Corporation.

(5) Accounts and Loan Receivable

At June 30, 2003, accounts and loans receivable consisted of the following:

	Accounts Receivable	Loans Receivable
Foreign-Trade Zone Division	\$ 259,030	\$ —
Natural Energy Laboratory of Hawaii Authority	261,804	—
High Technology Development Corporation	42,374	—
Financial Assistance Branch:		
Hawaii Capital Loan Program	—	7,378,843
Hawaii Community-Based Development Loan Program	—	227,114
Hawaii Innovation Development Loan Program	—	161,306
Hawaii Disaster Commercial Loan Program	—	41,419
	563,208	7,808,682
Less allowance for doubtful accounts	(311,724)	(3,936,135)
Accounts and loans receivable, net	\$ 251,484	\$ 3,872,547

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June 30, 2003

(6) Due to Other State Agencies

The Aloha Tower Development Corporation (the ATDC) is a State agency established under HRS Chapter 206J, primarily to redevelop the Aloha Tower complex in Honolulu. The complex encompasses Piers 5 to 23 of Honolulu Harbor. In September 1993, the State Department of Transportation – Harbors Division (Harbors) entered into a lease with the ATDC (ATDC lease) which grants the leasehold interest in portions of the Aloha Tower complex to the ATDC. The ATDC is required annually to reimburse Harbors for any losses in revenues during the term of the lease caused by any action of the ATDC or the developer and to provide replacement facilities for maritime activities at no cost to Harbors.

In September 1993, the ATDC subleased lands surrounded by Piers 8 and 9 and a portion of land surrounded by Pier 10 to a developer and entered into a capital improvements, maintenance, operations, and securities agreement (Operations Agreement) with the developer and Harbors. Harbors continues to operate the harbor facilities at Piers 8, 9, and 10. The lease between the ATDC and the developer requires the developer to construct, at the developer's cost, various facilities as designated in the developer's proposal and to reimburse Harbors for all losses in revenues and increased expenses which may be incurred by Harbors. The ATDC, Harbors, and the developer agreed that in lieu of reimbursing Harbors for losses in revenues during the construction period, the developer would perform certain work to repair the structure of Piers 8 through 11, the cost of which would otherwise be incurred by Harbors. The developer offset the maximum allowable cost of repair of \$1,100,000 against its obligation to Harbors for losses in revenues.

As of June 30, 2003, the first phase of the Aloha Tower complex development has been completed.

Pursuant to this Operations Agreement, the developer is current on amounts owed to the ATDC as of June 30, 2003. Pursuant to the ATDC lease, the ATDC owes Harbors approximately \$3,829,000 as of June 30, 2003. This amount is reflected in the economic development special revenue fund in the Department's basic financial statements.

**DEPARTMENT OF BUSINESS,
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Notes to Basic Financial Statements

June 30, 2003

(7) Capital Assets

Changes in capital assets during the fiscal year ended June 30, 2003 were as follows:

	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2003</u>
Capital assets not being depreciated:				
Land	\$ 134,446,508	\$ —	\$ —	\$ 134,446,508
Construction in progress	17,756,003	1,209,202	—	18,965,205
Total capital assets not being depreciated	<u>152,202,511</u>	<u>1,209,202</u>	<u>—</u>	<u>153,411,713</u>
Other capital assets:				
Land improvements	311,128	—	—	311,128
Buildings and improvements	250,533,745	874,454	—	251,408,199
Equipment	2,994,400	1,599,528	283,783	4,310,145
Total other capital assets	<u>253,839,273</u>	<u>2,473,982</u>	<u>283,783</u>	<u>256,029,472</u>
Less accumulated depreciation for:				
Land improvements	197,048	20,742	—	217,790
Buildings and improvements	54,390,150	8,402,741	—	62,792,891
Furniture, fixtures, and equipment	2,498,653	525,370	208,722	2,815,301
Total accumulated depreciation	<u>57,085,851</u>	<u>8,948,853</u>	<u>208,722</u>	<u>65,825,982</u>
Total other capital assets, net	<u>196,753,422</u>	<u>(6,474,871)</u>	<u>75,061</u>	<u>190,203,490</u>
Total capital assets, net	<u>\$ 348,955,933</u>	<u>\$ (5,265,669)</u>	<u>\$ 75,061</u>	<u>\$ 343,615,203</u>

**DEPARTMENT OF BUSINESS,
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During the fiscal year ended June 30, 2003, depreciation expense was charged to functions of the Department as follows:

Hawaii Tourism Authority	\$ 7,185,901
High Technology and Strategic Development	696,417
Statewide planning and coordination	423,832
Business Services and Development	405,085
Foreign-Trade Zone	154,682
Natural Energy Laboratory of Hawaii Authority	77,180
Office of Planning	2,992
Energy Development and Management	1,573
Economic planning and research for economic development	1,191
Total depreciation expense	\$ 8,948,853

(8) Due to State Department of Budget and Finance

During the period in October 1992 through April 1998, the State issued a series of general obligation bonds whose proceeds were used to fund the construction of the Hawaii Convention Center (the Center). These bonds are obligations of the State and are secured by the State's full faith and credit. The debt service for the general obligation bonds are to be primarily funded by an allocated portion of the State's transient accommodations tax revenue and revenue generated from the operation of the Center. Prior to July 1, 2002, these funds were collected and accounted for by the State Department of Budget and Finance (Budget and Finance).

Effective July 1, 2002, the Convention Center Enterprise Special Fund (the Convention Center Fund) was established by Act 253, Session Laws of Hawaii 2002 (Act 253). In accordance with Act 253, the Convention Center Fund was placed within the Hawaii Tourism Authority (the Authority), an administratively attached agency of the Department, and was created to receive all revenues generated from the Center's operations and an allocated portion of the revenues received from the State's transient accommodations tax. Act 253 further states that all funds collected by the Convention Center Fund are to be used to pay all expenses arising from the use and operation of the Center and to use those funds collected to fund debt service payments. However, responsibility for debt service payments to the bondholders on the general obligation bonds referred to above remains with the State through Budget and Finance.

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Upon creation of the Convention Center Fund, the Authority and Budget and Finance entered into an agreement whereby the Authority agreed to reimburse Budget and Finance for debt service payments, which differs from the actual debt service payments to bondholders, in accordance with a predetermined payment plan. The terms of the payment plan requires the Authority to reimburse Budget and Finance for principal and interest payments at an imputed interest rate of 6.00% through January 1, 2025. At June 30, 2003, the outstanding principal and interest amounts required to be reimbursed by the Authority was \$318,265,000 and \$263,192,963, respectively. The scheduled payments to maturity for each of the next five years and thereafter in five-year increments are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 7,335,000	19,095,917	26,430,917
2005	7,780,000	18,655,817	26,435,817
2006	8,245,000	18,189,917	26,434,917
2007	8,740,000	17,694,917	26,434,917
2008	9,265,000	17,169,917	26,434,917
2009 – 2013	55,330,000	76,815,885	132,145,885
2014 – 2018	74,035,000	58,103,785	132,138,785
2019 – 2023	99,080,000	33,063,085	132,143,085
2024 – 2025	48,455,000	4,403,723	52,858,723
	<u>\$ 318,265,000</u>	<u>263,192,963</u>	<u>581,457,963</u>

The Authority's ability to reimburse Budget and Finance is contingent upon continued receipt of future transient accommodations tax allocations from the State. Accordingly, the obligation to reimburse Budget and Finance for debt service as described above has not been recorded in the Authority's basic financial statements. However, the Authority's obligation to reimburse Budget and Finance in accordance with the mutually agreed upon payment plan represents a commitment of the Convention Center Fund.

For the year ended June 30, 2003, the Authority was required to reimburse Budget and Finance \$26,431,117 for debt service. At June 30, 2003, the unpaid amount due to Budget and Finance was \$6,601,294, which is recorded as due to State Department of Budget and Finance in the accompanying basic financial statements.

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ECONOMIC DEVELOPMENT AND TOURISM
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June 30, 2003

(9) Accrued Vacation

Changes in accrued vacation payable during the fiscal year ended June 30, 2003 were as follows:

Balance, July 1, 2002	\$	2,257,049
Additions		892,741
Deletions		<u>(833,910)</u>
Balance, June 30, 2003		2,315,880
Less current portion		<u>(597,497)</u>
	\$	<u><u>1,718,383</u></u>

(10) Retirement Benefits

(a) Employees' Retirement System of the State of Hawaii

All eligible employees of the Department 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 provides retirement benefits as well as death and disability benefits. All contributions, benefits, and eligibility requirements are established by Chapter 88, HRS, 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 City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from the noncontributory option. The noncontributory option 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 option or to elect the new noncontributory option and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Both 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.

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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. Under this method, employer contributions to the ERS are comprised of normal cost plus level annual payments required to liquidate the unfunded actuarial liability over the remaining period of 27 years from June 30, 2002.

Measurement of assets and actuarial valuations are made for the entire ERS and are not separately computed for individual participating employers such as the Department. For the year ended June 30, 2003, the Department was required to make contributions amounting to \$1,079,240. No contributions were required and made by the Department for the fiscal years ended June 30, 2002 and 2001.

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

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

There are currently approximately 23,300 state retirees receiving such benefits. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive reimbursement of the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis. For the fiscal year ended June 30, 2003, the Department's contribution for post-retirement health care and life insurance benefits was approximately \$876,000.

Effective July 1, 2003, the Hawaii Employer-Union Health Benefit Trust Fund (EUTF) replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

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June 30, 2003

(11) Nonimposed Employee Fringe Benefits

Payroll fringe benefit costs of employees of the Department funded by state appropriations (general fund) are assumed by the State and are not charged to the Department's operating funds. These costs, totaling \$2,042,994 for the fiscal year ended June 30, 2003, have been reported as revenues and expenditures within the Department's general fund.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the Department's economic development special revenue fund.

(12) Fund Balance Deficit

The general fund had a deficit in its unreserved fund balance at June 30, 2003 of \$300,456. The deficit resulted from recognition of expenditures under GAAP in 2003 and will be funded with 2004 state allotted appropriations.

(13) Commitments and Contingencies

(a) Leases

The Department leases office facilities and equipment under various operating leases expiring through 2006. Future minimum lease commitments of noncancelable operating leases as of June 30, 2003 were as follows:

Fiscal year ending June 30:	
2004	\$ 137,900
2005	113,400
2006	62,700
2007	<u>500</u>
	<u>\$ 314,500</u>

The Department's rental expenditures for the fiscal year ended June 30, 2003 were approximately \$134,000.

(b) Accumulated Sick Leave

Employees hired on or before July 1, 2001 earn sick leave credits at the rate of one and three-quarters working days for each month of service. Employees hired after July 1, 2001 earn vacation at the rate of one and one-quarter or one and three-quarters working days for each month of service depending upon the employees' years of service and job classification. Sick leave credits may accumulate without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, an employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2003, accumulated sick leave approximated \$7,258,000 for the Department.

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Notes to Basic Financial Statements
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(c) *Deferred Compensation Plan*

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation Plan are not reported in the accompanying basic financial statements.

(d) *Risk Management*

GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, establishes accounting and financial reporting standards for risk financing and insurance related activities of state governmental entities and requires the recordation of a liability for risk financing and insurance related losses if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. The excess layers insured with commercial insurance companies are consistent with the prior fiscal year. Settled claims have not exceeded the coverage provided by commercial insurance companies in any of the past three fiscal years. A summary of the State's underwriting risks is as follows:

Property Insurance

The State has an insurance policy with a variety of insurers in a variety of layers for property coverage. The deductible is \$250,000 per occurrence. The deductible for windstorm coverage is 3% of loss subject to a \$250,000 per occurrence minimum. This policy includes earthquake, named hurricane, and flood coverage with a deductible of 3% of loss subject to a \$250,000 minimum and a \$10,000,000 annual aggregate. The limit of loss per occurrence is \$25,000,000. This policy also includes terrorism coverage whose limit of loss per occurrence is \$10,000,000 with a deductible of \$250,000 per occurrence.

The State also has a crime insurance policy for various types of coverages with a minimum limit of loss of \$1,000,000 per occurrence and a maximum limit of \$10,000,000 with \$250,000 deductibles. Losses not covered by insurance are paid from legislative appropriations of the State's General Fund.

General Liability (including Torts)

Claims under \$10,000 are handled by the risk management office of the Department of Accounting and General Services. All other claims are handled by the Department of the Attorney General. The State has personal injury and property damage liability, including automobile and public errors and omissions, insurance policy in force with a \$3,000,000 deductible per occurrence. The annual aggregate per occurrence is \$7,000,000.

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June 30, 2003

Losses under the deductible amount or over the aggregate limit are paid from legislative appropriations of the State's General Fund.

Medical Insurance

The State's community hospitals included in the HHSC are insured by a comprehensive hospital professional liability policy. The policy covers losses from personal injury, professional liability, patient property damage, and employee benefits. This policy covers losses up to a limit of \$20,000,000 per occurrence and in the aggregate.

Self-Insured Risks

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses are administered by third-party administrators. The State administers its workers' compensation losses.

(e) Litigation

From time to time the Department is named as a defendant in various legal proceedings. Although the Department and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the Department because judgments, if any, against the Department are judgments against the State and would be paid by legislative appropriations of the State General Fund and not by the Department.

***SECTION III – COMPLIANCE AND INTERNAL CONTROL
OVER FINANCIAL REPORTING***



P.O. Box 4150
Honolulu, HI 96812-4150

**Report on Compliance and on Internal Control over Financial Reporting
Based on an Audit of Financial Statements Performed in Accordance
with *Government Auditing Standards***

To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii:

We have audited the basic financial statements of the Department of Business, Economic Development and Tourism, State of Hawaii (the Department), as of and for the year ended June 30, 2003, and have issued our report thereon dated January 30, 2004. 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.

Compliance

As part of obtaining reasonable assurance about whether the Department's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D, Hawaii Revised Statutes) and procurement rules, directives, and circulars, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period of employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.



This report is intended solely for the information and use of the Department's management and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 30, 2004

***SECTION IV – COMPLIANCE AND INTERNAL CONTROL
OVER FEDERAL AWARDS***



P.O. Box 4150
Honolulu, HI 96812-4150

**Report on Compliance with Requirements
Applicable to Each Major Program and on
Internal Control over Compliance in Accordance with
OMB Circular A-133**

To the Director of the
Department of Business,
Economic Development and Tourism
State of Hawaii:

Compliance

We have audited the compliance of the Department of Business, Economic Development and Tourism, State of Hawaii (the Department), 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, 2003. The Department's major federal programs are identified in the summary of auditors' 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 Department's management. Our responsibility is to express an opinion on the Department'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 Department's compliance with those requirements and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department 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, 2003. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 03-01 and 03-02.



Internal Control over Compliance

The management of the Department 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 Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of internal control over compliance would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Department as of and for the year ended June 30, 2003, and have issued our report thereon dated January 30, 2004. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 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.

This report is intended solely for the information and use of the Department's management and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 30, 2004

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Schedule of Expenditures of Federal Awards

Year ended June 30, 2003

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditures
RESEARCH AND DEVELOPMENT CLUSTER				
DEPARTMENT OF DEFENSE				
Research and Technology Development: National Defense Center of Excellence for Research in Ocean Sciences	12.910		\$ 31,707,564	\$ 3,770,527
Hawaii Electric Vehicle Demonstration Project		MDA972-97-2-0001		2,819,393
Total Department of Defense		MDA972-97-2-0002 MDA972-95-2-0009	10,292,000 13,077,479	158,192
				6,748,112
DEPARTMENT OF TRANSPORTATION				
Research and Technology Development: Hawaii Electric Vehicle Demonstration Project		DTRSS6-99-T-0017	4,009,129	707,159
Total Research and Development Cluster				7,455,271
OTHER PROGRAMS				
DEPARTMENT OF COMMERCE				
Coastal Zone Management Administration Awards: Hawaii Coastal Zone Management Program	11.419		2,295,000	1,110,722
		NA17OZ2333		232,037
		NA17OZ1600	400,000	227,311
		NA17OZ1121	1,620,000	221,014
		NA07OZ0115	1,156,000	79,301
		NA97OZ0161	1,121,000	14,228
		NA07OZ0186	225,000	1,884,613
Total Department of Commerce				1,884,613
ENVIRONMENTAL PROTECTION AGENCY				
Solid Waste Management Assistance: EPA Jobs Through Recycling Program	66.808		236,000	69,352
		X999817-01		
Brownfield Pilots Cooperative Agreements: Brownfields Economic Redevelopment Hawaii Assessment Demonstration Pilot	66.811		200,000	12,137
		BP-98966301		81,489
Total Environmental Protection Agency				81,489

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Schedule of Expenditures of Federal Awards
Year ended June 30, 2003

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditures
OTHER PROGRAMS (continued)				
DEPARTMENT OF ENERGY				
State Energy Program:				
Formula Grant	81.041	DE-FG51-02R021337	\$ 379,294	\$ 343,240 *
Special Projects:	81.119			
Distributed Energy Building Guide		DE-FG51-01R021287	100,000	76,981 *
Rebuild America 4		DE-FG51-97R020881	255,000	67,485 *
Cooling Climates		DE-FG51-01R021285	170,000	51,781 *
Power Parks		DE-FG51-98R021191	190,000	48,532 *
Hilo Bayfront Lighting		DE-FC51-02R021399	450,000	36,165 *
Commercial Guidelines		DE-FG51-98R020979	28,000	25,302 *
Remote Renewables		DE-FG51-99R021082	20,000	24,401 *
Remote Solar for Essential Services		DE-FG51-99R021084	37,616	16,051 *
Promulgation of Codes and Standards		DE-FG51-98R020978	131,000	4,865 *
Advanced Building Technologies		DE-FC51-02R021376	30,000	54 *
Clean Cities		DE-FG51-97R020759	50,000	292 *
		DE-FG51-97R020881	50,000	26 *
Subtotal CFDA 81.119				352,435
Distributed Energy Resources Center				
NELHA Gateway Project	81.049	DE-FG02-00CH11066	3,945,000	332,201 *
A Financial Assistance Program for State and Municipal Demonstration of Light and Heavy Duty Alternative Fuel Vehicles				
Demonstration of Light and Heavy Duty Alternative Fuel Vehicles	81.111	DE-FG07-97ID13501	144,200	10,880
Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training, and Technical Analysis Assistance				
Energy Efficiency and Renewable Energy Activities	81.117			
Bioenergy Program Support 1		DE-FC51-02R021359	450,000	33,000
SEP Initiatives 2		DE-FC51-01R028604	30,000	11,851
Support for Renewable Center		DE-FC51-01R028606	6,700	5,000
Subtotal CFDA 81.117			10,000	1,353
Regional Biomass Energy Program:				
Bioenergy Program Support 2	81.079	DE-FC51-02R021318	15,000	25,488
Total Department of Energy				1,115,448

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM**

STATE OF HAWAII

Schedule of Expenditures of Federal Awards

Year ended June 30, 2003

Federal Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grant Number	Federal Program Award Amount	Federal Expenditures
<i>OTHER PROGRAMS (continued)</i>				
FEDERAL EMERGENCY MANAGEMENT AGENCY				
Hazard Mitigation Grant:				
Emergency Generator Survey Phase I	83.548	FEMA-961-DR-HI	45,611 \$	19,980
Total Expenditures of Federal Awards			\$	\$ <u>10,556,801</u>

(*) Denotes major federal program as defined by OMB Circular A-133.

See accompanying notes to schedule of expenditures of federal awards and independent auditors' report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Notes to Schedule of Expenditures of Federal Awards
Year ended June 30, 2003

(1) Basis of Presentation

The Department's basic financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, as described in the notes to the basic financial statements. The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the cash basis of accounting, which is the same basis of accounting used to prepare federal grant reports. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

(2) Subrecipients

Of the federal expenditures presented in this schedule, the Department provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>CFDA Number</u>	<u>Amount Provided to Subrecipients</u>
Coastal Zone Management Administration Awards: Hawaii Coastal Zone Management Program	11.419	\$ 508,247
State Energy Program: Formula Grant	81.041	89,882
State Energy Program: Special Projects	81.119	95,645
Distributed Energy Resource Center NELHA Gateway Project	81.049	332,201

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Schedule of Findings and Questioned Costs
Year ended June 30, 2003

(I) Summary of Auditors' Results

- (a) The type of report issued on the basic financial statements: **Unqualified opinion**
- (b) Reportable conditions in internal control were disclosed by the audit of the basic financial statements: **None noted**
Material weaknesses: **None noted**
- (c) Noncompliance which is material to the basic financial statements: **None noted**
- (d) Reportable conditions in internal control over major programs: **None noted**
Material weaknesses: **None noted**
- (e) The type of report issued on compliance for major programs: **Unqualified opinion**
- (f) Any audit findings which are required to be reported under Section .510(a) of OMB Circular A-133: **Yes**
- (g) Major programs:

Research and Development Cluster:

Department of Defense:

12.910 – National Defense Center of Excellence for Research in Ocean Sciences

12.910 – Hawaii Electric Vehicle Demonstration Project

Department of Transportation:

12.910 – Hawaii Electric Vehicle Demonstration Project

Other Programs:

Department of Commerce

11.419 – Coastal Zone Management Administration Awards

Department of Energy

81.041 – State Energy Program – Formula Grant

81.119 – State Energy Program – Special Projects

81.049 – NELHA Gateway Project

- (h) Dollar threshold used to distinguish between Type A and Type B programs: **\$316,704**
- (i) Auditee qualified as a low-risk auditee under Section .530 of OMB Circular A-133: **No**

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Schedule of Findings and Questioned Costs

Year ended June 30, 2003

(2) Findings and Questioned Costs Relating to Federal Award

**Department of Energy
State Energy Program – Formula Grant
CFDA No. 81.041
Federal Award No. DE-FG5102R021337**

Finding 03-01 Reporting

Condition: During our reporting testwork, we noted that the Department's State Energy – Formula Grant program failed to submit four Federal Cash Transaction Reports (SF-272) to the U.S. Department of Energy (DOE) on a timely basis.

Criteria: In accordance with the grant agreement between the Department and the DOE, the Department is required to submit SF-272 reports to the DOE on a quarterly basis no later than 30 days following each reporting period.

Effect: By failing to submit required federal financial reports on a timely basis, the Department's State Energy – Formula Grant program is not in compliance with the terms of the grant agreement between itself and the DOE. This may jeopardize the program's ability to receive future federal funding.

Cause: We were informed that the Department's State Energy – Formula Grant program's inability to submit required financial reports on a timely basis is primarily attributable to a lack of personnel resources.

Questioned Costs: None.

Recommendation: We recommend that the Department ensure that all required federal financial reports are properly prepared and submitted to the respective federal granting agency within prescribed deadlines.

**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT AND TOURISM
STATE OF HAWAII**

Schedule of Findings and Questioned Costs
Year ended June 30, 2003

Department of Energy

State Energy Program – Special Projects
CFDA No. 81.119
Federal Award No. Various

Finding 03-02 Reporting

Condition: During our reporting testwork, we noted that the Department's State Energy – Special Projects program failed to submit 13 Federal Cash Transaction Reports (SF-272) and 6 Financial Status Reports (SF-269) to the U.S. Department of Energy (DOE) on a timely basis.

Criteria: In accordance with the grant agreement between the Department and the DOE, the Department is required to submit SF-272 and SF-269 reports for each federally funded project to the DOE on a quarterly basis no later than 30 days following each reporting period. During the year ended June 30, 2003, the Department's State Energy – Special Projects program had 12 projects for which federal funds were spent.

Effect: By failing to submit required federal financial reports on a timely basis, the Department's State Energy – Special Projects program is not in compliance with the terms of the grant agreement between itself and the DOE. This may jeopardize the program's ability to receive future federal funding.

Cause: We were informed that the Department's State Energy – Special Projects program's inability to submit required financial reports on a timely basis is primarily attributable to a lack of personnel resources.

Questioned Costs: None.

Recommendation: We recommend that the Department ensure that all required federal financial reports are properly prepared and submitted to the respective federal granting agency within prescribed deadlines.



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

LINDA LINGLE

GOVERNOR

THEODORE E. LIU

DEPUTY GOVERNOR

RAYMOND M. JEFFERSON

DEPUTY DIRECTOR

No. 1 Capitol District Building, 250 South Hotel Street, 5th Floor, Honolulu, Hawaii 96813
Mailing Address: P.O. Box 2359, Honolulu, Hawaii 96804
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Fax: (808) 586-2377

March 5, 2004

KPMG LLP
Pauahi Tower, Suite 2100
1001 Bishop Street
Honolulu, HI 96813

Dear Auditors:

In response to the Schedule of Findings and Questioned Costs for the Fiscal Year Ended June 30, 2003, we offer the following comments:

Department of Energy
State Energy Program – Formula Grant
CFDA No. 81.041
Federal Award No. DE-FG5102R021337
Finding 03-01 Reporting

CFDA No. 81.119
Federal Award No. – Various
Finding 03-02: Reporting

Program's Response:

To meet the reporting requirements of the U.S. Department of Energy, the Energy Resources, and Technology Division will take appropriate steps to improve the timely submission of the Financial Status Reports and Federal Cash Transaction Reports. The Division recognizes that one way to address the findings is to acquire additional assistance to the Division's accountant and will be pursuing this option. In addition, the Division will give priority to the preparation and submission of the reports to comply with federal deadlines and requirements.

Thank you for the opportunity to provide comments on the audit report.

Sincerely,

Ken N. Kitamura
Administrative Services Officer



**DEPARTMENT OF BUSINESS,
ECONOMIC DEVELOPMENT & TOURISM**

LINDA LINGLE
GOVERNOR
THEODORE E. LIU
DIRECTOR
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March 5, 2004

KPMG LLP
Pauahi Tower, Suite 2100
Honolulu, Hawaii 96813

Dear Auditors:

The following is the status of the prior year's audit finding for the Fiscal Year ended June 30, 2002 relating to Cash Management:

Finding 02-05 Cash Management

Department of Defense
National Defense Center of Excellence for Research in Ocean Sciences (CEROS)
Program's Response:

The CEROS program invests its grant funds in interest-bearing accounts through the State Treasury Investment Pool System. CEROS has remitted interest earned to the federal granting agency on an annual basis in accordance with the terms of the agreement. The CEROS program continues to monitor its cash balances regularly and requests advances only when cash balances are reasonably low to minimize the time elapsing between the receipt and disbursement of funds from the federal granting agency. Although this has resulted in several instances where payments to contractors were delayed, the CEROS program continues to monitor its balances to maintain the minimum needed for disbursement.

Department of Defense
Department of Transportation
Hawaii Electric Vehicle Demonstration Project (HEVDP)
Program's Response:

The HEVDP Program invested its grant funds in the State Treasury Investment Pool System. The interest on funds under Cooperative Agreement MDA972-95-2-0009 has been remitted to the Department of Defense. All funds from the Department of Defense have been expended.

The funding from the Department of Transportation (DOT), CFDA No. DTRS56-99-T-0017 is issued under an Advanced Vehicle Program (AVP) Other Transaction Agreement that does not follow directives of OMB Circular A-102. The agreement follows procedures in which funds are drawn from DOT after contract milestones are completed, then payment is issued to the contractor thus minimizing the time between the receipt and disbursement of funds. There are also advances to cover program administrative expenses. The grant's cash balance is being invested in the State Treasury Investment Pool System and the interest income is used to cover expenses of the HEVDP Program.

Sincerely,



Ken N. Kitamura
Administrative Services Officer